

New Law on Transfer Pricing Has Been Introduced



On 18 July 2011 the Russian President signed Law #227-FZ “On introduction of changes to Russian legislation aimed to improve tax transfer pricing rules”. The new law will come into force from 1 January 2012, whilst some provisions will be deferred until 2013 and 2014. It should be noted that a probability of amending of already passed law in a 2011 still exists but most likely within a separate procedure of a new draft law adoption. The law is generally closer to the OECD Transfer Pricing Guidelines. The key provisions of the new law are summarised below.

I. Related Parties

The list of related parties includes 11 categories. One of the main criteria of recognizing the parties as related is ownership threshold which should be more than 25%.

However, the law maintains the right of a court to recognize parties as being related based on the grounds which are not specified in the law. Taxpayers may claim themselves affiliated irrespective of the provisions of the Russian Tax Code.

II. Transfer Pricing Methods

The number of transfer pricing methods has been increased to five:

- 1) Comparable uncontrolled price;
- 2) Resale-minus,
- 3) Cost-plus;
- 4) Comparable profitability;
- 5) Profit-split.

The law provides more detailed guidelines on how to apply each method. CUP remains the primary method and may now be applied where information concerning at least one comparable transaction is available. It should be noted that in some cases the resale minus method is a primary one (for example, in case of resale of goods). The application of two or more of the methods listed is permitted. If none of the methods is appropriate, the market price of a one-off transaction may be determined by performing an independent appraisal in accordance with the applicable Russian or foreign legislation.

III. Controlled Transactions

The new law stipulates that transfer pricing control may be applied to a group of similar transactions, not just a single transaction as under the current rules. In comparison with the current transfer pricing rules, the list of controlled transactions has been reduced.

1. Cross-border

The following cross-border transactions are subject to control:

- Cross-border related-party transactions, including supply arrangements with third-party intermediaries;
- Cross-border transactions with goods traded on commodity markets, e.g. crude oil or precious metals, if the transaction amount exceeds RUB 60 million;
- Cross-border transactions with offshore residents of jurisdictions on the so-called Ministry of Finance’s “blacklist”, if the transaction amount exceeds RUB 60 million.

2. Domestic

The following transactions between related parties are subject to transfer pricing control:

- If the aggregate annual amount of income resulting from transaction between related parties exceeds in a calendar year (with possible exclusions, for example, if both parties are registered in the same region, or do not generate losses):
 - RUB 3 billion in 2012;
 - RUB 2 billion in 2013;
 - RUB 1 billion starting from 2014.
- Related party transactions, if transaction volume exceeds RUB 60 million in a calendar year, and one of the following applies:
 - it involves operations with mineral resources subject to ad valorem rate of mineral extraction tax (MET), and one of the parties is a MET tax payer at ad valorem rate; or
 - one of the parties does not pay profits tax or pays it at a 0% rate (i.e., a participant in project “Skolkovo”); or
 - one of the parties is a resident of a special economic zone¹.
- Related party transactions, if transaction volume exceeds RUB 100 million in a calendar year, and one of the following applies:
 - one of the parties pays unified tax on imputed income or unified agricultural tax.

Transaction between companies which are members of a consolidated taxpayer group will not be subject to transfer pricing control. This regime, included in a law which is currently under consideration, is expected to apply only to the largest taxpayers. A draft law on consolidated taxpayer regime was adopted by the State Duma in a first reading on October 22, 2010. Unless the law comes into force, the above exception regarding consolidated taxpayers is not valid.

IV. Sources of information

The information required to determine the market price/profitability should be obtained only from available sources (both official and publicly available), in particular:

- 1) Prices and quotations from stock or commodity exchanges (both domestic and foreign);
- 2) Customs’ data relating to Russian overseas trade;
- 3) Official sources of information on prices (and price fluctuations) and exchange quotations held by the federal, regional and local authorities, including statistical data; also, official sources held by foreign countries and international organizations or contained in other published and/or available publications and databases;
- 4) Information prepared by special pricing agencies;
- 5) Information on the taxpayer’s own transactions (internal comparables).

If the information contained in the above sources is not available or is insufficient, the following information may be used:

- 1) Information on prices (and price fluctuations) and exchange quotations obtained from published and/or available publications and databases;

¹ This provision will come into force on January 1, 2014

- 2) Information from company accounts and statistical reports, including that published in available Russian or foreign publications and databases;
- 3) Information from independent appraisals;
- 4) Other information.

The law specifically states that for the purposes of determining the profitability range, the accounting and statistical data of foreign organizations may be used only if Russian sources do not exist or are unavailable (thus, for example, European search results may not be relevant).

V. Transfer Pricing Documentation

Companies will be obliged to keep specific transfer pricing documentation if the total amount of income of all controlled transactions received by taxpayer with the same counterparty exceeds:

- 1) RUB 100 million in 2012;
- 2) RUB 80 million in 2013;

These restrictions will not be applicable since 2014.

The transfer pricing documentation will need to contain the following information:

- Structure and terms of the transaction, parties involved and their functions, pricing methodology;
- A description of the transfer pricing methods, sources of information used and rationale for the choice of transfer pricing method;
- Information on other factors which might influence the price (for example, marketing strategy);
- Information on adjustments to the tax base.

The tax authorities will be allowed to request transfer pricing documentation from taxpayers no later than 1 June of the year following the calendar year in which the controlled transactions were performed. A taxpayer will be obliged to file documentation with the tax authorities within 30 days after receiving their request.

Moreover, taxpayers will be obliged to submit information on controlled transactions (i.e., notifications) in a calendar year to the tax authorities not later than on May 20 of the next year. These notifications should be made only if transactions fall under the abovementioned requirements for transfer pricing documentation.

VI. Advanced pricing agreements

- “Major taxpayers” (i.e., with annual tax payments exceeding RUB 1 billion or annual revenue/assets exceeding RUB 20 billion) may enter into an advance pricing agreement (“APA”) with the tax authorities (other criteria may also be used).
- The new law envisages the potential participation of foreign federal executive bodies in charge of control and supervision in the area of taxes and duties in APAs, provided that one of the companies involved is a tax resident of that foreign state.
- The tax authorities have 6 months to review an APA application, extendable to a maximum of 9 months. An approved APA would be valid for 3 years and may be prolonged for a further 2 years at the request of the taxpayer.
- An APA would not be changed even if relevant provisions of tax legislation are amended.

VII. Transfer Pricing Audit

Transfer pricing audits may cover the preceding three-year period. The new provides for the following exceptions:

- 2012 will be open for transfer pricing audit only until 31 December 2013,
- 2013 will be open for transfer pricing audit only until 31 December 2015.

VIII. Adjustments

- The new law allows taxpayers to make adjustments to the tax base in accordance with the chosen TP method (i.e. voluntary adjustments), provided that these do not lead to a reduction in tax liabilities. Hence, the law does not provide for a possibility to make downward adjustments. Thus, application of profitability-based methods (i.e. comparable profitability and profit split) might be limited.
- The exception to this is where the tax authorities impose an additional tax assessment on a taxpayer as a result of a transfer pricing audit, with the taxpayer's counterparty being allowed to use the determined market price for the purposes of calculating its own profits tax and VAT liabilities (so-called "corresponding adjustments").

IX. Penalty

Starting from 2014 transfer pricing penalties of 20% of the amount of additional tax payable will be introduced. A penalty of 40% of the underpaid tax (but not less than kRUB 30) will be applied in 2017 and will be used if the price/profitability is outside the market range (resulting in an underpayment of tax) and if the required transfer pricing documentation has not been prepared.

X. Permanent Establishment

The taxable income of a foreign legal entity's permanent establishment (PE) in Russia or a Russian legal entity's PE abroad would be determined taking into account the specific functions performed, risks borne, and assets employed by the PE. The new law does not provide for any specific rules which should be applied in such cases, including the allocation of income and expenses between a head office and a PE.

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In its current form, the transfer pricing law answers many of the criticisms of the earlier drafts.

International business will welcome the further alignment of the law with OECD principles. Finally, although a number of deadlines for implementation have passed in previous years, 1 January 2012 is the realistic start date for the new rules. Thus, taxpayers should consider the potential impact of the new rules in the nearest future.

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