

# NEW TAX LEGISLATION: TRANSFER PRICING NOVELTIES

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Not so long ago, the tax legislation of Ukraine was supplemented with provisions on transfer pricing. The purpose of the new legislation is to introduce the tax control of prices in contractual relations between related parties, as well as with non-residents. For the transactions that are recognized as controlled, usual prices will apply for tax purposes.

According to the new version of Article 39 of the *Tax Code of Ukraine*, controlled transactions are commercial transactions of purchase (sale) of goods (works, services), performed by taxpayers:

- with related persons — non-residents;
- with related resident persons, who:
  - (i) declare the negative value of the object of taxation for income tax purposes;
  - (ii) apply special tax regimes at the beginning of the reported year;
  - (iii) pay corporate income tax and/or value added tax at a rate that differs from the main rate at the beginning of the reported year;
  - (iv) were not payers of corporate income tax and/or value added tax at the beginning of the reported year.

Transactions with non-residents are deemed controlled if the non-resident is registered in the country, where the income tax rate (corporate tax) is 5 or more percentage points lower than in Ukraine, or if the non-resident pays income tax in his own country at the rate lower by 5 or more percentage points. The list of such countries is approved by the Cabinet of Ministers of Ukraine.

All of the above transactions are considered controlled ones on condition that the total amount of the taxpayer's transactions with each counterpart equals or exceeds UAH 50 million (excluding VAT) in a calendar year.

In order to calculate that criteria, one should take into account transactions pertaining to purchase/sale of goods (works, services), as well as amounts of loans, deposits, credit, interest on such loans, deposits, credits, repayable financial aid, the cost of goods under commission contracts, suretyships, agency and other similar contracts, amounts of commission remuneration, and the cost of investment. The volume of controlled transactions should be calculated on the basis of contractual versus usual prices. If the taxpayer had purchase and sale transactions with an individual contractor in the reported period, it is necessary to calculate the total sum of the transactions. If the goods are returned to the seller within one reported period, the amount of such return should be deducted to calculate the criterion. If the return of goods takes place in the next calendar year, the value of the return is not included in the calculation and it does not reduce the total amount of all transactions.

The following methods are used to determine the usual price in controlled transactions:

- the method of comparable uncontrolled price (analogue of sale);
- price of resale method;
- “cost plus” method;
- net profit method;
- profit distribution method.

Taxpayers may use any method that they reasonably consider as acceptable, but when there is the possibility of applying the method of comparable uncontrolled price (analogue of sale) or any oth-

er method, the analogue of sale method should be used. Practice shows that this method provides the most accurate results and, therefore, it is made a priority.

Depending on the method of determining the price, taxpayers should calculate the market price range or the market range of profitability. The information on comparable transactions is used for this calculation, and the procedure of calculation is approved by the Cabinet of Ministers of Ukraine.

The sources of information on comparable transactions are officially recognized and approved by the Cabinet of Ministers of Ukraine. If the information is missing or it is not sufficient, taxpayers can use other public and publicly available sources.

For the purposes of tax control, a calendar year is a reporting period for transfer pricing. Taxpayers are required to submit a report on controlled transactions in electronic form before May 1 of the year following the year of reporting.

Upon request of the controlling authority to justify the level of the contract price, documentation of the controlled transactions should be submitted. The request may be sent not earlier than May 1 of the year following the calendar year in which the transaction occurred. The documentation on individual controlled transactions is submitted in any form, but the documentation of major taxpayers should contain specific mandatory information. Smaller taxpayers should also provide their primary accounting documentation.

Audits of the controlled transactions will be performed by officers of the territorial tax authority, but officers from the national office will be in charge of the audits. The duration of the audits of controlled transactions shall not exceed six months. Under certain circumstances, audits may be extended for the same period.

Large taxpayers are entitled to conclude an agreement on coordination of prices in controlled transactions with the Ministry of Revenue and Taxes. Coordination may apply to the list of goods (works, services), their price, the list of information sources, and the period of such coordination.

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**O**ur philosophy on protecting a client's rights is simple — to prevent legal risks and litigation.

International Legal Center EUCON provides services representing the interests and outsourcing of non-residents and residents doing business in Ukraine and abroad.

An important feature of services provided by the firm is a comprehensive study of clients' problems, in particular, the involvement of auditors, financial advisers, tax advisers, deep doctrinal research tasks. This approach in work caused the structure of the Center, 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 team of International Legal Center EUCON advises clients on the most complicated issues of tax, transfer pricing, corporate, business restructuring, assets protection, commercialization of IP rights objects, tax planning with application of non-material assets.

According to the annual research of Yuridicheskaya Praktika Publishing and Kommersant Ukraine, International Legal Center EUCON has permanently been part of TOP-50 leading law firms in Ukraine since 2010.

In 2013 the firm became a laureate of Legal Awards of the Year in Law Firm — Breakthrough of the Year nomination. Yaroslav Romanchuk, managing partner, was named among the 5 finalists in the following nominations: The best tax lawyer and The best partner of a law firm. Moreover, in 2013 International Legal Center EUCON became a finalist in The Law Firm of the Year in the Taxation Sphere nomination.

It was in 2013 that for the very first time International Legal Center EUCON took part in the independent rating The Legal 500: EMEA and was ranked second as the best law firm specializing in taxation.

In view of the current trends in tax policies, the International Legal Center EUCON has established a separate transfer pricing practice and engaged lawyers in addition to auditors and assessors. Thus, our clients receive a full range of services in this area — starting from development of internal policies and documentation to protection of interests in the process of contesting decisions.

International Law Center EUCON and the International Audit Union established and operate the Transfer Pricing School attended by managers of accounting and financial divisions.

Violations of legislation in the field of transfer pricing shall entail the following penalties:

5% of the total amount of the controlled transaction for failure to submit a report on controlled transactions;

100 minimum wages for failure to submit documentation on controlled transactions.

Penalties for violations of the transfer pricing provisions committed during the period from 1 September 2013 to 1 September 2014 are imposed at the rate of UAH 1 USD for each violation. But this does not apply to penalties for the failure to submit reports or documentation.

Temporarily, till 1 January 2018, specific rules for determining the usual price will be effective for the transactions with non-residents from the low tax jurisdictions concerning imports/exports of the following commodities: grains, oils, inorganic and organic chemical products, ferrous metals, and products made of ferrous metals.

At the taxpayer's discretion, the usual price for such goods can be determined in the following way:

— if the commodities are traded at the exchange — at the level of exchange prices, if they are not traded — at the level of the reference prices published in specialized trade publications. And such prices can be:

— reduced by not more than 5% for the sale of goods;

— increased by not more than 5% for the purchase of goods.

If such sources contain information about the price range, the maximum value of the price range is used for the purchase of goods and the minimum value of the price range if used for the sale of goods.

If the special rules (described in paragraph 1) are used and the price of commodities in the controlled transaction is smaller than the usual price (the sale of goods), and/or higher than the usual price (the purchase of goods), taxpayers shall be entitled to:

— independently (not later than on 1 May of the year following the reported period) determine and pay the tax liability based on the usual price, and to submit to the tax authority copies of the primary documents confirming controlled transactions, including contracts, specifications, customs freight declaration, bills of lading, invoice, proof of shipment and/or receipt of the goods, as well as the source of information based on which the usual price was determined. At the same time, such taxpayers are exempt from penalties (financial sanctions);

— apply any of the pricing methods provided in clause 39.3.1 of the *Tax Code of Ukraine*. The taxpayer will need to provide to the controlling authority copies of contracts (agreements) between such party and the subsequent recipient of the goods (if the recipient is not a related person of the party of the controlled transaction and/or the taxpayer).

Since the legislation on transfer pricing is a novelty for our taxpayers and practices of its application are only developing, litigation will definitely follow. Grounds for litigation may include additional tax liability resulting from inconsistency of contractual prices, and also recognition of a transaction as a controlled one. Many taxpayers have issues with establishing a full list of related persons, finding comparable transactions, and choice of the pricing method.