

4 Steps a CEO Should Take Concerning the New Transfer Pricing Rules

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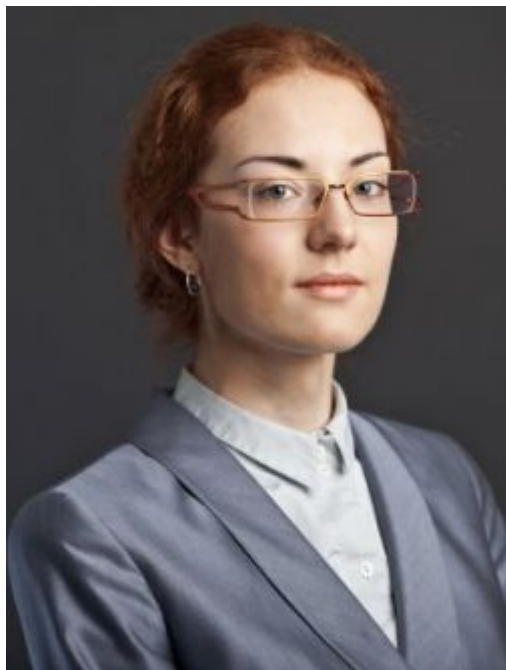
The new law on transfer pricing adopted in July and coming into effect from Jan. 1, 2012, will affect most large and midsized businesses operating in Russia, whether Russian or multinational. The new legislation is a lot more detailed than previously and, although tax directors and managers will be handling most of the details, there are several steps CEOs should take to ensure that their business is prepared.

Determining Controlled Transactions

Transfer pricing control extends to legally specified transactions, with the list of controlled transactions having been revised.

The good news is that the law (despite initial debates to the contrary) continues to apply only to goods, works and services, which effectively exempts royalties and interest from transfer pricing control. In addition, domestic transactions with unaffiliated parties are no longer subject to transfer pricing control. This eliminates the need to monitor 20 percent deviations on your transactions with customers, which has been common under existing rules.

The definition of related parties has been significantly extended, moving closer to the notion of "affiliated persons" used in corporate legislation. Additionally, although the related party ownership threshold has been raised from 20 percent to 25 percent, this was accompanied by changed calculation rules for indirect ownership participation, making this criterion more stringent.



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Domestic transactions with related parties are subject to control if they exceed a certain threshold; so some transactions may be exempt below the threshold.

The bad news is that cross-border transactions with related parties remain subject to tax control irrespective of size.

Consider Revising Intra-Russian Corporate Structures to Eliminate Some Controlled Transactions

After identifying transactions that could be subject to transfer pricing control, consider whether feasible structural steps could reduce them in number. Although generally little can be done regarding imported products (as all cross-border related-party transactions are controlled), restructuring transactions within Russia to reduce controlled transactions may be possible.

For example, it may be possible to consolidate several existing legal entities into one, or to move companies to the same region (doing business in the same region eliminates the need to control transactions subject to certain conditions). Also, in some cases it may also be possible to eliminate regional branches of a particular legal entity (or replace them with branches from another entity less exposed to transfer pricing adjustments), as the existence of separate subdivisions in other regions may be a determining factor in whether a transaction is subject to transfer pricing control.

Aligning Tax Requirements With Commercial Considerations, Customs and Other Price Regulations

New transfer pricing rules are not necessarily aligned with the requirements of the Russian

customs legislation or other regulatory regimes (such as state pharmaceutical price controls). Therefore, the best technical method for tax purposes will not necessarily be acceptable to customs or other authorities, which may unnecessarily increase the tax burden.

Also, where goods imported into Russia are resold, the law suggests that the resale method should be used for tax purposes to determine whether the import price is arm's length. As a result, commercial and marketing policies (that is, the range of discounts or bonuses granted to distributors on imported products) may indirectly impact tax acceptable import practices. Because of this, it is important to ensure that transfer pricing justification for tax purposes is not done in isolation and not viewed purely as a compliance exercise. Make sure that choices made by tax specialists in developing transfer pricing documentation match choices made elsewhere in the company (such as by customs, marketing departments, etc.) and vice versa.

Make Sure That Transfer Pricing Documentation Is Reviewed by Tax Litigation Lawyers

Under the new transfer pricing law, transfer pricing audits are now separate from regular tax audits with slightly different rules, with a special transfer pricing audit team established within the Federal Tax Service.

This significantly increases the possible need to defend the appropriateness of transfer pricing in court. Therefore, it is essential that any documentation prepared in relation to transfer pricing gets reviewed by a high-quality tax litigation lawyer, should the transfer prices eventually require defense in court.

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