

## RECENT CASES

### ***RATIO DECIDENDI OF SELECT DECISIONS OF RUSSIAN HIGHEST COURTS***

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#### **Ruling of the Supreme Court Judicial Division for Economic Disputes of January 17, 2017 No. 309-KG16-13100**

Legal issue: Whether the transfer of property under accord and satisfaction agreement terminating the contract of loan would be subject to VAT taxation?

*Ratio decidendi:* Lower courts were wrong in deciding that such transfer of property would be exempt from VAT similarly to the repayment of money under loan. Transfer of property by virtue of accord and satisfaction agreement for the purpose of cancelling obligations under loan contract is in legal terms the sale of a property, in which case the transferring party must pay output VAT from such sale, whereas the receiving one may offset input VAT.

#### **Judgment of the Constitutional Court of the Russian Federation regarding the constitutionality of execution of the European Court of Human Rights judgment of July 31, 2014 in the case “OAO Neftyanaya kompaniya ‘YUKOS’ vs Russia” (January 19, 2017 No. 1-P)**

Legal issue: The constitutional feasibility of execution of the European Court of Human Rights judgment – to the extent it puts Russia under obligation to pay €1.87

billion to former shareholders of “Yukos” by way of compensation for unlawfully levying tax penalties for the years 2000 and 2001 and execution fees.

*Ratio decidendi:* The Constitutional Court has deemed the execution of the ECHR decision to be impossible. In the opinion of the Court, the interaction between the Convention legal order and the Russian Constitution may not take place in the form of subordination, since only a dialogue between two different legal systems may serve as a ground for proper balance between them, and the efficiency of the Convention’s rules within the Russian constitutional order depends, to a great extent, on the respect shown by the European Court of Human Rights to the national constitutional identity. While acknowledging the fundamental significance of the European system of the protection of human rights and freedoms, of which the judgments of the ECHR make a part, the Constitutional Court of Russia is ready to search for a lawful compromise for the sake of supporting this system; but the Court reserves the right to decide, to what degree it is ready to accept such compromise, because in this particular question the limits of such compromise are determined by the Constitution of the Russian Federation. As an international treaty signed by the Russian Federation, the Convention enjoys greater legal force in law-application procedures than any federal law, but not equal to or greater than that of the Constitution of the Russian Federation. In the situation when the very substance of a decision of an international body for the protection of human rights and freedoms impinges unlawfully upon the basic principles and rules of the Constitution of the Russian Federation, Russia may deviate, by way of exception, from performing the obligations placed upon it by such decision, provided that this deviation is the only possible way to avoid the violation of the national Constitution.

The European Court of Human Rights by its judgment from July 31, 2014 found Russia in violation of the property rights of the company “Yukos,” which caused material damage to the applicant company. However, the fact of principal importance is that the material losses were the consequence of illegal activities of the company itself, whereas the State had to apply the measures of responsibility, including the administrative one, in order to compensate for the property damage borne by the State. The company “Yukos,” as is clear from the court decisions against it, showed itself to be a persistent tax defaulter and ceased to exist, leaving unpaid outstanding tax obligations. The activities of the company had a law-destroying effect, undermining the stability of constitutional legal regime and public policy.

Furthermore, the Court found that the payment under ECHR decision to former shareholders of the company who engaged in illegal scheming to avoid taxation, as well as to their heirs and legal successors, of such significant sum of monetary compensation from public funds which were systematically deprived by the company of due amounts of tax payments necessary for meeting public obligations to all the

citizens and overcoming the financial and economic crisis, contradicts the principles of equality and justness in tax relations.

As for the interpretation of Art. 113 of the Tax Code given by the Constitutional Court in its judgment of July 14, 2005 (implying the right of a court to extend statute of limitations if it expired due to a taxpayer's obstruction of tax control measures), the such interpretation is the only reasonable one and corresponds to the authentic intent of the federal legislator. Accordingly, the application of this rule to tax disputes of "Yukos" relating to years 2000 and 2001 is not a retroactive one and does not constitute an act of arbitrary and unforeseeable law-application.

All the same, the Constitutional Court does not exclude the possibility of Russia's showing good will with regard to setting the limits of such compromise and means of its achievement as long as it concerns "Yukos" shareholders who suffered losses because of illegal actions of the company and its managers. Therefore, the Government of the Russian Federation is empowered to consider paying out respective amounts in the procedure provided for by Russian and foreign legislation for distribution of newly-found property of a liquidated legal entity; but it may only be implemented only upon finalizing the settlements with creditors and eliciting other property (for instance, the one hidden in offshore accounts). However, such payments may not, in accordance with this judgment, affect receipts and expenditures of public budgets, as well as the property of the Russian Federation.

There are two individual opinions of members of the Court.

Judge Vladimir Yaroslavtsev, dissenting, believes that the request of the Ministry of Justice of the Russian Federation is not admissible and proceedings in the case should be ceased. In case of disagreement with the ECHR decision, Russian authorities ought to appeal against it to the Grand Chamber within 3 month term, as provided for by Art. 43 of the Convention. However, they failed to exercise their right to appeal and thus they acknowledged, formally speaking, the legality and validity of the violations of the Convention that have been found by the ECHR. This inconsistent and quite contradictory position of Russian authorities has effectively led into a "legal dead end" the solution of the question at hand. Hence the Ministry of Justice found a "simplified solution" by filing the case at the Constitutional Court stating the impossibility to execute the ECHR judgment. But such application may not be admitted by virtue of the principle *nemo iudex in propria causa* (no one can be a judge in his own case), because the conclusion of the ECHR regarding the violation of the Convention was in a considerable degree based on the finding that the Russian Constitutional Court had violated the principle of legality in its judgment of July 14, 2005.

In the opinion of Judge Yaroslavtsev, only legislator may establish and change the statute of limitations with regard to a criminal liability. The statute imposes a 3 year term, which is barring and preclusive; that is why its expiration constitutes a mandatory and unconditional ground for discharging a person from such liability.

The provisions of Art. 113 of the Tax Code of the Russian Federation in the new version could be applied only from January 1, 2007 onwards, i.e. from the time when this article was amended by the legislator who provided for the possibility to interrupt the statute of limitations with regard to tax violations.

The Ministry of Justice of the Russian Federation should not seek easy ways of resolving the problem by means of applying to the Constitutional Court; instead, it was necessary to continue dialogue with the Committee of Ministers of the Council of Europe.

Judge Konstantin Aranovsky, concurring, also believes that the request of the Ministry of Justice is not admissible, because the case was resolved by the ECHR without the procedural opponent. ECHR decision affects the rights of third persons who did not participate in the case, and it requires of the violator himself to determine the victims in its case and assign compensation amounts to them. Strictly speaking, it does not allow considering the decision as a judicial act and considering Russia as obligated to pay compensation judicially, even if it does pay something out of respect to the ECHR decision. The Convention law requires to list by name the persons awarded payments by the Court, which makes it impossible to award payments to nameless groups. This affects the rights of Russia itself, because even if it makes certain payments to "Yukos" shareholders, it will not oblige the "victims" to regard the compensation received as just and equitable one, because the Court failed to consider the case with their participation, even *in absentia*.

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of January 19, 2017 No. 305-ES15-15704**

Legal issue: What is the relation between paras. 1 and 2 of Art. 1107 of Civil Code, that is, between the requirement to compensate all profits received as a result of unjust enrichment, and the requirement to pay interest under Art. 395, Civil Code for the use of monies belonging to another person?

*Ratio decidendi*: Inferior courts made a mistake, believing that in case of unjust enrichment both profits derived and interest incurred should be paid. The interest indicated in para. 2 must be set off against profits indicated in para. 1. Para. 2 established a simplified procedure for proving the minimal amount of income in case of pecuniary enrichment, but at the same time it does not preclude the recovery of profits in a greater amount in accordance with rules of para. 1, provided that the existence of such excessive profits has been proved. The opposite interpretation, which limits the amount of recoverable income solely by para. 2, that is, by an interest alone, would make it profitable to use property belonging to others and would create an incentive for the defendant to continue intentionally using it and returning it to the owner as late as possible.

Besides, profit consists of net revenue, that is, gross revenue minus expenses. Therefore, in case the bank is a defendant in a case, it would be wrong to determine its income as corresponding to a credit interest rate: it is also necessary to take into account the expenses of the bank relative to issuing credits.

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of January 24, 2017 No. 305-KG16-10570**

Legal issue: Whether the owner of all apartments in a residential house must register his right of ownership to it as a single object of real estate, if he wants to demolish the house and register his right of ownership to the land under it?

*Ratio decidendi:* Contrary to the opinion of lower courts, there is no need to do so. From the moment of registration of his right of ownership to this apartment the buyer of an apartment also acquires by virtue of the law the right to a share in common property to the land plot under the house.

When a single person owns all the apartments in a residential house, he by virtue of the law becomes the owner of all shares in the land plot and from the moment of registration of his ownership to the last apartment in the residential house becomes an owner of the entire land plot thereunder. Since that moment onwards the existence of the right of common shared ownership is no longer possible, and it turns into the right of individual ownership in real estate. As for a demolition of a residential house situated on a land plot, it may not serve as legal grounds for terminating a right of ownership to this land plot.

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of January 24, 2017 No. 310-ES16-14179**

Legal issue: Whether good-faith mortgage lender may demand that the mortgaged property (a flat) be foreclosed – in the context of legal relations arising before July 1, 2014?

*Ratio decidendi:* Good-faith mortgage lender may demand foreclosure. Although the rule of Art. 335, Civil Code, in which the notion of good-faith mortgage lender is found, came into force on July 1, 2014, whereas the relations between parties precede it, this notion had already existed in the decisions of the Supreme Arbitrazh (Commercial) Court. Therefore, the legislation in force before 2014 already implied that the rights of mortgage lender could survive in case of invalidity of the transaction by which the owner (mortgagor) had acquired the property in question (i.e. the collateral), provided that the mortgage lender was unable, acting reasonably and with proper prudence, to discover the flaws of such transaction.

**Ruling of the Constitutional Court on the denial to accept for consideration the petition of the All-Russian Social Organisation of Disabled Persons – Russian Association of Blind Students and Professionals against the violation of constitutional rights and freedoms by parts 6 and 11 of Art. 45 and part 17 of Art. 48 of the Federal law “On the Election of the Deputies of the State Duma of the Federal Assembly of the Russian Federation” (January 26, 2017 No. 203-O)**

Legal issue: Whether the Association may challenge in the Constitutional Court the decision of the Central Electoral Commission prohibiting the signing of subscription lists by means of digital signature or facsimile.

*Ratio decidendi:* The Constitutional Court held that the case was inadmissible because the organisation was challenging the constitutionality of the federal law without quoting any facts of violation of its members’ rights, which would have been examined and legally assessed by courts, i.e. it is requesting an abstract judicial review of constitutionality of the federal law. However, by virtue of Art. 125 of the Constitution and Art. 3 of the Law on the Constitutional Court the petitioner is not listed among the entities entitled to apply to the Constitutional Court in such fashion.

The ruling is accompanied by two individual opinions of the members of the Court.

Judge Nikolai Bondar, dissenting, believes that the Court ought to admit the petition for consideration. The subsidiary character of the constitutional justice does not imply restrictive interpretation of its competence; in view of the exhaustion of the ordinary judicial remedies its competence ought to be interpreted in the manner ensuring the most efficient restoration of violated rights and freedoms of the applicant. Not only the courts of general jurisdiction and commercial courts, but particularly the Constitutional Court itself should minimize strict formalism, so that the constitutional rights might enjoy real and efficient protection.

The failure of the federal legislator, in spite of the position expressed earlier by the Constitutional Court, within many years to regulate properly the issue of participation in electoral procedures by disabled persons incapable of signing subscription lists with their own hand testifies to the fact that the gap in legal regulation which was indicated earlier by the Constitutional Court has become persistent. This may lead to a massive violation of electoral rights of persons belonging to the respective socially vulnerable class of the population. This circumstance constitutes an additional argument for admitting the petition and its consideration on merits.

Judge Alexander Kokotov, dissenting, also disagreed with the refusal to admit the case for consideration. He points out that the decision of the Supreme Court to return the application (an administrative suit) to Association was based on the fact that once before the Supreme Court has already considered and resolved an analogous application by a political party. Consequently, the substantive answer given by the

Supreme Court to that party was in fact its answer to the Association as well. Therefore, one may argue that the Association, when filing petition with the Constitutional Court, might base its right to apply to it on the decision of the Supreme Court with regard to another applicant (the political party). It is exactly what the Association has done.

Besides, it would be good if the federal legislator, without waiting the Constitutional Court's resolution of the question posed by the applicant, would have provided in the election laws the means enabling blind voters and other incapable persons to have a full-fledged participation in the nomination of candidates.

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of January 30, 2017 No. 305-ES16-14210**

Legal issue: Whether supplier may demand that the customer performs the contractual obligation to provide bank guarantee from a bank?

*Ratio decidendi:* The supplier may demand this. Lower courts were wrong in regarding this obligation (to provide a bank guarantee) as being impossible to perform, solely on the ground that the customer is unable to force the bank to issue such guarantee. However, the impossibility to perform an obligation occurs only if the action which constitutes the substance of the obligation may not be carried out by whatever person or entity. Yet, the issuance of bank guarantees is a standard and regular bank service rendered by credit organisations with the purpose to derive profits.

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of February 9, 2017 No. 305-KG16-15387**

Legal issue: Whether a company may be allowed to take part in a government tender (in the form of request for quotation), if it offers zero price (0.00 RUR)?

*Ratio decidendi:* Courts wrongly proceeded from the idea that zero price characterizes the contract as gratuitous and that it is contrary to the purposes of state procurement solely because such offer is not commensurate to the minimal expenses borne by the winner. However, when determining the winner, it does not matter whether the proposed contract is feasible for him; the only thing which matters is price. Besides, the procurement legislation does not prohibit statements in the offer that goods or services are procured without consideration, and the lack of consideration does not constitute a ground for declining such offer. This conclusion accords to the principles of procurement system aiming at the efficiency of buying goods or services for governmental or municipal needs. Such offer does not restrict competition, because it does not prevent other bidders to offer the same terms of contract. This distinguishes the request for quotation from an electronic contract where offering zero price of a contract is not admissible.

**Judgment of the Constitutional Court on the constitutionality of provisions of Art. 212.1 of the Criminal Code of the Russian Federation in connection with the petition of the citizen I.I. Dadin (February 10, 2017 No. 2-P)**

Legal issue: The constitutionality of the criminal prosecution for a violation of the procedure for conducting meetings, assemblies, manifestations and picketing, given that the accused has already been repeatedly (more than twice within 180 days) brought to administrative responsibility.

*Ratio decidendi:* The Court found the provisions in question not to be contrary to the Constitution, but gave them a narrow interpretation. It pointed out, *inter alia*, that:

- crime has to be characterized by a particular social danger; otherwise even an action which might appear to be formally criminal should not be regarded as such;
- federal legislator, when deciding which actions that are dangerous for persons, State and society should be considered as crimes must avoid an excessive use of criminal repression;
- federal legislator may use criminal liability in the interest of proper protection of constitutionally significant values even when the illicit action is being committed by a person who has already been administratively punished for analogous actions, that is, may use so-called “administrative *res judicata*”;
- all the same, if such violation was merely formal and did not in reality entail negative consequences or a danger thereof, it may not be considered as having a criminal social danger, and therefore making the accused responsible on the sole basis of repeated perpetration of such offence would be outside the realm of constitutionally admissible restriction of citizen rights by criminal legislation;
- punishment in the form of deprivation of freedom is possible only in the absence of other means to ensure achievement of the purposes of criminal liability;
- court decisions on bringing a person to administrative liability, although being prejudicial in nature, may not be regarded as incontestable; this requires the verification by a court of all the circumstances of previous violations on the basis of equality of parties and in an adversarial procedure.

**Review of court practice of the Supreme Court of the Russian Federation No. 1 for the year 2017 (affirmed by the Presidium of the Supreme Court on February 16, 2017)**

In the first review of the Supreme Court practice in 2017 the following decisions deserve particular attention:

- if a debt is nominated in a foreign currency, the interest on it under Art. 395 of the Civil Code shall be calculated in accordance with Central Bank average interest rate for short-term credits; if this rate is not published yet, then the average rate for

short-term currency credits shall apply, and it must be confirmed by the statement of a leading bank at the place of creditor's sojourn (this issue remained unresolved for a long time both in law and judicial practice);

- the risks of fluctuations in the exchange rate of foreign currency lie with the borrower under a credit contract: the repayment of the amount of loan should be made in the very currency which is indicated in the contract; the fact that the borrower is mother of a large family and unemployed may not be regarded as a material change of circumstances, because it does not prove that the plaintiff is deprived of what she might have expected when signing the contract;

- consumer protection laws shall not apply to disputes between banks and depositors, as long as their relations are regulated by the Civil Code and bank account contracts;

- if the person who seeks in court to reverse a judicial decision on the ground of a ECHR judgment failed to enclose with his application the text of judgment's unofficial Russian translation, the court must nonetheless proceed with such application. At the same time, the judge should, upon a motion of a party or at his own accord, apply to the representative of Russia at the ECHR, asking him to provide a translation of the respective judgment;

- if jurors found the accused to be guilty, but deserving lenience, the court, when delivering its sentence, should not take aggravating circumstances into account.

### **Review of practice of consideration by courts of cases involving the application of certain provisions of Sec. V.1 and Art. 269 of the Tax Code of the Russian Federation (affirmed by the Presidium of the Supreme Court on February 16, 2017)**

The Review relates to transactions between interdependent entities and cases of thin capitalization. Among the most interesting interpretations are the following:

- repeated deviation of price from the market level may be just one of the signs indicating that there is an unjustified tax benefit in place; in order to prove that the company evaded paying taxes, one should determine other circumstances discrediting a business cause of the transaction – for example, interdependence between parties to the transaction, formation of the organisation in question immediately before the disputed transaction, the use of special forms of settlements and terms for payment, and so on;

- the Review explains what is the correct way the Federal Tax Service should determine the amount of certain taxes which are calculated on the basis of market prices (for example, VAT and profit tax). The Tax Code does not contain special methods of calculating such taxes, but it does not mean that the Tax Service may arbitrarily assess tax liability. It should be guided by the rules of Sec. 5.1 of the Tax Code. The Supreme Court believes that the rules contained therein are of supplementary nature and do not necessarily apply to transactions of interdependent persons only. Therefore, they are applicable to determining market prices in the context of above-mentioned taxes in the course of both field and internal tax audits;

– controlled debts may occur not only between parent and daughter companies, but also between sister companies. In the latter case the dependence of a Russian taxpayer from a foreign organisation may be indirect – when both firms are controlled by the same parent company;

– if taxpayer failed to defend his position and the interest paid under his loans was requalified as latent dividends, he may nonetheless apply to them a reduced tax rate provided for in a relevant international treaty on the avoidance of double taxation (this is a solution of a long-felt problem, because in thin capitalization disputes tax authorities failed to fully take into account the real relations of parties and in case of success and judicial requalification of loans as dividends were reluctant to apply the reduced rate for dividends in question);

– the presumption that prices in transactions between interdependent entities are market ones (arm's length transactions) may be refuted only by the Federal Tax Service and not by inferior tax authorities;

– the right of the court, as provided by Sec. V.1 of the Tax Code, to take into account any circumstances relevant for determining whether the transaction is arm's length one or not, should not serve as a ground for ignoring the rules, established by a law for the purpose of calculating the amount of taxes in controlled transactions (this point purports to curb the practice of courts to determine the market price without due regard to calculation methods provided for by Art. 40 of the Tax Code).

### **Ruling of the Supreme Court Judicial Division for Economic Disputes of February 20, 2017 No. 306-ES16-16518**

Legal issue: Whether the procurator (public prosecutor), when applying to a court in the interest of an uncertain class of persons, should use the mandatory extrajudicial dispute settlement procedure before?

*Ratio decidendi:* Extrajudicial dispute settlement procedure promotes quick and mutually beneficial resolution of conflicts; however, the procurator should take measures for preliminary extrajudicial settlement only when the Procuracy appears in court as a party to a substantive legal dispute. In other cases (for instance, when he enters the proceedings for the sake of ensuring legality) he is not under obligation to do so. Therefore, lower courts erred when demanded from the procurator to use such extrajudicial procedure.

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