

Deloitte.

Transfer Pricing
The new wave
of regulations
continues



Transfer Pricing

Introduction

As previously announced in our [Transfer Pricing News No.1](#), the expected Instruction on Transfer Pricing has been finalized and published by the Ministry of Finance in the Official Gazette No. 97, dated 26 June 2014, and enters into force on that same date. It contains only few minor changes from the announced Draft, whilst all the related provisions anticipated in our [Transfer Pricing News No.1](#) are now valid and effective. Below, we take a quick look at the rules and procedures included in this Instruction.

Definition of Associated Parties

Subject to Transfer Pricing Regulation are all Albanian taxpayers engaged in cross-border transactions with 'associated parties'. As stated in our [Transfer Pricing News No.1](#), associated parties have a direct or indirect participation in the management, control or capital of one another or by a same third party. The Instruction further explains when enterprises are deemed to be associated and provides a catch-all rule for all the cases, where facts and circumstances evidence that a person 'effectively controls the business decisions of the other person'. However, in this case the burden of proof falls on the Tax Administration.

Controlled Transactions

The transactions subject to Transfer Pricing Regulation, named 'controlled transactions', are defined in our [Transfer Pricing News No.1](#). The Instruction further specifies as such any type of transactions between associated parties that affect the taxable profit of the Albanian taxpayer, including but not limited to:

- Transactions involving tangible goods, like raw materials, finished goods, fixed assets, etc.;
- Services transactions;
- Transactions involving intangible property, like royalty, license, payment for use of patents, trademarks, know-how, etc., and any other intellectual properties;
- Financial transactions, including leases, interest, guarantee fees.
- Capital transactions, including purchase or sale of shares or other investments, purchase or sale of long term tangible and intangible assets.

As anticipated in our [Transfer Pricing News No.1](#), any transactions with parties established in tax haven countries will be deemed controlled transactions and will be subject to Transfer Pricing Regulation, regardless of the relationship between the parties. Annex I of the Instruction provides a list of 65 countries considered as tax havens, e.g. Monaco, San Marino, British Virgin Islands, Liechtenstein, Marshall Islands, Monaco, U.S. Virgin Islands, Philippine, Hong Kong etc..

Market Principle

The Transfer Pricing Regulation requires an Albanian taxpayer engaged in controlled transactions with associated parties to ensure consistency of the controlled transactions with the 'market principle'.

The Instruction explains that the market principle in the Transfer Pricing terminology is equivalent to the 'arm's length principle' as defined in the OECD Model Tax Convention (the basis of all Double Tax Treaties between Albania and other countries).

Comparability Analysis

To determine consistency of controlled transactions with the market principle, the Instruction recommends the 9-step process of comparability analysis given by the OECD Transfer Pricing Guidelines (of 2010). This process is considered as best practice, but is not compulsory.

- Step 1: Determination of years to be covered;
- Step 2: Broad-based analysis of the taxpayer's circumstances;
- Step 3: Understanding the controlled transaction(s) under examination;
- Step 4: Review of existing internal comparables, if any;
- Step 5: Determination of available sources of information on external comparables, if needed;
- Step 6: Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator;
- Step 7: Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable;
- Step 8: Determination of and making comparability adjustments where appropriate;
- Step 9: Interpretation and use of data collected, determination of the arm's length remuneration.

Comparables

A 'comparable uncontrolled transaction' is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ('internal comparable') or between two independent companies, neither of which is a party to the controlled transaction ('external comparable'). External comparables may be domestic or foreign. Based on the Instruction, taxpayers should first look for domestic comparables. In their absence, foreign comparables will be accepted by the Tax Administration provided that the impact of geographic differences and other factors is analyzed and taken into account.

Our note: A common source of external comparables is the commercial databases such as AMADEUS (Pan-Europe region), KOMPASS (global), OSIRIS (global), etc., which are developed by special editors in an electronic format suitable for searches and statistical analysis.

Internal/external comparables should undergo a comparison exercise with the controlled transaction, by examining 5 'comparability factors' or attributes:

- 1) Characteristics of property or services transferred;

- 2) Functions undertaken, assets employed and risks assumed by the parties;
- 3) Contractual terms between the parties;
- 4) Economic circumstances of the market;
- 5) Business strategies of the parties.

If there are found differences of material impact on the comparison (e.g. due to different accounting practices, contractual terms, geographic markets etc.), it may be necessary to perform certain comparability adjustments to eliminate the effect.

Transfer Pricing Methods

The 5 approved and recommended methods to determine consistency of the controlled transaction with the market principle are the following:

- 1) Comparable Uncontrolled Price Method;
- 2) Resale Price Method;
- 3) Cost plus Method;
- 4) Transactional Net Margin Method; and
- 5) Transactional Profit Split Method.

The Instruction provides clarifications and illustration by example for each method.

It is not required to determine consistency with the market principle by applying more than one method. The taxpayer may also apply other methods, where it can be proved that none of the above methods can reasonably be applied to determine consistency with the market principle for the controlled transaction, and such other method yields a result consistent with the market principle. The burden of proof in such case lies with the taxpayer.

The selection of the most suitable method is particularly important because the Tax Administration will use that selected method as a basis to conduct the Transfer Pricing audit at the taxpayer.

The OECD Transfer Pricing Guidelines provide further guidance for the selection of the most suitable method for different types of transactions.

Transfer Pricing Adjustments

The application of the selected Transfer Pricing method may produce a range of reliable figures, used to define the arm's length range or the 'market range'. If the financial indicator of the controlled transaction (e.g. price or profit margin) is within the market range, no adjustment is necessary. If it falls outside, the Tax Administration is entitled to adjust the taxable profit of the taxpayer until the financial indicator used (e.g. price or profit margin) equals the median of the market range.

Corresponding Adjustments

To eliminate double taxation in transfer pricing cases, the Tax Administration may consent corresponding adjustments to an Albanian taxpayer, party to a controlled transaction which has been subject to a (primary) Transfer Pricing adjustment by the tax authorities of the other country. The competent authorities consult each other (if necessary) to determine corresponding adjustments through the mutual agreement procedure provided in the respective Double Tax Treaty.

Documentation Requirements

As anticipated in our [Transfer Pricing News No.1](#), the Transfer Pricing Regulation requires the taxpayers to prepare the Transfer Pricing documentation up-front and make it available to the Tax Administration within 30 days following a request. The preparation and submission of the documentation on time does not prevent the Tax Administration from making a Transfer Pricing adjustment (if necessary), but avoids the application of penalties of 5% up to 25% on any additional tax liabilities assessed (only interest for late payment applies).

The Transfer Pricing documentation must address at least the following:

- Overview of the taxpayer's business operations and organizational chart;
- Description of the corporate organizational structure of the group;
- Description of the controlled transaction(s), including analysis of the comparability factors and details of applicable transfer pricing policy (where relevant);
- Explanation of the selection of most appropriate transfer pricing method;
- Comparability analysis as described above;
- Explanation of any economic analysis and projections relied on;
- Details of any advance pricing agreements or similar applicable to the controlled transactions;
- Conclusion as to consistency of the conditions of the controlled transactions with the market principle, including details of any adjustment made to ensure compliance.

This documentation may be submitted in electronic or paper format, in Albanian or English language (in which case the Tax Administration reserves the right to request translation).

As anticipated in our [Transfer Pricing News No.1](#), the Instruction requires taxpayers engaging in controlled transactions exceeding in aggregate 50,000,000 LEK within a year, to complete and submit to the Regional Tax Directorate an 'Annual Controlled Transactions Notice'. The form and content is specified in Appendix II of the Instruction.

The Annual Controlled Transactions Notice should not be considered as complete and sufficient Transfer Pricing documentation. It is a file prepared in addition to the Transfer Pricing documentation and required to submit within the 31st March of the following year for information purposes. In case of failure to submit it on time, the taxpayer will be subject to a fixed fine of 10,000 LEK per month of delay.

Deloitte Contacts

Olindo Shehu, CPA
Partner
Deloitte Albania
oshehu@deloittece.com

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.