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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

Russia

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TAX



Russia

KPMG observation

On 18 July 2011 a federal law was signed which introduced significant changes to Russian transfer pricing rules effective 1 January 2012. Amendments to the new transfer pricing rules are expected in the near future. The new rules are more specific and in line with international practice and the Organisation for Economic Co-operation and Development (OECD) Guidelines.

Basic information

Tax authority name

Federal Tax Service (FTS).

Citation for transfer pricing rules

- Chapter 14.1. (Articles 105.1-105.2 of the RF Tax Code) – Associated counterparties
- Chapter 14.2. (Articles 105.3-105.6 of the RF Tax Code) – General provisions on prices and taxation. Information used for comparability analysis
- Chapter 14.3. (Articles 105.7-105.13 of the RF Tax Code) – Transfer pricing methods
- Chapter 14.4. (Articles 105.14-105.16 of the RF Tax Code) – Controlled transactions. Preparation and submission of documents for tax authority monitoring. Notification of controlled transactions
- Chapter 14.5. (Articles 105.17-105.18 of the RF Tax Code) – Tax authority monitoring of transactions between associated counterparties
- Chapter 14.6. (Articles 105.19-105.25 of the RF Tax Code) – Advance pricing arrangements. Articles 129.3-129.4 of the RF Tax Code – Penalties
- Certain articles of Chapter 25 of the RF Tax Code stipulate specific

transfer pricing rules for securities and derivatives (Article 280 of the RF Tax Code) and interest (Article 269 of the RF Tax Code).

Effective date of transfer pricing rules

1 January 2012.

What is the relationship threshold for transfer pricing rules to apply between parties?

More than 25 percent direct/indirect ownership of one company by another company including parties in which one company participates directly or indirectly and such participation exceeds 25 percent (sister companies).

Moreover, the definition of related parties also includes:

- parties that are controlled by the same CEO or board of directors, 50 percent of which are the same persons
- parties where one party has the right to appoint the CEO for the other party or at least 50 percent of the board of directors for the other party
- party and an individual where the individual performs the duties of the party's chief executive officer
- parties and/or individuals, if the share of direct participation of each

preceding party in each subsequent organization equals more than 50 percent

- individuals, if one individual is subordinate to another individual by official position
- an individual, his or her spouse, parents (including adoptive parents), children (including adopted children), full and half brothers and sisters
- a trustee and ward by a court decision on related party status.

What is the statute of limitations on assessment of transfer pricing adjustments?

The tax authorities can audit only the three calendar years preceding the year in which the decision to conduct a transfer pricing audit was taken by the transfer pricing authority.

The new transfer pricing rules also stipulate certain transitional provisions:

- a decision to conduct a tax audit of controlled transactions in 2012 can be taken no later than 30 June 2014 (amendments to the transfer pricing legislation of April 2013)
- a decision to conduct a tax audit of controlled transactions in 2013 can be taken no later than 31 December 2015.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes, a taxpayer must submit notification to the tax authorities about controlled transactions that occurred in each calendar year by 20 May of the following year.

What types of transfer pricing information must be disclosed?

The form of the taxpayer's notification is rather complex and contains the following main fields:

- calendar year in which a transaction subject to the transfer pricing regulations occurred
- subject matter of the transaction
- information about the parties to the transactions, (name, taxpayer's identification number)
- income received and expenses incurred relating to the transaction
- grounds for classifying the transactions as controlled
- pricing methods used by the taxpayer
- information sources used by the taxpayer.

Some fields in the form are optional.

When providing information on the subject matter of the transaction, it will be necessary not only to give a full description (e.g. goods, works, services, or property rights), but also to submit more detailed data, including the code for the subject matter of the transaction in accordance with one of three classifications:

- TN VED (Foreign Economic Activity Commodity Nomenclature)
- OKP (Russian Classification of Products) (for goods)
- OKVED (Russian Classification of Economic Activities) (for works, services, or property rights).

The most detailed information is required for transactions with goods where the taxpayer will have to inform the tax authority additionally of:

- the country of origin, shipping (loading) point
- delivery (discharging) point
- as well as the terms of delivery.

What are the consequences of failure to prepare or submit disclosures?

Failure to submit notification to the tax authorities about controlled transactions or the disclosure of incorrect data may result in fine of 5,000 Russian rubles (RUB) per taxpayer.

Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

Yes, a study is required for each controlled transaction.

With respect to Russian transfer pricing rules, the following transactions can be identified as controlled transactions:

- cross-border transactions, including:
 - transactions between related parties (in 2012 – RUB100 million, in 2013 – RUB80 million and since 2014 with no threshold limit)
 - transactions with commodities quoted on exchanges (exceeding RUB60 million)
 - transactions with counter-parties which are residents of certain 'black-listed' jurisdictions (exceeding RUB60 million). The list of such jurisdictions is confirmed by the Order of the Russian Finance Ministry of 21 August 2012 № 115n.
- domestic transactions, including:
 - transactions between related parties exceeding RUB1 billion (in 2012 – RUB3 billion, in 2013 – RUB2 billion)
 - transactions between related parties where any of the parties either pays mineral extraction

tax or uses a special tax regime (exceeding RUB60 million).

The documentation should be filed only at the request of the tax authorities. No penalty is provided for not filing documentation where no request has been made.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

The penalty for underpayment of tax arising from non-compliance with the transfer pricing regulations is 40 percent of the underpaid tax. A taxpayer is exempt from payment of this penalty if the relevant transfer pricing documentation is provided to the tax authorities. This penalty applies starting from 2017.

For 2012-2013, the penalty will not apply. For 2014-2016, the penalty will be 20 percent of the underpaid tax.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

Transfer pricing documentation should be filed only at the request of the tax authorities. The documentation can be requested by the tax authorities not earlier than 1 June of the year following the year in which a controlled transaction occurred. For transactions controlled in 2012 the deadline is 1 December 2013 (amendments to the transfer pricing legislation of April 2013). A taxpayer must file the relevant transfer pricing documentation within 30 working days from the date of the tax authorities' request.

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

No. Transfer pricing documentation can be presented in any form, but should contain the following:

- indication of the parties to the transaction and their residence, description of their functions, assets and risks attributable to the transactions

- description of the transaction: subject matter, terms and conditions, methodology applied, etc.
- justification of the transfer pricing method applied: indication of sources of information used, calculation of the range of arm's length prices/profitability, amount of income received and/or expenses incurred relating to the transactions and related economic benefits received
- description of adjustments to the tax base (if any) performed by the taxpayer
- other information necessary to justify the transfer prices used.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes. In the case where general transfer pricing methods (or a combination thereof) cannot be applied for the purposes of transfer pricing analysis of a non-recurrent transaction (i.e. sales of real estate), the arm's length level of price could be determined using an independent appraisal report.

Is there a priority among the acceptable methods?

Yes. Comparable uncontrolled price (CUP) method, is generally the first priority method and should be applied when information concerning at least one comparable transaction is available. In some cases, the resale price method is the first priority method (for instance, in the case of further resale of goods to the third parties). Cost plus method, transactional net margin method (TNMM) and profit split methods may be used only if the CUP/resale price method is not applicable, or if the application of these methods would not allow

for a reasonable conclusion as to the compliance/non-compliance of the actual prices with arm's length prices.

A combination of several transfer pricing methods can be applied to a specific controlled transaction.

Also an independent appraisal report could be used as a source of information on arm's length pricing in a transaction if none of the above mentioned methods or their combination could be applied and such transaction is performed on a non-recurrent basis.

If there is no priority of methods, is there a "best method" rule?

There is no most appropriate method rule in the transfer pricing regulations. Methods are prioritized. Certain methods cannot be applied unless non-application of other methods has been justified.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?

The taxpayer must provide the transfer pricing documentation to the tax authorities within 30 working days from the date of the tax authorities' request.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

Any additional tax assessments can be contested by a taxpayer to a higher-level tax authority or in court.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

If a transfer pricing adjustment results in an additional tax liability, the taxpayer is subject to late payment interest of 1/300 of the currently effective refinancing rate established by the Central Bank of the Russian Federation.

The penalty for underpayment of tax arising from non-compliance with the transfer pricing regulations is 40 percent of the underpaid tax. This penalty applies starting from 2017. For 2012-2013, the penalty will not apply. For 2014-2016, the penalty will be 20 percent of the underpaid tax.

To what extent are transfer pricing penalties enforced?

Articles 129.3-129.4 of the RFTax Code – Penalties.

What defences are available with respect to penalties?

If a taxpayer makes a transfer pricing self-adjustment and pays the additional tax liabilities and late payment interest prior to the tax audit, no penalties should apply.

A taxpayer is exempt from the 40 percent penalty if the relevant transfer pricing documentation has been provided to the tax authorities.

What trends are being observed currently?

Not applicable. The new rules are effective as of 1 January 2012.

Special considerations

Are secret comparables used by tax authorities?

No.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes. The use of pan-European benchmarking studies for Russian transfer pricing purposes could be challenged by the tax authorities as the new transfer pricing rules stipulate:

- that accounting data of foreign companies can be used to test the arm's length nature of prices applied by Russian companies (or foreign companies with Russian permanent establishment) only if no data of Russian comparable companies is available

- that financial data of foreign companies must be adjusted based on Russian accounting principles. Therefore, adjustments to a pan-European benchmarking study may be required by the Russian tax authorities. However, this may be impossible to do in practice
- an explicit list of search criteria to be used for benchmarking purposes.

Therefore, the pan-European benchmarking studies could only be acceptable if performed in accordance with these criteria. Based on the above, pan-European benchmarking studies would likely be challenged by the Russian tax authorities.

Where the results of a benchmarking study performed on the basis of local comparables differ from the results of pan-European benchmarking studies, the local benchmarking study will likely prevail and the Russian tax authorities may have grounds for an additional tax assessment.

Do tax authorities have requirements or preferences regarding databases for comparables?

The results of benchmarking studies aimed at testing the arm's length nature of prices/margins of Russian companies (or foreign companies with a Russian permanent establishment) are more likely to be acceptable if the data for the search were obtained from Russian databases (i.e. SPARK, RUSLANA, etc.).

To test the arm's length nature of prices/margins of European companies, the Amadeus database can be used.

What level of interaction do tax authorities have with customs authorities?

There is some interaction, but it is generally limited.

Are management fees deductible?

Yes. They must be supported by documentation evidencing the fact that services were actually rendered and that a Russian taxpayer received the economic benefit from such services.

Are management fees subject to withholding?

They are not subject to withholding income tax. However, they are likely subject to VAT, which is to be withheld by the Russian taxpayer which is the recipient of the services.

Are year-end transfer pricing adjustments permitted?

No. True-ups/true-downs are generally not possible in Russia. 'Missing' the target profit range could result in negative consequences for a Russian company and related foreign counterparties, including:

- profits tax and VAT risks from a transfer pricing audit (if the Russian tax authorities consider the company's revenues as understated or the costs as overstated)
- customs risks from adjustment of import prices (if the Russian customs authorities consider them overstated) and even a slowdown or blocking of the customs clearance of goods
- unrecoverable Russian VAT (resulting from some of the tools used to adjust profit to fit within the target PLI range)
- tax risks for foreign counterparties (resulting from non-compliance with the transfer pricing rules or even an Advance Pricing Agreement (APA) with a foreign jurisdiction)
- unavailability of correlative adjustments in case of additional tax assessments.

Other unique attributes?

None.

Other recent developments

No.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive.

If extensive, is the competent authority effective in obtaining double tax relief?

The Russian competent authority has little experience in transfer pricing matters.

When may a taxpayer submit an adjustment to competent authority?

No formal rules exist in this area.

May a taxpayer go to competent authority before paying tax?

No formal rules exist in this area.

Advance pricing agreements

What APA options are available, if any?

An APA procedure was introduced by the new Russian transfer pricing rules. APAs (unilateral/bilateral) can initially be concluded for a maximum of 3 years, and can consequently be extended for another 2 years.

Is there a filing fee for APAs?

The fee for concluding an APA is RUB1.5 million.

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

No.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

APAs are available only for 'large taxpayer'. The general qualification criteria for a 'large taxpayer' varies depending at which level (federal or regional) such taxpayer is subject to tax administration. A taxpayer is considered a 'large taxpayer' at the regional level if any of the following criteria is met:

- total amount of annual federal taxes equals RUB1 billion
- total annual revenue equals RUB1 billion to RUB20 billion (amendment of Federal Tax Service dated 24 April 2012)

- total assets equal RUB100 million to RUB20 billion (amendment of Federal Tax Service dated 24 April 2012).

The qualification criteria for a 'large taxpayer' at the federal level are even higher.

According to the information posted on the official websites of the Federal Tax Service and OAO NK Rosneft, the parties entered into an APA on 20 November 2012, the first of its kind in Russia.

Under this agreement, OAO NK Rosneft and the Federal Tax Service agreed on certain pricing methods for oil sales transactions in the domestic market developed under the new transfer pricing rules. As of March 2014, not less than six confirmed APAs exist (for GazpromNeft, Aeroflot, LUKOIL and three for Rosneft).

Language

In which language or languages can documentation be filed?

The official language for all filings is Russian. In practice documentation can be prepared in English, but the tax authorities would likely require a Russian translation which must be available within the 30 working day period.

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