

LT In Focus

First judgement in dispute over application of new TP rules

Commercial Court of Moscow [releases Judgment](#) in case No. A40-123426/16-140-1066 of 27 January 2017 on dispute between Federal Tax Service and ZAO NK Dulisma over application of new transfer pricing rules.

[Matter in dispute](#)

[The Company's position](#)

[The Court's position](#)

Matter in dispute

In 2012, ZAO NK Dulisma (hereinafter, the Company) received revenues from a group of transactions relating to the exports of ESPO crude oil, where the buyer was a Hong Kong-based trader (hereinafter, the Trader). The Russian Federal Tax Service audited the pricing in the Company's controlled transactions for 2012 and, having discovered a price understatement, recalculated the Company's revenues based on the lower limit of the market price range, and assessed additional profit tax and penalties.

To determine the arm's length price, the regulator applied the **comparable uncontrolled price method**, using the Platts Dubai benchmark.

Upon institution of the proceedings, the Company fully settled the Federal Tax Service's claims. Notwithstanding the above, the Court reviewed the legitimacy of the regulator's claims and ruled that the **resolution made by the tax authorities based on the audit findings was fully compliant with the provisions of Section V.I of the Russian Tax Code**, including the application of the comparable uncontrolled price method and the use of the Platts benchmark; therefore, the additional assessments were lawfully and duly made by the tax authorities.

The Company's position

- The Company and the Trader are unrelated parties.
- Due to the small size of each batch, the Company was able to export oil only through the Trader and via the only sea port of Primorsky Krai, owned by AK Transneft. Taking advantage of the Company's restricted capacities, the Trader and AK Transneft jointly with the Russian Ministry of Energy actually dictated the oil sale prices.
- When applying the comparable uncontrolled price method, the Federal Tax Service did not take into account the prices set by the similar "smaller oil companies" for the same sort of oil sold to the same Trader via the same port.
- The Company would have not profited tax-wise from price understatement.
- The Federal Tax Service wrongfully denied the application of the resale price method in respect of this controlled transaction.

The Court's position

- The oil sale transaction under consideration shall be **treated as a related party transaction** based on Sub-items 2 and 3, Item 1, Article 105.14 of the Russian Tax Code, due to the reasons below:
 - It is an export transaction with an internationally traded commodity (oil);
 - The Trader is registered in Hong Kong, which is listed by the Russian Ministry of Finance as an offshore financial center.
- The transaction under consideration is treated on par with related-party transactions and is a **controlled** transaction pursuant to Item 7, Article 105.14 of the Russian Tax Code, as the revenues from the group of transactions **exceeded RUB 60 million in 2012**.
- **The Company has no TP documentation** for the above-mentioned controlled transactions, including the description of pricing methodology, for each batch.
- The controlled transactions notice filed by the Company for 2012 does not indicate the **pricing method applied to the transactions under review**.
- **The resale price method cannot be applied as:**
 - There is no information about the end customer the Trader sells the Company's oil to;
 - There is no information about further re-sale of oil purchased from the Trader.
- The information on prices set by the similar "small oil companies" that extract oil from the adjacent fields and sell it to the Trader **cannot be used for the purpose of application of the comparable uncontrolled price method** as not publicly available and due to tax secrecy.
- **The Court upheld the application of the Platts Dubai prices as a reference for ESPO crude**, including to bigger and smaller supply volumes, and even to other oil blends. Thus, the Platts Dubai crude prices can be used as an arm's length price benchmark subject to adjustments for quality and supply conditions.
- The reference the Company made to pressure exerted by AK Transneft and the Russian Ministry of Energy is based merely on the mass media publications and reporters' speculations, and shall not be taken into account by the Court due to the lack of evidence.
- **Proving that the taxpayer has profited tax-wise is optional** for TP controls purposes.



Dmitry Kulakov
Partner
Transfer Pricing
Deloitte CIS



Yulia Orlova
Partner
Metals
Deloitte CIS

"The tax authorities have been consistent in their position, but the case reflects the specifics of the Russian transfer pricing rules. The rules can actually dictate the prices in transactions with certain categories of goods between unrelated parties, and this might set a dangerous precedent for the companies whose transactions fall under the controlled transactions criteria."

"The case shows how an absence of transfer pricing documentation for export deals increases the risk of claims from the tax authorities following transfer pricing audits and dims the taxpayer's chances to challenge such claims in court. The risk is especially relevant for all Russian industrial exporters."

We hope that you will find the information in this edition interesting and useful. Please feel welcome to contact us for more details on the topics covered.

Best regards,

Deloitte CIS Partners

Contacts

Tax & Legal



Yulia Orlova
Partner
Metals
yorlova@deloitte.ru

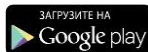
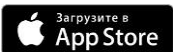


Dmitry Kulakov
Partner
Transfer pricing
dkulakov@deloitte.ru



Vladimir Elizarov
Partner
Transfer pricing
velizarov@deloitte.ru

TaxSmart app



deloitte.ru

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 244,000 professionals make an impact that matters, please connect with us on [Facebook](#), [LinkedIn](#), or [Twitter](#).

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. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.