

## LT in Focus

### Court of appeals decides in favor of Federal Tax Service in Uralkali's case

In 2012, Uralkali (the "Company") exported potash fertilisers through a related Swiss trader (the "Trader"). The Company prepared transfer pricing ("TP") documentation to substantiate the pricing in those controlled transactions, using the transactional net margin method (TNMM). However, when auditing the transaction, the Russian Federal Tax Service (the "FTS") applied the comparable uncontrolled price (CUP) method, sourcing price information from the Argus Media agency and, having discovered a price underestimation, recalculated the Company's revenues and assessed an additional profit tax liability of RUB 980 million and imposed penalties. The Company challenged the regulator's decision in court, seeking its invalidation; the appeal was sustained by a [resolution](#) of the Moscow Commercial Court of 16 June 2017.

The FTS disagreed with the resolution and challenged it with a court of appeals. The court of appeals [reversed](#) the judgement of the lower court and denied the Company's claim.

#### [Position of the first instance court](#)

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#### Position of the first instance court

- The TNMM was appropriately applied by the Company.
- The CUP method applied by the tax authorities does not ensure comparability of the financial and commercial terms of the controlled and compared transactions for the following reasons:
  - The FTS failed to take into account the difference in terms between the controlled transactions and the transactions selected as comparables, and namely the difference in time, terms of delivery, volume, and the ports of dispatch
  - The seller's functions and risks in the compared transactions and in the Company's transactions were not comparable
  - For comparison purposes, the FTS used quotes for goods that were not equivalent and/or whose properties were not identical with the goods sold by the Company

#### Position of the court of appeals

The court of appeals cited the following arguments underlying its judgement:

- The CUP method is given priority and other methods could be applied only if the CUP is inapplicable
- Argus Media quotations can be used as comparables for the CUP method purposes
- The Company's arguments citing the inapplicability of the CUP method sustained by the first instance court cannot be accepted for the following reasons:
  - **The reference to the inconsistency of properties of goods quoted by Argus Media and those sold by the Company to the Trader cannot be sustained as contradicting the Company's position underlying the application of the TNMM.**



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*"We are witnessing two completely opposite court opinions here. The conclusions of the court of appeals should be taken very seriously; however, we cannot be certain that the case is over now. I expect to see more of this dispute, continuing in the court of cassation. We will closely monitor any further developments in this case."*

The documentation prepared on the basis of this method by taxpayer sets forth that a uniform approach should be used for export supplies regardless of the type of potassium fertiliser, therefore export transactions in different types of fertilisers can be grouped together for TP purposes.

- **The argument stating that the quotation takes into account the data on transactions between Uralkali's affiliates is proved wrong by the explanations of Argus Media.** According to a letter from the agency, when calculating the quotations, it took into account the sales of Russian and Belorussian products by Belarus Potash Company (a related company) to third-party buyers. The Court also underlined that, according to the Company's explanations, Argus Media looked into the prices of second-tier transactions of Uralkali Group, i.e. the resale of Russian potash (with a mark-up charged by Uralkali Trading SA) to third parties. In the court's opinion, the above-mentioned fact "only confirms the comparability of supply volumes of the Company and the data from Argus Media."
- **The court rejected the arguments citing the incomparability of payment dates** as Argus Media published the arm's length price range formed by transactions with payment dates consistent with those of controlled transactions. According to the court, the agency does not average the prices in transactions with

different payment dates, recording them separately.

- In the court's opinion, grouping transactions with dispatch from the ports of the Black and the Baltic seas **for quotation purposes** does not signify an unjustified averaging of prices, but only expands the transaction price range, its minimum value being the lowest of the prices.
- The first instance court's conclusion **that Argus Media quotations are calculated on an aggregate basis without taking into account the supply volumes** was also rejected by the court of appeals, citing that Argus Media did not aggregate the prices, but determined separate quotations for different supply volumes, which further formed the price range.
- Furthermore, the court disagreed that **the term of supply was a material comparability criteria** as the potassium chloride market showed no volatility in 2012. The minimum quotation values as per Argus Media's data had remained unchanged from August 2011 to December 2012, amounting to USD 420 for regular potash and USD 430 for granular potash.

At the same time, the court of appeals did not comment on the first instance court's argument that the tax authorities should prove the fact of tax optimisation and moving capital abroad.

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## Conclusion

The takeaway from the judgement we have reviewed here is that the companies should be cautious when applying the TNMM to transactions in traded commodities, when pricing data for them are available from pricing agencies.

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We hope that you will find this newsletter interesting and informative. Our team has a vast experience in advising clients on transfer pricing issues and rendering support during pricing audits. Please feel free to contact us with any transfer pricing questions.

Best regards,

**Deloitte CIS Partners**

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