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Transfer Pricing Law: Reselling Goods

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Major suppliers of foreign goods often establish a subsidiary in Russia for the purposes of purchasing and importing foreign goods into Russia in order to resell them on the Russian market. The Russian company thus purchases goods from the foreign supplier, which is usually a related company (a member of the same group of companies).

Transactions between a Russian company and a related foreign supplier will be subject to price control rules for tax purposes. As of 2014, these rules shall apply to all transactions. For the time being, transactions shall be controlled in 2012 if the annual turnover of all transactions between the parties exceeds 100 million rubles. That threshold is lowered to 80 million rubles for 2013.

Typically, two types of supply agreements are entered into between a Russian company and its foreign supplier:

- An agreement under which the Russian company purchases foreign goods for sale in the Russian Federation;
- An agreement governing the resale of the goods purchased by the Russian company back to the foreign supplier. There may be a number of reasons for such resale back to the supplier:
- The goods were not sold in the Russian Federation over an extended period and there is a very low probability they will be sold (obsolescence);
- The goods are recalled by the foreign supplier due to a technical defect found in the goods in other markets;
- The foreign supplier wishes the goods to be returned by the Russian company due to a change in the group's sales strategy (for example, more profitable sales of a larger batch of goods on other markets).

The price of the goods sold back in this way is likely to be lower (perhaps significantly lower) than the price at which the Russian company sells the goods in the RF.

How should a Russian company prepare for potential tax audits of the price levels in sales of goods back to a foreign supplier, and how should it demonstrate that the prices match market levels for tax purposes?

In our view, the comparable uncontrolled price method is best used in this situation, since the Russian company sells the goods to independent customers — Russian consumers or distributors.

As a result, the price of the goods on the Russian market can be used to calculate the price for the return sale. At the same time, the conditions of the sale of goods back to the foreign supplier are materially different than the conditions of the normal sale of such goods to Russian consumers, and therefore the standard sales price in the Russian Federation needs to be significantly adjusted in order to ensure compatibility.

In particular, the following adjustments should be applied:

- An obsolescence factor should be applied when selling back obsolete goods that have not been sold on the Russian market for some time. The longer the goods are unsold, the lower the consumer value, and therefore, the lower the return sale price;
- For goods recalled by the foreign supplier, an adjustment factor should be applied based on the potential fall in the consumer value of the group of goods found to be defective; the adjusted price should at a minimum cover the cost of the purchase of the goods by the Russian company, transportation, insurance, etc.;
- Where the foreign supplier has decided to repurchase goods previously sold to the Russian company (for example, if the supplier has found a better sales market), the situation is very different; the foreign supplier must offer the Russian company a favorable price that is objectively acceptable to the Russian company. This price may be lower than the sale price on the Russian market, but only on the justification that a large quantity of goods is being purchased (wholesale discount), and the Russian company may have an economic interest in selling the entire batch of goods at a slight discount, refreshing its whole line-up of products. In this situation, a significant reduction in the price of the goods is hard to justify, particularly if an agreement has been reached on a return sale at the same price at which the Russian company purchased the goods. In this case, disputes with the tax authorities concerning under-pricing by the Russian company are almost inevitable.

We recommend agreeing on return sale conditions with foreign suppliers in advance, and preparing a document that substantiates the pricing used in the return sale. Indeed, as of 2013, the tax authorities will be auditing the prices being used this year in such transactions.

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