

WILL NEW CHANGES IN THE FIELD OF TRANSFER PRICING SOLVE TAXPAYERS' PROBLEMS?

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The legislation that regulates control transfer pricing in Ukraine came into force on 1 September 2013. Taxpayers had already received their first experience of the new rules, reported for 2013 and been preparing their reports for 2014. The International Law Center EUCON created a separate transfer pricing practice, and worked with its clients in this area under the legislation for two years. We held training sessions for accounting and financial professionals within the Transfer Pricing School, helped them to justify the price level, developed reports and documents on controlled transactions. During this time we were able to use the legislation in practice, to evaluate all its shortcomings, including those that can be used in favor of taxpayers. Everybody knows that sometimes certain wording, vagueness or lack of regulation, can be transformed into an opportunity that is advantageous for taxpayers. As an example, there is a situation with determining the usual price under the special rules that have been established for import and export transactions with certain commodities. According to the rules, the exchange price of goods was determined in accordance with stock quotes with an acceptable 5% range. The vagueness of the list of exchanges enabled us to use quotes of Ukrainian exchanges in the first place, and the lack of clear requirements on the term to use

that information enabled us to justify the price by comparing quotes within a fairly lengthy time frame. If we speak about the main problems of transfer legislation, the biggest challenge at the moment is certainly the lack of sufficient information on business transactions in the sources. First, there is little information in general, and secondly, it is difficult to find sufficient information to make a conclusion that a transaction can be considered comparable with respect to the controlled one. In this regard, we always recommend our clients to look for comparable transactions among domestic business transactions with unrelated parties in the first place.

Describing the changes to the legislation on transfer pricing that became effective on 1 January 2015 in general, we can say that they are not conceptual, but they significantly alter the order of administration.

Above all, I want to draw attention to an extended circle of persons that the legislation applies to. Earlier, a transaction was recognized controlled according to the criterion of UAH 50 million of the annual volume of business transactions with one person. Since 2015 the value criterion has been significantly reduced, and in view of the falling exchange rate of Hryvna, we are sure that many taxpayers will have to master the intricacies of transfer legislation.

In addition, legislators abolished control over transactions between residents of Ukraine, and in accordance with the worldwide practices, they will monitor only the foreign trade. Formally, they canceled special rules for import and export transactions with certain commodities, which originally were designated to be effective till 2018. But they kept some features of pricing for the goods traded at exchanges, which was reflected in the order of applying the first method (method of a comparable uncontrolled price). In the context

of transfer pricing, they practically excluded VAT from the controllers' sight. Under the new legislation, control should apply to the transactions that affect taxable income.

In general, the rules governing administration of the transfer pricing can be described as more stringent for taxpayers.

Thus, they expanded the list of grounds to recognize related persons. Since now, if a legal entity has loans (credits), repayable financial assistance from other entities or individuals that exceeds the equity of the legal entity more than 3.5 times (for financial institutions and leasing companies — more than 10 times), it is a criterion to recognize a relation. Apart from that, the legislation provides for the right of individuals and legal entities that are parties to the transaction to independently recognize themselves related and it introduces a notion of "actual control" over business decisions of another legal entity. The tax authorities will need to prove that actual control in court.

It introduces changes to the provisions governing audits:

- it establishes that audits of controlled transactions cannot exceed 18 months (before, it was 6 months);

- it provides for extension of audits for up to 12 months (before, it was 6 months);

- it provides for counter-audits and interviews of executives and/or employees of taxpayers who are parties to controlled transactions, during audits;

- audits of controlled transactions can be carried out covering the period of 2,555 days (seven years) (appropriate changes have been made to Article 102 of the TCU).

It provides for additional penalties in the amount of 5% of controlled transactions that are not declared in the report. The penalty for failure to submit documentation has been set at the level of 3% of the controlled transactions, where the

documentation was not filed, up to 200 minimum wages.

It says that taxpayers are obliged to maintain the transfer pricing documentation and it sets the unified deadlines to submit the documentation. Upon request of the controlling authority, the documentation should be filed within a month. Before, major taxpayers had two months for filing. Filing information upon additional request — 10 days of the latter's receipt. Earlier, it was 30 days.

Thus, it should be noted that all these provisions become effective on 1 January 2015 despite the fact that the reports on 2014 should be prepared under the provisions of Article 39 of the *Tax Code*, effective before 1 January 2015.

It also amended the list of business transactions that are recognized controlled. As was the case before, if the value criterion is reached, transactions with related non-resident persons and non-residents from jurisdictions approved by the Cabinet shall be subject to control. However, the list is compiled based on the following conditions:

- countries (territories) where the rate of corporate income tax (corporate tax) is 5% or more points lower than in Ukraine;
- countries that do not openly disclose the information on the ownership structure of legal entities;
- countries that do not have international agreements with Ukraine with provisions on exchange of information.

Apart from the above-mentioned transactions, business transactions on the sale of goods through non-resident commissioners are also subject to control. Such transactions will be considered controlled independently of the buyer's status in a transaction (resident or non-resident). The transactions conducted between related persons involving (mediation) persons, who are not re-

lated with them and do not perform any essential functions, do not have significant risks and do not use material assets, will also be recognized controlled. Functions or assets are deemed essential if related persons could not carry out or use them on their own without involvement of other persons.

We believe that canceling the priority of information sources was a very significant and positive change in comparison with the previous version. Earlier, the priority was to use official sources of information, which included individual publications and websites. The mentioned publications could not provide taxpayers sufficient information on prices in comparable transactions. From now on taxpayers may use information about their own transactions with persons who are not related or information from any other publicly available sources.

In general, all of the above changes reflect the trend to strengthen control over transfer pricing in Ukraine, especially due to the fact that the legislation was being prepared with the participation of strict international creditors of Ukraine. And now, when more taxpayers are going to study the legislation, there will be a need to understand the importance of training employees and adaptation of internal rules on control over transfer pricing. The International Law Center EUCON has extensive experience in preparation and implementation of such internal rules, which significantly simplify the life of accounting and financial departments, and in assisting them to create price justification algorithms, and division of responsibilities among decision-makers. Development of systemic control over the price level, monitoring procedures, and documentation of analytical calculations will enable problems to be avoided as well as possible additional tax changes.

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 Our philosophy for 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 formed the structure of the Center, which includes the attorneys sector, audit sector, tax sector and sector of scientific advisers who in unison find not only effective but also competent decisions.

The firm operates within two offices. Yaroslav Romanchuk heads the Ukrainian office in Kiev and Ihor Yatsenko is head of the Polish office in Warsaw.

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.

The firm's clients include international and Ukrainian industry leaders from oil and gas, energy, agriculture and food industry, telecommunications, trade, transport, metallurgy, chemical industry, construction, hospitality, finance, etc.

The performance of the International Legal Center EUCON and its partners is highlighted by numerous recognitions and awards.

Since 2010 EUCON has been included in the list of top 50 Leading Law Firms in Ukraine. In Ukrainian Law Firms. A Handbook for Foreign Clients, EUCON was also shortlisted as one of the Leading Law Firms in Tax for 2013-2014, while Yaroslav Romanchuk, managing partner, was named among the Top 5 tax lawyers in Ukraine. The 2014 edition of Legal 500 international legal directory gave the firm a high ranking and included it in Tier 2, while The Kyiv Post weekly — into Tier 1. The firm was recognized as The Best Tax Law Firm by Legal Awards 2014 and Breakthrough Firm in 2013.

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.