

To curb tax abuse through transfer pricing, tax service will need more specialists

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As of Jan. 1, transactions with 85 countries require transfer payment checks.

Theory versus practice

For his part, Rylovnikov says the new laws have delivered.

"I can't say it's ineffective," he says. "Checks are happening, there are results and additional tax charges... companies get requests (for information) from the tax authorities, and if a company has questionable transfer payments, they often submit corrections."

Still, although Ukraine's legislation increasingly meets international standards, transfer pricing enforcement – as with many things in the country – differs in theory and practice.

"If you compare it with other developed economies, there the checks end with many more additional tax charges and they're often dozens of times larger," Rylovnikov says.

Serhiy Golovniy, an investigative journalist who has actively covered tax evasion schemes, also has his doubts. Before 2013, the general situation was "total chaos, and everyone did what they wanted and no one controlled it," he says.

When the transfer pricing law came into force, Golovniy and his colleagues followed it closely, but didn't see the results they expected.

"As far as I can judge, many things have remained the same – at a minimum when a major holding sells its products for a lower price to a company in an offshore jurisdiction, which then sells it for a market



Lawmaker Tetiana Ostrikova, who sits on the parliament's tax committee, says that abuse of transfer pricing costs Ukraine nearly \$2 billion in tax revenues annually. (Ukrainian Photo Agency)

price..." he says. "And it's not only to offshore jurisdictions, but also to companies registered in Switzerland, Australia, Cyprus."

However, KPMG's Karpushin blames these issues on implementation, not legislation.

The law, he says, is strong and sound. And, according to the State Fiscal Service, it is working. In 2016, Ukraine saw Hr 2.6 billion (\$99.3 million) in voluntary tax adjustments, the Service said in a statement. That means taxpayers who believed they had violated the arm's length principle voluntarily adjusted their documentation and paid more taxes.

The problem, Karpushin says, is resources. He estimates that around 10 people work on transfer payments in the State Fiscal Service. That number should be increased to roughly 50, he says.

Moreover, Karpushin believes that it is not enough to simply receive transfer pricing reports and scrutinize them in an Excel spreadsheet. Instead, he thinks the Ukrainian tax authorities should use algorithms, big data, machine learning, and artificial intelligence to analyze all the received reports and decide which companies to audit.

Ukraine has the developers, programmers, and coders necessary to develop such an automated analytical program. And with transfer pricing a rapidly growing subject in global accountancy, there is a short window of time for Ukraine to create something innovative, Karpushin says.

"Maybe it's time not to look to other countries, but to build something here and show them." ■



Kyiv to host UEFA champions leagues finals on May 24-26

For the first time ever, Ukraine's capital will be hosting the final matches of the Union of European Football Associations, or UEFA, women's and men's champions leagues, annual football competitions among Europe's top-division football clubs. The final match between Spanish Real Madrid and English Liverpool will be played at Kyiv's Olimpiyskiy National Sports Complex and is expected to attract more than 70,000 tourists to Ukraine's capital which will give a boost to the city's budget. On average, each fan is expected to spend \$100-\$150 a day while in Kyiv. The women's final match between German Wolfsburg and French Lyon will be played at the Valeriy Lobanovskiy Dynamo Stadium on May 24. (Kostyantyn Chernichkin)

Changes in the Tax Code of Ukraine in the field of transfer pricing



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Tax legislation in the field of transfer pricing has in recent years, with the exception of 2018, been undergoing certain changes. The last major changes came with Law of Ukraine No. 2245-VIII of Dec. 7, 2017 "On Amendments to the Tax Code of Ukraine and some legislative acts of Ukraine on ensuring the balance of budget revenues in 2018," which introduced a number of changes in the sphere of transfer pricing. A number of the changes are purely technical in nature, but there are also some very significant innovations that all taxpayers that carry out foreign economic operations should pay attention to.

So, let's consider the key changes in the transfer pricing regulations that came into effect on January 1, 2018.

The first thing I would like to point out is the changes in the criteria for recognizing persons as being related to a business. The definition of "related persons" now takes into account the concept of the ultimate beneficial owner (controller).

The new wording of paragraph 14.1.159, clause 14.1 of Art. 14 of the Tax Code of Ukraine directly establishes that legal entities are considered bound if the ultimate beneficial owner (controller) of such legal entities is the same physical individual.

Accordingly, individuals and legal entities are considered to be related if the individual is the ultimate

beneficial owner (controller) of a legal entity.

In addition, paragraph 14.1.159 of the Tax Code of Ukraine is supplemented with two criteria that previously logically followed from the general definition of the term "related persons," but that are now spelled out literally:

- legal entities are related if the authority over the sole executive body of such legal entities is exercised by the same person;
- if an individual is recognized as being related to other persons, such persons are considered to be related.

Since Jan. 1, 2018, checks on Transfer Pricing have been extended to business transactions between non-residents and their permanent representative offices in Ukraine. Such operations will be subject to controls and checks if their volume exceeds UAH 10 million (after deducting indirect taxes) for the relevant tax (reporting) year. At the same time, the amount of annual income received by a permanent representative office of a non-resident in the reporting year will not be taken into account.

This norm entirely meets the requirements of Art. 7 of the OECD Model Tax Convention on Avoiding Double Taxation of Income and Capital, and Art. 7 of the UN Model Convention on Avoiding Double Taxation between Developed and Developing Countries.

To calculate the volume of transactions with one counterparty, the amount of such transactions should now be calculated on the basis of a price determined by the "arm's length" principle, rather than contractual prices as before. This rule is aimed at preventing the manipulation of contract prices in order to avoid checks on Transfer Pricing.

The criterion is added, assigning states to the list of low-tax ones. The list can thus include states (territories) that provide preferential tax breaks to business entities, or whose features of calculating the tax base effectively allow business entities not to pay corporate profit tax (corporate tax) or pay at a rate five or more percentage points lower than the rate in Ukraine.

Let us recall that from January 1, 2018, Cabinet of Ministers Decree No. 1045 of 27.12.17 came into force, which approved a new list of states whose transactions with residents are recognized as being subject to controls. To date, there has been much discussion about whether transactions with residents from this list will be considered as controlled in 2018. Legislators have so far adhered to a firm position – that is "yes" – so payers already today need to audit such transactions.

Despite the fact that the government of Ukraine has not submitted the three-tiered documentation requirements that were introduced by the OECD BEPS Action Plan, the list of information that should be disclosed in local Transfer Pricing documentation is expanded. Payers will additionally have to describe the organizational structure of the company, including the number of employees, and provide information on the financial indicators that were used to calculate the profitability indicators. It was also clarified that information on the parties to the CTs, on related persons and on the structure of the company should be indicated for the period of the transaction and on the date of the provision of documentation.

Undoubtedly, one positive innovation is the procedure for carrying out independent adjustments. Now such adjustments can be made to the minimum / maximum value of the range, and for the previous (2015-2016) periods.

Also, it can also be considered good news for taxpayers that when carrying out independent adjustments, fines will not be charged if, upon the results of the adjustment, a clarifying report is submitted before October 1 of the year following the reporting one.

The date after which the tax authorities can request the documentation was postponed from May 1 to October 1 of the year following the reporting year.

The procedure for the preliminary coordination of pricing has been improved. Now the terms of the Advance Pricing Agreements (APA) can be retrospective: if the taxpayer fulfills the conditions of the APA, it can be extended for the next period, and if changes are made to the legislation, the conditions of the APA can remain unchanged.

In general, taking into account the changes introduced, the national legislation on Transfer Pricing is increasingly in line with international standards, although it also has some "national specifics." However, I would like to note that most of the changes that have been introduced are positive for taxpayers, and improve the administration of the Transfer Pricing.

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