

Tax Alert

Ukrainian Verkhovna Rada accepts a Draft Law on Transfer Pricing at the second reading



On Thursday 4 July 2013, the Verkhovna Rada of Ukraine accepted a **Draft Law on Transfer Pricing No. 2515** (hereinafter, “the Draft Law”) at the second reading. This decision was supported by the votes of 231 People’s Deputies. The Draft Law has been sent to the President for signature.

The adopted Draft Law may be called a compromise between the version insisted on by the Ministry of Revenues and Duties and proposals suggested by representatives of business, since these options were only partially considered. Unfortunately, the Ministry took a principled stand on a range of critical issues, and these remained unchanged.

It should be noted that the effective date of the Draft Law was changed at the last moment. Therefore, once the Draft Law has been signed by the President of Ukraine, **new transfer pricing rules will come into effect** from 1 September 2013 (instead of 1 January 2014, as business representatives had insisted).

Given below is a summary of key provisions and amendments introduced by the new Draft Law as compared to the previous version adopted at the first reading.

Key Provisions of the Draft Law

Coming into effect

- Effective from 1 September 2013 (in the previous version – 1 July 2013)

Subject of transfer pricing

The following “controlled” transactions are the subject of transfer pricing provided that their volume exceeds UAH 50 million for the respective calendar year:

Controlled transactions

- Transactions with non-resident related parties
- Transactions with resident related parties that:
 - Have declared income tax losses for the previous reporting year
 - Enjoyed a special tax regime at the beginning of the current reporting year
 - Applied a non-standard income tax or VAT rate at the beginning of the current reporting year
 - Were not corporate income tax or VAT payers at the beginning of the current reporting year
- Transactions with a non-resident entity registered in a country with an income tax rate at least 5% lower than the rate applicable in Ukraine, or which pays corporate income tax at a rate at least 5% lower than the rate applicable in Ukraine

As compared to the previous version, the application of the Draft Law to domestic transactions between related parties has been limited.

Transfer pricing methods and their priorities

- Five methods are already specified in Art. 39 of the Tax Code of Ukraine, in particular:
 - Traditional methods:
 - Comparable uncontrolled price method
 - Resale price method
 - Cost plus method
 - Transactional profit methods:
 - Transactional net margin method
 - Transactional profit split method
- In the event that the determination of marketable prices makes it possible to apply several methods with the same degree of reliability, the comparable uncontrolled price method has priority

Data sources

- Officially-recognised data sources on market prices, a list of which is established by the Cabinet of Ministers of Ukraine
- Data from government and specialised agencies
- Other sources, including informational databases

Reporting and documentation

- A calendar year is a reporting period for transfer pricing purposes
- A report on controlled transactions for the previous calendar year must be submitted by 1 May. Therefore, it is possible that companies will have to submit their first report on controlled transactions by 1 May 2014
- Taxpayers must submit transfer pricing documentation (special documentation aimed at confirming that transactions were carried out in compliance with the rules) at the request of the tax authorities

The new Draft Law does not require major taxpayers to submit transfer pricing documentation or source documents together with the report of controlled transactions.

Advanced pricing agreement with tax authorities

- Only major taxpayers may enter into advance pricing agreements with the tax authorities in respect of the pricing approach to controlled transactions
- The subject may include a broad range of transactions, data sources, etc.

Tax liability adjustments

- Both individual adjustments by taxpayers (before tax audits) and pro rata adjustments based on audit results are stipulated
- In the event that the tax authorities detect deviations from market prices in a taxpayer's controlled transactions, the other party of these transactions (related party) is entitled to pro rata adjustments to its tax liabilities. In order to make these adjustments, a notice from the Ministry of Revenues and Duties will be required.

Penalties

- Up to 50% of underpaid tax liabilities in the event of adjustments by the tax authorities
- 5% of the controlled transaction amount in the event of failure to submit the transfer pricing report
- 100 tax exempt minimum amounts in the event of failure to submit the transfer pricing documentation
- For violations from 1 September 2013 to 1 September 2014, a fine of UAH 1 shall be applied

The new Draft Law does not provide for any penalties in the event of failure to submit source documents.

Specific transition rules

- Until 1 January 2018, specific rules may be applied to determine conventional export/import prices on certain commodities in the agriculture, metallurgy, chemical and oil & gas industries (budget-forming industries).
- According to these rules, a conventional price will be determined within a range of +/-5% from the indicative prices established by the Cabinet of Ministers of Ukraine and defined in accordance with stock market quotes or reference prices derived from specialised data sources.
- This rule shall apply to transactions with non-residents from countries with an income tax rate at least 5% lower than the rate applicable in Ukraine.
- Specifically, in the event that the prices of the above controlled transactions differ from the conventional prices established by the Cabinet of Ministers of Ukraine, taxpayers shall be entitled to apply conventional methods when determining transfer prices.

The new Draft Law expressly provides for the possibility, rather than a requirement, to apply the aforementioned special rules.

Special rules for forward contracts

- For forward and other similar contracts, transfer prices will be determined as of the date of conclusion of the respective agreement (the previous version did not include such a provision).

Contacts

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