

New Rules for Transfer Pricing

On 1 January 2015 the Law adopted by the Verkhovna Rada came into force amending some provisions of the Tax Code of Ukraine with the aim of improvement of the transfer pricing tax control and elimination of controversies in previous versions.

The Law No. 72-VIII dated 28 December 2014 introduces several important changes which should be taken into consideration when reporting on the controlled transactions.

Affiliates

Thus, the Law specifies a new list of legal entities and individuals that refer to affiliates and also provides for their features.

Criteria for affiliation could be:

- ownership of corporate rights of the other legal entity in the amount of 20 or more per cent, or
- possibility to appoint sole executive bodies or 50 and more per cent of the collegiate body or supervisory board or
- if the amount of all credits (loans), repayable financial aid from one legal entity or individual, or credits (loans), repayable financial aid from other legal entities or individuals, which are provided under guarantee of this legal entity, exceeds the amount of own capital by 3.5 and more times. For financial institutions and companies that conduct only leasing activities this amount shall not exceed the amount of own capital by more than 10 times.

In addition, clause 20.1.40 (1) of the Tax Code entitles the controlling authorities to refer to court in order to deem persons as affiliates on the basis of facts and circumstances that one person exercised actual control over business transactions of the other person and/or that the same individual or legal entity exercised actual control over business transactions of each legal entity.

Arm's length principle

The adopted Law introduces the arm's length principle under which a taxpayer, being a participant of the controlled transaction, determines the amount of taxable income in accordance with this principle.

For the purposes of transfer pricing, the commercial transactions are any type of transactions, contracts or agreements, either documentary confirmed or unconfirmed, which can affect the taxpayer's taxable income.

Such transaction include (the list is non-exhaustive):

- transactions with such goods as raw materials, ready products, etc.;
- rendering service transactions;
- transactions with intangible assets, such as royalty, licenses, patent, trademark, know-how fees, etc., and with any other intellectual property objects;
- financial transactions, including leasing, participation in investments, loans, commission for guarantees, etc.;
- transactions with capital, including sale and purchase of shares or other investments, sale and purchase of long-term tangible and intangible assets.

Now such transactions are deemed to be controlled if the following conditions are simultaneously satisfied:

- the overall amount of income of a taxpayer and/or its affiliates from all types of activity, which are taken into account when determining the object of corporate income tax, exceeds UAH 20 million (about EUR 1.1 million) for the relevant tax (reporting) calendar year;
- the amount of such commercial transactions of a taxpayer and/or its affiliates with one counterparty exceeds UAH 1 million (about EUR 55,000) or 3 per cent of the taxpayer's income that is taken into account when determining the object of corporate income tax for the relevant tax (reporting) calendar year.

The controlled transactions for corporate income taxation are:

- commercial transactions in relation to sale of products through non-resident commission agents;
- commercial transactions with non-resident affiliates. Such non-resident shall be registered in a state where: a) the corporate income tax rate is on 5 or more per cent less than in Ukraine; b) no public access to information about ownership structure of legal entities is available; c) no bilateral treaty with Ukraine on information exchange has been concluded.

Methods of establishment

Methods, specified by the Tax Code, are employed to establish that a controlled transaction corresponds to the arm's length principle with the purpose of verification of accuracy and completeness of calculation and payment of corporate income tax and VAT.

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A taxpayer is allowed to employ any method, which it considers to be the most appropriate, to establish that a controlled transaction corresponds to the arm's length principle. However, in case there is a possibility to use both a comparable uncontrolled price method and any other, the former shall be used.

Fines

Among other new developments introduced by the Law there is increase of fines for breach of transfer pricing rules, in particular:

- a fine in amount of 100 minimal wages (UAH 121.800, about EUR 6.700) if the taxpayer failed to submit (untimely submitted) the report and/or information on controlled transactions completed during a year;
- for failure to include information on all controlled transactions completed during the reporting period there is a fine of 5% (previously 1%) of the amount of the controlled transactions that were not recorded in the report;
- failure to provide documentation at the request of the tax authorities leads to a fine of 3% of the amount of the controlled transactions for which no documentation was submitted, but in any case not more than 200 minimal wages (UAH 243.600, about EUR 13.400) for all undeclared controlled transactions.

It should be noted that all aforementioned changes and new developments will be practically applicable from 2016 for reports on 2015. Reports on 2014 are prepared under the old rules.