

B2B: New Russian Transfer Pricing Reality

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Taxpayers that are active in more than one country have to cope with many uncertainties, but one thing is certain: Every tax authority in every country is putting more and more energy into assuring that no one pays less taxes than they should. Transnational companies have to be very prudent when setting transfer prices, as these prices constitute the basis for taxation. It is therefore very important to identify the point where the company's tax burden is optimal on an international level, the amount of tax paid is sufficient from the point of view of tax authorities, and there is no double taxation at group level. Finding this "constellation" requires a vast amount of energy and effort from taxpayers.

All these questions became relevant for Russian taxpayers on Jan. 1, 2012 when new detailed transfer pricing rules came into effect. Overall, the concept of new Russian transfer pricing rules is in line with the OECD approach, though such an approach was adapted to Russian realities. For example, in most countries domestic transactions are not subject to transfer pricing control, but in Russia certain domestic transactions will be treated as controlled from a transfer pricing perspective.

Russian officials confirmed that the new legislation contains a lot of evaluative criteria, which is quite unusual for Russian tax legislation.

The novelties among these principles include:

- A list of related parties;
- A list of controlled transactions;
- Transfer pricing methods;

- The submission of notification on controlled transactions and transfer pricing documentation;
- The possibility of mirror adjustments;
- The possibility to conclude an advance pricing agreement;
- Special audits performed by the tax authorities; and
- Penalties for violations of transfer pricing rules.

Though there was a list of related parties before Jan. 1, 2012, it has been replaced with a new one. Thus, the new rules establish 11 criteria of interdependency; this list is generally closed, but under certain conditions the court may decide that parties are related if the relationships between the parties might affect the financial results of the transaction.

Special attention is paid to the list of controlled transactions. It includes not only transactions between related parties but also transactions with off-shore companies (above certain limits), transactions performed through an unrelated party if such entity does not perform any real functions and does not add any value to the transactions. Obviously, the tax authorities have a new tool that may be adjusted in accordance with the taxpayer's situation. Unfortunately, the legislator removed a 20 percent safe-harbour, therefore, all controlled transactions might be audited by the tax authorities, unless other limits are provided for by the law.

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It should be noted that prices applied by the taxpayer are deemed to be at market level unless otherwise proved by the tax authorities, and to prove otherwise the tax authorities should pass a long route. If the transfer pricing documentation is presented by the taxpayer, it should be reviewed by the tax authorities first. Further, if the taxpayer's justification is inadequate for the transactions, and the tax authorities proved its incorrectness, then they must make their own research, meaning preparation of detailed transfer pricing documentation is crucial for taxpayers. Finally, both arguments of the taxpayer and the tax authorities will be presented to court, which makes the final decision. Also, it is the court's exclusive authority to impose penalties on taxpayers in respect of violation of transfer pricing rules.

In order to avoid additional day-to-day work related to transfer pricing, the largest taxpayers have the opportunity to conclude advance pricing agreements with the tax authorities. Once concluded all transactions within the scope of such an agreement are not subject to any further control. The downside of this option is that it is available only for the largest

taxpayers.

The first audit will be Nov. 20, 2013 when taxpayers must submit the so-called "Notification on controlled transactions" for 2012. If the taxpayer has not done any work in this respect yet, then it is recommended to make a review of all transactions with related parties as soon as possible to find out which of them will be subject to control.

Due to the opaqueness of different statements in the new rules, we believe that their practical application will give rise to a lot of questions and disputes with the tax authorities. At the same time, it was declared that the new transfer pricing rules are aimed at controlling the larger taxpayers, so in theory they should not affect small and medium businesses.

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