



TRANSFER PRICING: TOPICAL ISSUES IN 2017

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Facts & Figures

No **1** in accounting, HR & payroll in Northern Europe.

No **7** in accounting, HR & payroll in Russia.



> 2300
employees at Accountor Group



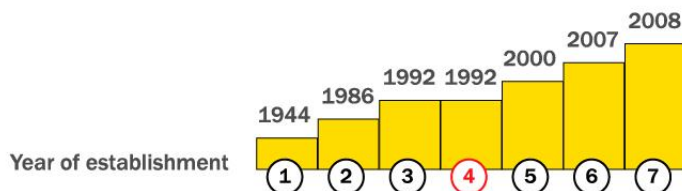
> 200
employees at Accountor Russia



> 100 000
clients at Accountor Group



> 1 000 50
clients in Russia from more than 50 countries



Client service through a partner network in



Azerbaijan



Kazakhstan



Belarus

Rules and regulations in force in 2017

Key rule: If the commercial or financial conditions in transactions between related parties are different from those applied on the market, the incomes that could have been received by the parties, but were not received due to the difference in conditions, will be taken into account for tax purposes (unless this results in a decrease in payable tax amounts).

Penalty for non-payment of tax due to the use of prices not in line with market prices:

2014- 2016	- 20% of unpaid tax amount
2017-...	- 40% of unpaid tax amount

Audits:	2014 – up to May 20, 2017
	2015 – up to May 20, 2018
	2016 – up to May 20, 2019

Calendar 2017

Up to March 28, 2017

- Companies are entitled to make adjustments to profit tax for 2016

Up to May 20, 2017

- Submission of Notification on controlled transactions for 2016

From June 01, 2017

- Beginning of tax audits for 2016

Within 30 days of request

- Submission of Transfer Pricing documentation

Federal Tax Service Statistics

15,642 reports on controlled transactions in 2016

1,900 notices issued by tax authorities during field and desk tax audits

6,000 decisions to bring to liability under Article 129.4

RUB 23.8 million – Penalties under Article 129.4

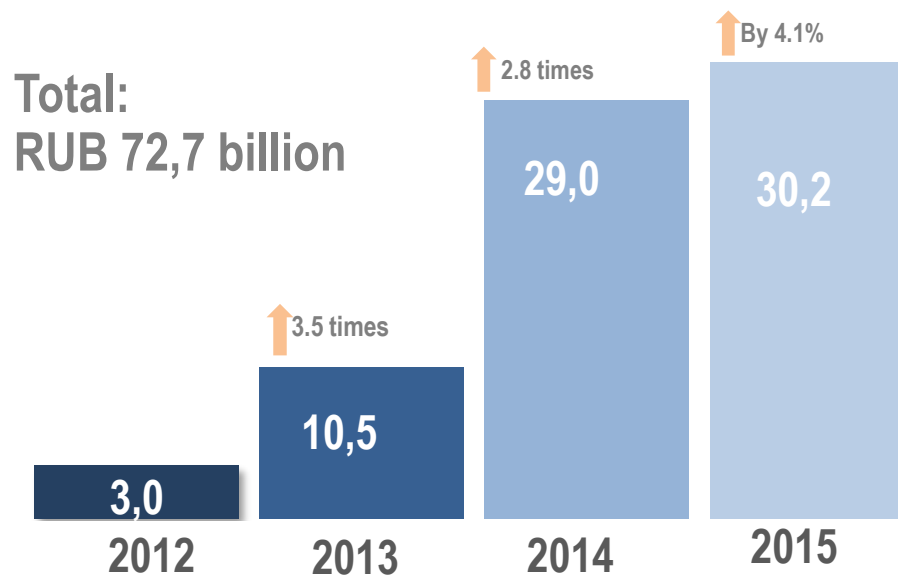
RUB 73.9 billion – Adjustment of tax base at companies' own initiative
(voluntary tax base adjustment)

RUB 11.1 billion – Additional tax paid at companies' own initiative
(voluntary payment of additional tax)

Voluntary tax base adjustment

In 2012-2015, taxpayers voluntarily increased their tax base by **over RUB 73.9 billion** of which **RUB 72.7 billion** of profit tax

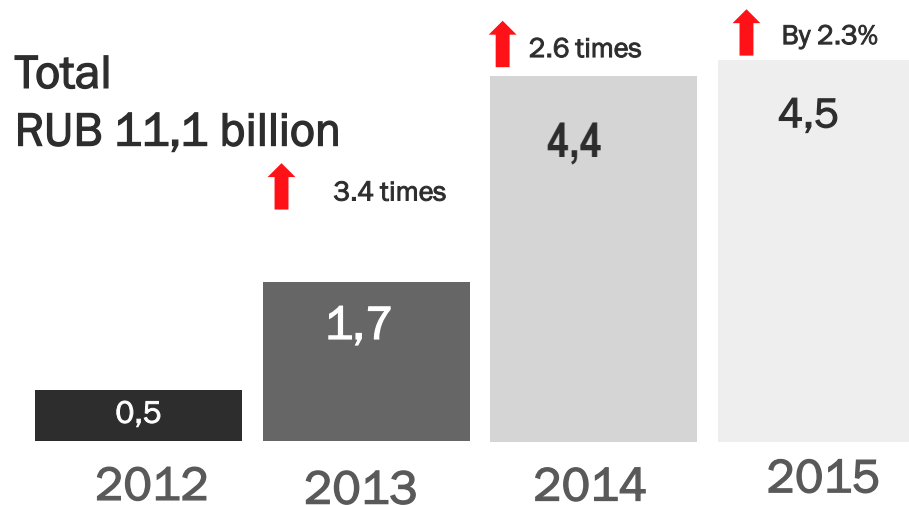
Amounts of Adjusted Profit Tax Base



Voluntary adjustments: Additional tax payment

In 2012-2015, taxpayers calculated and made additional tax payment of RUB 11.2 million of which profit tax in the amount of RUB 11.1 billion.

Profit Tax Received from Organizations



Transfer pricing documentation: step-by-step



Regulations and guidelines

Russian Tax Code:

Part V.1. Related parties. General provisions on prices and taxation. Tax control over transactions between related parties. Pricing agreement (introduced by Federal Law N 227-FZ dated July 18, 2011)

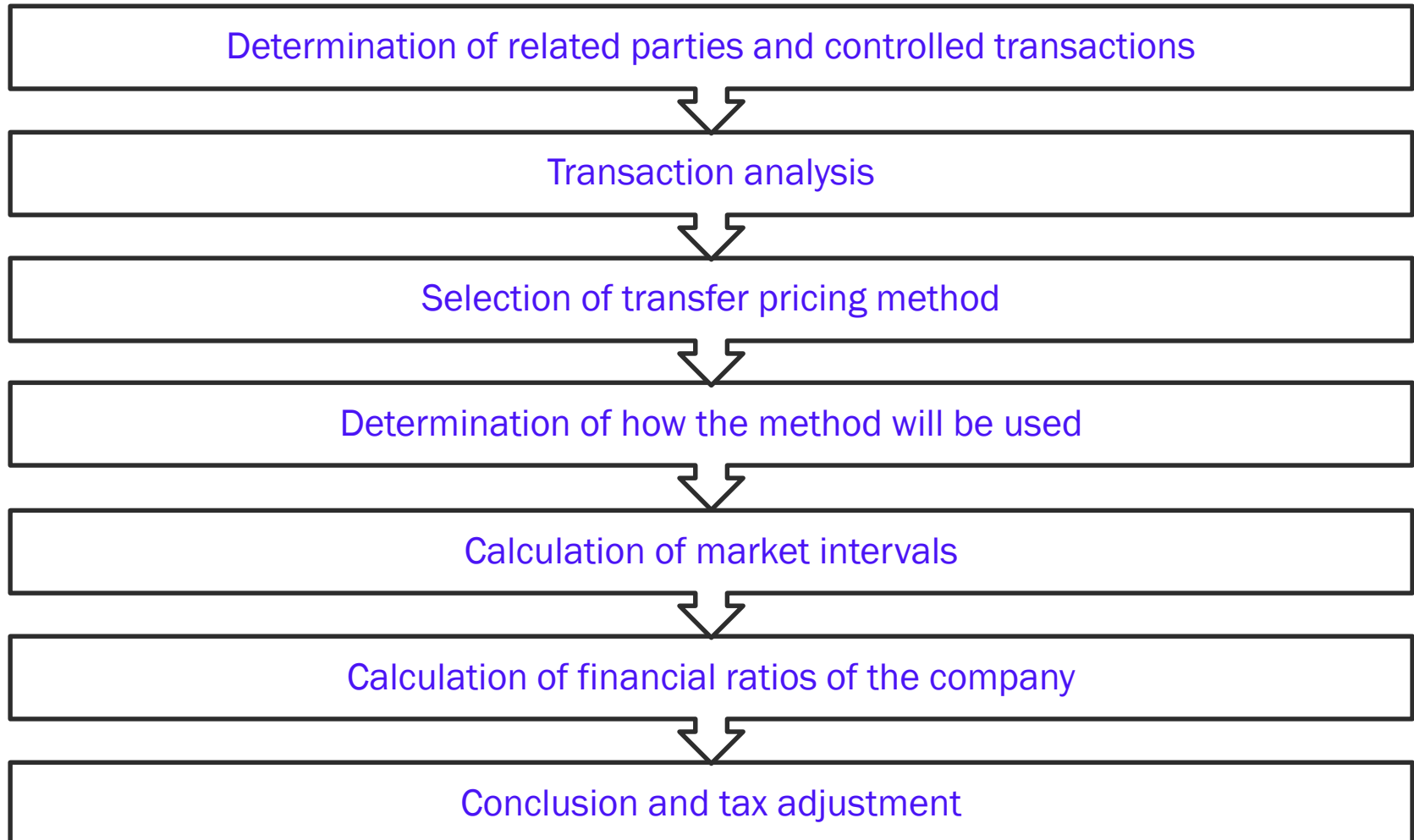
OECD Guidelines: OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (July 2010)

Group policy on transfer pricing

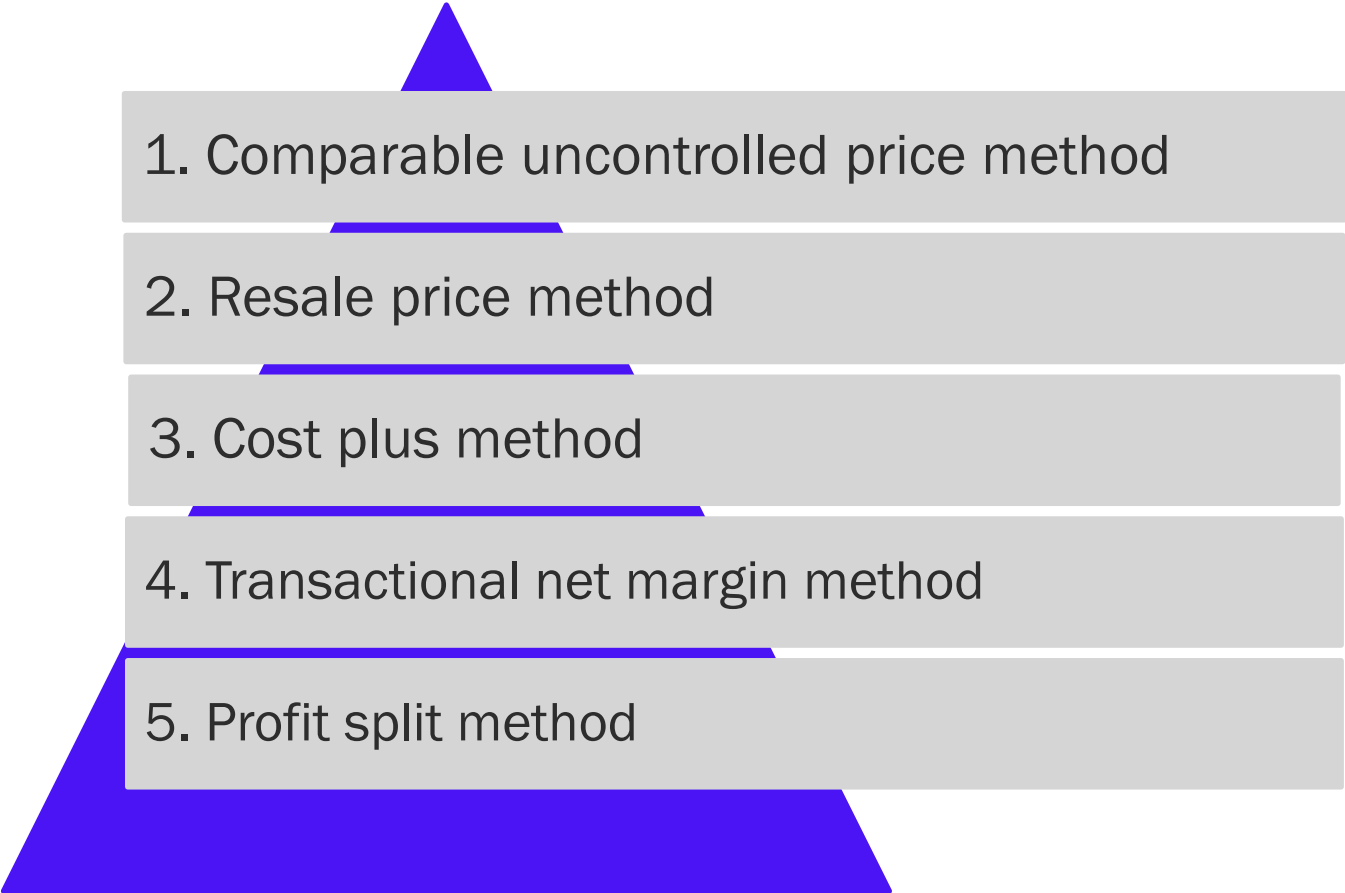
Letter of the Russian Ministry of Finance and Federal Tax Service N OA-4-13/14433@ dated August 30, 2012 about documentation preparation and submission for tax control purposes

Other clarifications from the Russian Ministry of Finance and Federal Tax Service

Stages of documentation preparation



Ranking of methods



1. Comparable uncontrolled price method

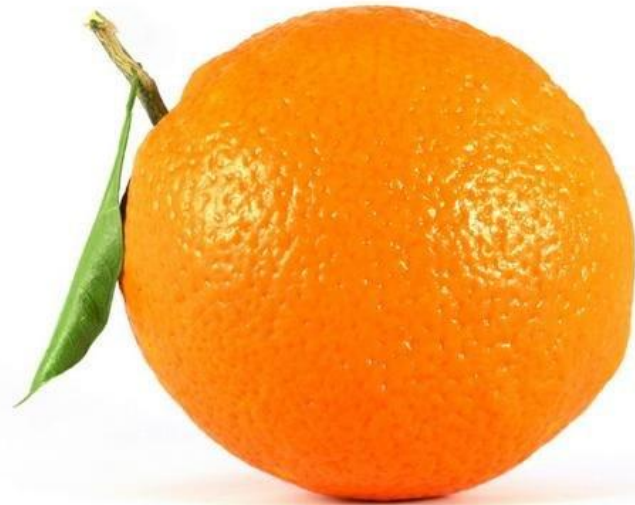
2. Resale price method

3. Cost plus method

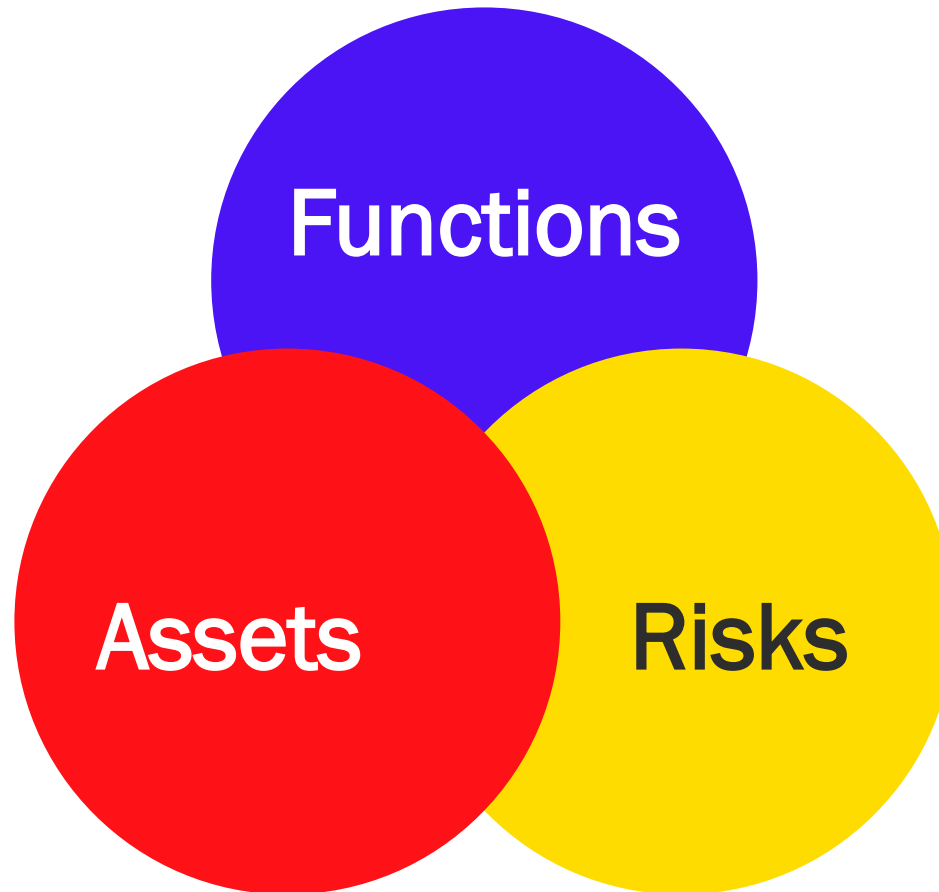
4. Transactional net margin method

5. Profit split method

Product price or transaction margin?



Functional analysis



Same functions, risks...=> comparable margin



Selection of method

Method 1 – Comparable uncontrolled price method – the priority method for all transactions except resale of goods

Important: Identical/similar goods:



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Method 2 – Resale price method – first to be applied for resale of goods

Methods 2 and 3 – Resale price method and cost plus method – applied if it is possible to ensure that the financial statements on the basis of which market intervals are calculated are comparable. If this is not possible, then **Method 4 Transactional net margin method** is used.



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The price of a one-off transaction is justified by an **independent evaluation** conducted in accordance with Russian and foreign laws on valuation activities.

Sources of information (1/2)

- + Quotes from Russian and foreign stock exchanges
- + Customs statistics of the Russian Federation
- + Official sources of information from Russian state authorities, foreign countries, international organizations, publicly available publications, information systems
- + Data from price reporting agencies
- + Details of taxpayer transactions
- + Market value of items subject to valuation

! Arm's length range may be calculated for Russian companies on the basis of the financial statements of foreign organizations only if it is not possible to calculate it on the basis of the financial statements of Russian companies

Sources of information (2/2)

+ Statistical and financial reporting

Bureau Vand Dijk: Orbis, Amadeus, Ruslana

Interfax: SPARK

RoyaltyStat and others

+ Price reporting agencies

Reuters, Bloomberg, Platts, Argus and others

+ Publicly available information systems

Tsena-Inform, Megasoft, Chem-courier, Metal Bulletin, Metal-pages, Fertecon

Group policy

+ Document content:

Description of activity of group and individual companies

Description of key types of transactions

Description of pricing methods/price analysis methods

Price ranges or margins

+ Local actions:

Description of controlled transactions in Russia

Functional analysis

Justification of the choice of price analysis method

Calculation of market intervals

Economic analysis: comparison of price/margin with market price/margin

Compensating adjustments

+ Article 105.18 Russian Tax Code: Compensating tax adjustments are possible among Russian taxpayer organizations:

(1) Upon receipt of a notice from the Russian Federal Tax Service allowing to make such adjustments

(2) When another taxpayer informs that it has submitted a tax return with an adjusted amount and has paid additional tax

+ The Russian Tax Code does not provide for compensating tax adjustments for transactions with foreign companies.

+ In practice:

Adjustment increasing a company's tax liabilities in Russia may/must be made

Adjustment decreasing a company's tax liabilities is expressly prohibited (Article 105.9-12 Russian Tax Code).

When Russian Tax Code methods are not appropriate: Cases and solutions (1)

Unique product/service

- + Comparison of margin not price
- + Search for internal comparable transactions
- + Adjustments to bring transaction conditions closer to market conditions

No price manipulation but transaction margin is not within market range

- + Search for other economic reasons that affected transaction margin (marketing strategies, seasonality, specific risks...)
- + Adjustments to market range and economic analysis

When Russian Tax Code methods are not appropriate: Cases and solutions(2)

- + Service provided by a foreign company, difficult to assess the effect on Russian organization's margin
 - + Selection of the tested party to the transaction
 - + Determination of markets for analysis
 - + Calculation of margin based on foreign company data
- + Package of services from Group companies
- + Management services, expense carryforward
- + Currency risks

Legislation changes in 2017

+ Penalty - 40% of unpaid tax amount

+ Interest-free loans between related parties under which the place of registration or residence of all the parties and beneficiaries is the Russian Federation are not controlled transactions

+ Safe loan interest rate range:

75%-125% of key rate of the Central Bank of Russia (from March 27, 2017 – 9.75%).

7.31%-12.19%

+ Disclosure of ultimate beneficiaries: effect on transfer pricing analysis

Price checks: Review of court practice



Audit timing

Decisions to conduct an audit are issued within 2 years of :

- + Receipt of **Notification** on controlled transactions;
 - 2014 – audits until May 20, 2017
 - 2015 – audits until May 20, 2018
 - 2016 – audits until May 20, 2019

- + Receipt of a **notice** from the tax authority that has audited the organization

- + Submission of a **revised tax return** decreasing the tax amount calculated taking into account transfer pricing adjustments

Risk group for price check

- + International trade of commodities
- + Offshore transactions
- + Large turnovers under controlled transactions
- + Turnovers under controlled transactions determine a significant part of company revenues/expenses

2017:

Moscow Arbitration Court Decision No. A40-123426/16-140-1066 dated January 27, 2017

- + Understatement of price of oil exported to an independent entity in Hong Kong
- + Tax authorities used Comparable Uncontrolled Price Method based on quotes published by independent price reporting agency Platt's
- + Payment of additional profit tax and fine – RUB 177 million
- + No documentation justifying price level
- + Taxpayer argument: particularities of the oil market, the particular ways small oil companies operate

Review of court practice on cases related to the application of certain provisions of Section V.1 and Article 269 of the Russian Tax Code was approved by the Supreme Court of the Russian Federation on February 16, 2017

Who is entitled to control prices? (1)

The Federal Tax Service of the RF controls prices for compliance with market level, and field and desk tax audits may not exercise such control (Article 105.17(1) Russian Tax Code)

If market prices are used to calculate tax as provided in Part 2 of the Russian Tax Code, tax authorities are entitled to use transfer pricing methods for determination of revenues/profits

Who is entitled to control prices? (2)

Report of tax authorities for 2016 (www.nalog.ru)

Identification of unjustified tax benefit through manipulation of prices:

*As of January 01, 2017 local tax authorities had issued **306 decisions** (not challenged in pre-action protocol) with a total amount of additional tax payment of **RUB 3.3 billion***

*Rejection of VAT refund in the amount of **RUB 49.5 million***

When does unjustified tax benefit arise?

When prices are not in line with market prices, this does not in itself give rise to unjustified tax benefit

A set of circumstances need to occur to give rise to unjustified tax benefit :

- + Interrelatedness*
- + Recent establishment of organizations*
- + Mutual settlements*
- + Multiple deviation of price from market level*

Interrelatedness

- + Courts may declare that entities are related if a counterparty is able to affect decisions regarding the financial and economic activities of the taxpayer
- + The interrelatedness of parties to a transaction is the basis for adjusting revenues if all the conditions for recognition of a controlled transaction are met. In particular, transactions between Russian related parties + transaction income exceeding RUB 1 billion

Economic factors affecting price

Russian Tax Code Article 105.7(11): Courts may take into account other circumstances important to determine compliance of transaction price with market price without the limitations provided by Articles 14.2 and 14.3 of the Russian Tax Code

Supreme court:

Taxpayers are entitled to provide evidence that income shortfall is due to reasons other than interrelatedness

- + **Market value report** should be used only if there is no other sources or for a one-off transaction when other transfer pricing methods are not applicable
- + Penalty for non-submission of **Notifications on controlled transactions** is imposed once regardless of the number of transactions not included in the report
- + No penalty for provision of false information in Notifications on controlled transactions is imposed if **transactions can still be identified** despite the erroneous statements in the report

Expected changes for foreign companies



+ Standardization of transfer pricing documentation for international data exchange

Who will be affected by the changes?

The new rules will apply to

Russian organizations and permanent establishments of foreign companies in Russia

which are part of international group of companies which compile consolidated statements

The group's annual turnover for the preceding financial year is equal to or greater than

+ RUB **50 billion** if the parent company of the group is in the Russian Federation

or

+ **the amount of total revenues** established by the country in which the parent company of the group is located

The new requirements will apply for financial years starting from **2017**

New reporting forms, documentation levels

1) Notice of affiliation with an international group of companies

Filed every year within 8 months of the end of the financial year by Russian group members

2) Country information for international group (Country-by-Country report)

Filed within 12 months of the end of the financial year by Russian companies that are parent companies or authorized by members of the group

3) Global documentation (=Master File)

Filed within 3 months of receipt of a request from tax authorities by Russian companies that are parent companies or authorized by members of the group

4) National documentation (=Local File)

Filed within 30 days of receipt of a request from tax authorities

Let's get ready for change: actions to be taken by companies in 2017

Submission to group of information necessary to prepare Country-By-Country Report

Comparative check of local transfer pricing documentation with information in Master File

Comparative check of the data from functional analysis of transactions with Russian company

Application of transfer pricing analysis general approaches to the same transactions in the Group

Bench-mark analysis for transactions where the tested party is a Russian company

Thank you for your time.

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