

INFORMATION LETTER

Transfer Pricing in Russia: What is the Likelihood of an Audit?

On 20 November 2013 for the first time Russian taxpayers should have filed with controlling authorities notifications on controlled transactions¹ (“**Notifications**”) in accordance with the new transfer pricing rules. According to the Federal Tax Service² taxpayers filed 5,000 Notifications with respect to operations performed in 2012. Notifications for 2013 must be filed by 20 May 2014.

According to the transition provisions³ the tax authorities are entitled to initiate transfer pricing audits for 2012 within a seven month period (from 1 December 2013 to 30 June 2014) and for 2013 – within an 18 month period (from 1 June 2014 to 31 December 2015).

As was repeatedly noted by tax authorities, one of the principal aims of the Notification is to provide the tax authorities with the necessary array of preliminary information which, together with other data on the activity of the company and its contractors accumulated by the tax authorities, will be used to decide whether to conduct a transfer pricing audit of the controlled transactions.⁴ In this regard the criteria used to make such a decision is rather interesting.

According to information from public sources,⁵ the Federal Tax Service is currently developing a document reflecting the *risk assessment criteria to be used by a tax authority in the course of selecting controlled transactions (taxpayers) for auditing*. In other words, the tax authority is preparing a list of criteria. If a company meets at least one of these criteria, the tax authority will automatically launch a transfer pricing audit with respect to such company in order to check whether the prices under selected controlled transactions have been set correctly.

Specifically, factors which may serve as grounds for an audit include when:

- a large part of income (expenditures) of a company is formed based on transactions made with counterparties registered in states included

on the blacklist of the Ministry of Finance of the Russian Federation, approved by Decree No. 108H dated 13 November 2007. Included among such states are Liechtenstein, Panama and the British Virgin Islands. In addition, Cyprus may also potentially be put back on the list;⁶

- there is a drastic change (shift) in proceeds (profitability) under controlled transactions when there is no external market reason for such. This includes any material change in the outcome of a controlled transaction, when there are no reasons for such changes in the market;
- there is a drastic increase in the amount of income (proceeds) of a related offshore company based on controlled transactions;
- there is an increase in a company's expenditures, or a company's loss, caused by the increase of payments under interest-bearing loans or royalties payable to related companies;
- the implementation of tax avoidance schemes and breaches of the principle of due diligence by a company have been revealed.

In addition to the above, there are also criteria which cannot alone serve as sufficient grounds for applying control measures, but together may have an impact on the decision making. Such criteria include, but are not limited to, the following:

- no information on a contractor under a controlled transaction is available in databases or public sources of information (for example, on the Internet) – the controlling authorities may ask how the company managed to find out about such contractor when the authority was unable to find any information on it;
- restructuring involving offshore companies;
- “migration” of taxpayers from one region to another: if a company changes the place of its registration regularly and the controlling

¹ – In the form established by joint decree No. MMB-7-13/524@ of the Ministry of Finance of the Russian Federation and the Federal Tax Service of the Russian Federation dated 27 July 2012

² – http://www.nalog.ru/rn77/taxation/transfer_pricing/4347012/

³ – Article 4.8 of Federal Law No. 227-FZ *On amending specific pieces of legislation of the Russian Federation in connection with improving the principles of price determination for tax purposes* dated 18.07.2011

⁴ – Interview of D.V. Volvach *Notifications on Controlled Transactions: the First Fruits* <http://www.garant.ru/article/507662/>

⁵ – Transfer pricing conference (3-4 April 2014, Moscow) <http://rgtcap.com/index.php/ru/events-ru/126-tp14-ru>

⁶ – <http://www.vedomosti.ru/finance/news/19459271/kipr-otvetil-na-ugrozu-chernogo-spiska>

authorities believe this to be unreasonable, this may have an indirect impact on the decision to carry out a transfer pricing audit of such company;

- there is inconsistency between the number of a company's employees or assets and the functions performed by such company;
- there is a refusal to provide or disclose information, or a blanket refusal to cooperate;
- the other party to the transaction fails to submit a Notification.

According to information from public sources,⁷ a document listing the criteria is currently being developed by the Federal Tax Service of Russia.

This information should be taken into account when planning business operations and when preparing Notifications and transfer pricing documentation regarding controlled transactions that is to be provided to the tax authorities in order to prove that prices under controlled transactions comply with market prices if a company formally meets the abovementioned criteria and is subject to controlling measures.

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⁷— Transfer pricing conference (3-4 April 2014, Moscow) <http://rgtcap.com/index.php/ru/events-ru/126-tp14-ru>

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