

**Legal Alert – 22 July 2013**

**NEW TRANSFER PRICING REQUIREMENTS PENDING**



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The Draft Law of Ukraine "On Introducing Changes to the Tax Code of Ukraine Regarding Transfer Pricing" (the "**Transfer Pricing Law**") was adopted by the Ukrainian Parliament on 4 July 2013 and was sent to the President for signing. If signed by the President, the Transfer Pricing Law will take effect as of 1 September 2013. The transfer pricing requirements shall be applicable to both domestic and international (foreign economic) transactions.

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I. Transfer pricing requirements

Under the Transfer Pricing Law, the transfer pricing is defined as a system of determining *usual prices* for goods/services in *controlled operations* (as defined below).

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Usual price is a price of goods (works, services) as determined by the parties to an agreement, if otherwise is not established by the Tax Code. *Usual price*, if the tax authorities do not prove otherwise, is considered to be equal to the fair market price.

Transfer pricing is applicable to commercial operations if two components are in place:

- counterparty component; and
- amount component.

A. Counterparty Component

The Transfer Pricing Law introduces new definition – "*controlled*" operations, with the following operations to be considered *controlled operations*:

1. commercial operations on purchase (sale) of goods (works, services) which are performed by tax payers with *related parties* (as defined below) – non-residents;
2. commercial operations on purchase (sale) of goods (works, services) that are performed by tax payers with *related parties* – residents, which:
  - i. have declared negative value of the corporate profit tax object for the preceding tax (reporting) year;
  - ii. use special tax regimes, as of the beginning of the tax (reporting) year;
  - iii. pay corporate profit tax and/or value added tax at the rate below the base tax rate under the Tax Code, as of the beginning of the tax (reporting) year;
  - iv. were not payers of the corporate profit tax and/or value added tax, as of the beginning of the tax (reporting) year;

3. commercial operations with non-residents registered in jurisdictions where the corporate profit tax rate is by 5 percent lower than in Ukraine<sup>1</sup> (the "**Lower CPT Jurisdictions**").

The list of such Lower CPT Jurisdictions (states, territories) shall be approved by the Cabinet of Ministers of Ukraine.

The Transfer Pricing Law lists the following *related parties*:

- legal entities - in case when one of such entities either directly and/or indirectly (through a related party) has corporate rights in another such legal entity of 20% or more;
- individuals and legal entities - in case when an individual directly and/or indirectly (through a related party) has corporate rights in another legal entity of 20% or more;
- legal entities - if one and the same person directly and / or indirectly owns corporate rights in such legal entities and the amount of share of the corporate rights in each legal entity is 20% or more;
- legal entity and a person which has the authority to appoint (elect) a single-person executive body of such a legal entity or to appoint (elect) 50% or more of its collegial executive body or supervisory council;
- legal entities in which single-person executive bodies were appointed (elected) by the decision of the same person (owner or its authorized body);
- legal entities in which 50% or more of the collegial executive body or supervisory council were appointed (elected) by the decision of the same person (owner or its authorized body);
- legal entities in which 50% or more of the collegial executive body and/or supervisory council are comprised of the same individuals;
- legal entity and an individual - in case when an individual acts as a single-person executive body of such a legal entity;
- legal entities in which the powers of a single-person executive body has one and the same individual;
- individuals: husband (wife), parents (including adopting parents), children (adult children, minor, including adopted), full-blood and non-full-blood siblings, guardians, and children over whom guardianship, custody is established.

#### B. Amount Component

Operations referred to in the above Counterparty Component section shall be considered *controlled operations* provided that the total amount of the transactions of a taxpayer with each counterparty is equal to or exceeds UAH 50 million (excluding VAT) for a relevant calendar year.

The prices in the *controlled operations* must correspond to the fair market price of such operations in order to avoid tax implications.

The Transfer Pricing Law establishes several methods of determining the contract price in *controlled operations*:

1. *comparative uncontrolled price* (for sale of similar goods/services in uncontrolled operations);
2. resale price;
3. "expenses plus";

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<sup>1</sup> The CPT rate in Ukraine currently is 19% and will be reduced to 16% starting 1 January 2014.

4. net profit method;
5. distribution of profits.

The Transfer Pricing Law further indicates that a tax payer can choose a determining method to determine the contract price in *controlled operations*, but "*comparative uncontrolled price*" method should be used in the first place, if applicable.

It is foreseen by the Transfer Pricing Law that *large tax payers*<sup>2</sup> can negotiate prices in controlled operations with the Ministry of Revenue and Dues (the "**Ministry**") by means of entering into a respective agreement.

## II. Reporting obligations

The Transfer Pricing Law requires that tax payers which, during a calendar year have performed *controlled operations*, must report on such operations to the Ministry. The reporting year is a calendar year. The tax payers must report to the Ministry (by means of electronic mail) by 1 May of the year following the reporting year.

The state tax authorities can execute control over *controlled operations* by means of monitoring the prices of *controlled operations* and by conducting inspections. Tax control over transfer pricing envisages adjustment of tax liabilities of a taxpayer in a *controlled operation* to the level of tax liabilities as calculated in a comparative uncontrolled operation the parties to which are not related parties.

## III. Penalties

Pursuant to clause 120.3 of the Tax Code, failure by a tax payer to provide a report and/or required documents related to a *controlled operation* shall be fined with:

1. 5% from the total amount of the controlled operation – in case of failure to file a report on controlled operations;
2. 100 minimal salaries – for failure to provide required documents by large tax payers.

Section "Transitional Provisions" of the Tax Code contains provisions pursuant to which penalties for violation of general transfer pricing requirements shall be fined with UAH 1 for each instance of violation, if such violations are committed during the period from 1 September 2013 till 1 September 2014. This exception, however, should not be applicable to violations foreseen by clause 120.3 of the Tax Code.

We hope that you find this Legal Alert helpful and will be happy to address your questions.

### Disclaimer

The content of this Legal Alert is not legal advice, but a general informational summary of the law. Resource to qualified legal counsel is always required for legal advice. Failure to make timely inquiries of legal counsel may cause important legal deadlines to be missed.

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<sup>2</sup> Pursuant to clause 14.1.24 of the Tax Code of Ukraine, a large taxpayer is a legal entity with the amount of income from all activities for the last four consecutive tax (reporting) quarters exceeding UAH 500 million or which for the last four consecutive tax (reporting) quarters has paid to the State Budget of Ukraine the total amount of taxes exceeding UAH 12 million.