

Transfer Pricing

Country Guides





Russia

Arm's Length Principle

Transactions are required to be made in line with the arm's length principle. This means that transactions between related companies must be made under similar terms and conditions as would have been agreed between unrelated companies. The Organisation for Economic Co-operation and Development (OECD) Guidelines are mainly followed with some exceptions.

Transfer Pricing Methods

The following methods are applicable:

- Comparable Uncontrolled Price method (CUP)
- Resale Price Method (RPM)
- Cost Plus Method (CPM)
- Transactional Net Margin Method (TNMM)
- Profit Split Method (PSM).

At the same time the application (interpretation) of these methods is not sufficiently clear and may differ from the methodology adopted in OECD countries.

The new Russian rules proclaim a 'best method' principle but allow *for combination of the* above methods. The hierarchy and logic in the application of the transfer pricing methods is very similar to that of the OECD Guidelines, namely: the priority is given to CUP method, then RPM and CPLM, further TNMM, and Profit split method has the lowest priority.

The CUP method will remain the primary transfer pricing method to be used over all other methods. If this method is not applicable, the taxpayer is free to choose between the remaining four, although the profit split method should be used as 'the method of the last resort.' The choice of a particular transfer pricing method should be supported with:

- due consideration of the functions performed
- the commercial (economic) risks assumed
- the assets employed in a controlled transaction.

Definition of Related Companies

Companies are regarded as related under following basic conditions:

- entities where one party (the party and its related parties) has more than a 25% direct or indirect participation in these entities
- entities where (i) more than 50% of the directors of these companies are the same individuals or (ii) not less than 50% of the directors are appointed/ chosen by the same individual
- entities, where the same individual/entity acts as the sole executive body and on the basis of some other criteria.

Courts will keep the right to recognize parties related for reasons other than those stipulated in the Tax Code if the relationship between the parties may have an impact on the conditions and outcome of a transaction performed by these parties or the results of their economic activity.

The control also applies to commodity trade transactions, transactions with foreign entities registered in low-tax (offshore) jurisdictions, black-listed by the Russian Ministry of Finance subject to a revenue cap of RUB 60 mln per year irrespective of the fact whether the companies are affiliated or not.

Cross-border intra-group transactions shall be controlled regardless of their amount.

Reporting Requirements

The Russian taxpayers are obliged to provide the Russian Federal Tax Service with a special report disclosing controlled transactions considered as not arm's length transactions by 20 May of the year after the relevant transactions occurred.

The taxpayers also shall create the internal set of documents stipulating transfer pricing methods and internal compliance procedures for transfer pricing control purposes.

Document Requirements

A company has the obligation to keep and present documentation on transactions with related companies if the total value of the transactions to one company exceeds RUB 100,000,000 in the year 2012 and RUB 80,000,000 in the year 2013 (the thresholds are applicable till January 1, 2014).

Briefly, sufficient documentation must include:

- information about the nature of the transactions, the companies involved, assets used and risks assumed by each company
- a description of the transfer pricing policy and how it has been applied, as well as information on the data used to determine the arm's length price.

Cost Sharing

The Russian tax authorities usually do not recognize cost sharing arrangements and can be aggressive about management fees as evidenced by existing tax court practice.

Interaction Between Customs Valuation and Transfer Pricing

The Tax Code is silent on the cooperation between the Russian tax and customs authorities for transfer pricing purposes. Although the Tax Code allows the Russian tax authorities to use the data of the Russian customs authorities, the application of the customs authorities' data for transfer pricing purposes is questionable since customs statistics often ignores important details of the transactions and may include both related and non-related party transactions that makes such data unsuitable for transfer pricing purposes.

Dispute Resolution

The tax authority may adjust the taxable income if transactions with related companies differ from the market value.

Performance of comparability analysis basically follows OECD standards.

Similarly, it is necessary to consider such factors as:

- characteristics of the property or services
- contractual terms
- economic circumstances
- business strategies
- markets and conduct functional analysis.

Both internal and external comparables are accepted, however, according to the recent clarifications by the Russian Ministry of Finance, use of internal comparables, where such are available in the hands of a Russian taxpayer, on transactions with third parties is mandatory and has the prevailing force.

The Russian Ministry of Finance explicitly stated that internal comparable cannot be ignored by the controlling tax authorities. The Tax Code permits the use of various informational sources including commercial databases, data collected by various state authorities and stock exchange prices.

The Tax Code does not directly prohibit the use of foreign comparables nor establish a superior status of the Russian comparables. In these circumstances an assessment of the reliability of various data sources will still play an important role and will remain a point of particular controversy. An underpayment of tax may result in the imposition of a fine corresponding to 40% of non-paid tax amount, however not less than RUB 30 000. The limitation on transfer pricing adjustments by the tax authorities is three years. Advance pricing agreements applicable for three years are available, provided that the transactions are made with foreign companies that have concluded tax treaties with Russia.

Laws and Rules

Transfer pricing is regulated by Federal Law No.227–FZ included into the Russian Tax Code. The law includes a definition of related parties and reporting and documentation provisions. Further, it prescribes applicable transfer pricing methods and includes provisions regarding advance pricing agreements and penalties.

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