

FUNDS TRANSFER PRICING IN UKRAINE: IS IT TIME TO GET READY?



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Any discussion regarding funds transfer pricing implies the activities and recommendations of the Organization for Economic Cooperation and Development in this area. On the one hand, it means that the issue has long ago gone beyond the borders of individual countries and, on the other hand, the lack of legislative regulation of funds transfer pricing in some countries triggers a natural interest to all possible options of such regulation.

Discussion of draft acts on funds transfer pricing is now in full swing. In our opinion, there is every reason for such discussion. At least this is evidenced by several drafts registered in the Verkhovna Rada of Ukraine, but also by the active position of the fiscal authorities and the state as a whole in this area. Everyone understands that enactment of Article 39 of the *Tax Code* with its current language neither ensures any efficient regulation of the funds transfer pricing in Ukraine, nor the principle of arm's length.

NOTHING IS NEW

Large foreign corporations have known for a long time how the system of state regulation of funds transfer pricing works in the world. More and more countries are making changes to their legislation to introduce funds transfer pricing rules. By the way, funds transfer pricing was the main issue discussed at the session of the Tax Commission of the ICC (headquartered in Paris), which was held in November in New Delhi. This issue has affected all countries.

The USA, Japan, India, China, Canada, France, Germany and some other countries are the most advanced in terms of regulation of funds transfer pricing. The legislative logic in such countries is simple and clear: leaving corporate pricing without control enables abuses (minimization of taxes), which is equal to the loss of a large part of budget revenue. For example, the relevant changes to

Russian legislation came into effect in early 2012. Taxpayers in Russia are getting ready to submit the first annual reports, to be visited by inspections, and to see the development of new judicial practice.

NATIONAL LEGISLATION

Now about Ukraine. It should be noted that there is a wrong opinion that government regulation of the funds transfer pricing will start in January 2013. Article 39 of the *Tax Code*, which deals with the methods and procedures of determining and applying usual prices, has significant drawbacks and it will not work without a number of additional clarifications. The main aspects that need to be addressed include introducing a minimum threshold for amounts of controlled transactions, development of a detailed methodology for application of pricing methods, development of requirements for the necessary documentation that is necessary to confirm the price level, and setting mechanisms to control how pricing rules are used.

At the same time, it is necessary to clearly define sources of information used to determine the price level. What are official sources? If, for example, a taxpayer asks a marketing company to research market prices, could its findings be used without any additional approvals? Also, in our opinion, the consequences and benefits of making pricing agreements are not clear for tax purposes. How can the conclusion of such an agreement protect a taxpayer, and can an approved price be considered a market price? And there should be control in place to make changes to legislation actually work. But this is not an easy task, as this is a specific work that requires analysis, knowledge and analytical skills. Who will do the job in the tax agency?

For example, Russia has opted to establish a separate unit — Interregional Inspection for Funds Transfer Pricing. To sum up:

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the *Tax Code* seems to have at least some provisions, but there is no practical guide as to their application. And the State Treasury craves for money.

RUN-THROUGH

What should be done in the current situation, since the expected act is still pending, and provisions of Article 39 of the *Tax Code* will not work to regulate the funds transfer pricing at least in the way that taxpayers and the government might wish it to? We recommend our clients to start preparing for the inevitable, as approval of new rules is just a matter of time. However, we do have a reference points, including, for example, Draft Act No.11477 of 12 April 2012. It makes it possible to estimate the directions and magnitude of the proposed changes, as well as individual risks for each taxpayer. One can see the list of controlled transactions and maximum amounts. For example, along with transactions with affiliated persons, the list includes transactions with non-residents registered in the jurisdictions, where income tax rate is 5 % points lower than in our country. However, there is the annual threshold of UAH 50 million for transactions to get into the control zone. Imports/exports of certain goods (grain, fats and oils, coal, gas, ferrous metals, etc.) are subject to special rules that would apply for a few years.

We should be prepared if we do not want the act to a surprise. One needs to know that special attention will be given to the sale and purchase of goods or products through related persons, intra-group services, sale at a price below the purchase price, sale of imports below the customs price, and significant deviation of prices compared with identical goods or services.

First of all, transactions should be analyzed and indicators should be established to see that transactions are outside the risk zone. For example, it can include the use of intangible assets by friendly companies without paying roy-

alty; non-beneficial barter; low or high interest loans, guarantees; placement of companies in jurisdictions with low tax burden with no other apparent purpose, etc. An inventory should be taken of all business strategies, processes, corporate structures (which one way or another are used in the company). Also, it is reasonable to pre-select the best method for determining the funds transfer price in view of risks and benefits. It is necessary to develop and approve a company's internal procedures, as it is assumed that there will be constant monitoring of controlled transactions and it is important to determine who and how will be handling such issues. By the way, representatives of regulatory agencies abroad are often provided with information about history, traditions, and special features of corporations. It allows mollifying original attitudes of fiscal agencies to funds transfer pricing. Specialists at our company have developed a special service module that helps diagnose the business and implement the funds transfer pricing methodology, which will enable a business to get ready for new tax rules.

CONCLUSIONS

In fact, taxpayers still have time to get ready to bring their business activities into compliance with the rules of funds transfer pricing that is known in the world as the principle of arm's length. However, the time for preparation is limited: as soon as clear criteria of controlled transactions and funds transfer pricing are developed, the regulatory authorities will become active. This is confirmed by the practical implementation of the novelty in the *Tax Code* — Article 188 on the sale of imported goods at prices no lower than customs prices in situations where the imported goods under long-term contracts fail to be sold in Ukraine at such prices (for various economic reasons). Therefore, it is necessary to be prepared without any delay. Ignoring this will certainly lead to the conducting of business at one's own risk.

Our philosophy of protecting a client's rights is simple — prevent legal risks and litigation.

Our company provides services representing the interests and outsourcing of non-residents and residents doing business in Ukraine and abroad.

An important feature of our services is a comprehensive study of a client's problems. In particular, the involvement of auditors, financial advisers, tax advisers, deep doctrinal research tasks. This approach in work caused the structure of the company, which includes the attorneys sector, audit sector, tax sector and sector of scientific advisers who together find not only effective but also competent decisions.

The firm's intellectual center is a group of scientific advisors who have scientific publications in such fields as investment policy, land law, tax law, intellectual property, business law and in public-private partnership.

A significant part of our practice involves representing clients in administrative proceedings against the State Tax Service and State Customs Service of Ukraine, including:

- appeal against tax notice-solutions in administrative and judicial procedures;
- legal solution of customs disputes relating to customs clearance and customs value;
- drafting of legal documents;
- representing clients when considering appeals and statements of claim;
- defense in criminal cases initiated by the effects of control measures.

Our company specializes in the following areas of law:

- Competition law;
- Mergers and acquisitions;
- Corporate law;
- Intellectual property;
- Due diligence;
- Administrative law;
- Criminal law / economic crime;
- Land law;
- Labor law.