

In Focus

Analyzing important tax amendments

Tax & Legal



[Secondary adjustment](#)

[Expansion of related party criteria](#)

[Information for transfer pricing study](#)

[Use of median value of arm's length ranges](#)

[Transactions with offshore entities](#)

[Transfer pricing reports](#)

[Advance pricing agreements](#)

[Safe harbor rates](#)

[Fines for transfer pricing breaches](#)

Autumn tax amendments: tightening transfer pricing rules

A major [tax package](#) introducing amendments to the Russian Tax Code has recently passed the third reading in the State Duma.

Increasingly under the spotlight, the proposed measures providing for a major clampdown on the transfer pricing rules are:

- to classify TP adjustments for controlled transactions with non-residents as dividends subject to withholding tax;
- to expand the related party criteria;
- to calculate arm's length prices as the median of the arm's length range;
- to expand the scope of reportable information on controlled transactions;
- to increase the fines for transfer pricing breaches;
- to change the safe harbor interest income/expense rates.

Read on for a more detailed review.



Secondary adjustment

The adjustment of price in a controlled transaction will be treated as dividends and subject to withholding tax, if the following prerequisites are met:

- the transaction is made between related parties (if interpreted literally, including the transactions treated equally with related-party transactions);
- one of the parties to the transaction is not a Russian resident;
- the price effectively used in the transaction differs from the arm's length value;
- such difference has resulted in a tax base adjustment (voluntary or following a tax audit);
- as a result of the adjustment, the party to the transaction that is not a Russian tax resident generated income in the amount of the adjustment.

Withholding tax will be charged at a rate of 15 percent.

Income treated as dividends will be considered received by the foreign person on the last day of a calendar year the transaction was made in.

With this mechanism, the authorities apparently want to control profit shifting through non-arm's length controlled transactions.

It is worth noting that the practice of charging withholding tax on the amount of price adjustment had existed before the amendments.

Thus, in a number of tax disputes, the tax authorities were able to prove that due to applying non-arm's length prices in foreign trade transactions, foreign entities were paid passive income that had to be taxed at source:

- Case No. [A40-192349/2022](#): overestimation of expenses to purchase freight forwarding services from a nominal foreign provider;
- Case No. [A60-26858/2022](#): overpricing of equipment and medicinal substances purchased through a conduit Hong Kong company;
- Case No. [A19-14604/2022](#): overpricing of medicinal substances purchased through a conduit Cypriot company.

Importantly, all the above-mentioned disputes had arisen from the regular field tax audits and not from the special transfer pricing audits carried out by the Federal Tax Service (FTS of Russia).

Apart from overpricing, one of the critical arguments was the nominal provider: in all of the disputes, the tax authorities were able to prove that the foreign provider was artificially integrated into the supply

chain to manipulate prices, obtain tax benefits and shift money to a low-tax jurisdiction.

The amendments provide for charging withholding tax on any price adjustment in controlled transactions with non-resident related parties carried out under transfer pricing rules, regardless of the taxpayer's intention to avoid tax.

We would also like to highlight some details of the amendments:

- a formal interpretation of the amendments allows to treat the amount of adjustment as dividends not only in related-party transactions, but also in those equated to such, for example, in transactions with persons [registered in offshore jurisdictions](#), or in [traded commodities](#) transactions;
- reclassification into dividends will not depend on the legal structure of the group: for example, adjustments on transactions between sister companies may also be treated as dividends;
- it is not entirely clear whether it will be possible to claim preferential withholding tax rates under the current tax treaties: most likely, in this case the definitions of the terms "dividends" and "other income" in the tax treaty will need to be analyzed;
- reclassification into dividends will apply not only to the acquisition of goods/work/services/property rights from foreign persons at overstated prices, but to the sale of goods/work/services/property rights to foreign persons at understated prices.

The assessment of tax at source can only be avoided by making a voluntary adjustment of the tax base and returning income in the amount of the adjustment by a foreign person to the taxpayer's Russian account by the tax due date for the period in which the controlled transaction was carried out.

If the date was missed, the assessment of at-source tax can be avoided if:

- the income is returned to the taxpayer's Russian account before a decision to audit tax payments in controlled transactions was made;
- when calculating the corporate/personal income tax base, the taxpayer factored in the foreign person's imputed use-of-money interest calculated with reference to 1/300 of the key rate of the Central Bank of Russia.

During tax audits of controlled transactions, the tax authorities will simultaneously audit the payment of at-source tax.



Expansion of related party criteria

The following persons will also be treated as related parties:

- the controlling person and its controlled foreign corporation (CFC);
- all CFCs of the same controlling person.

In practice, it will mean that the participation threshold will be reduced from 25 to 10 percent for foreign companies controlled by the Russian persons with a total interest exceeding 50 percent.

Furthermore, two entities will now be recognized as related, if an individual that owns more than 25

percent in one of them and/or has powers to appoint their sole executive body or at least 50 percent of members of the collegial executive body or board of directors, and an individual who owns more than 25 percent in another entity and/or has similar powers, are recognized as related [by virtue of kinship or marriage](#).

For instance, two companies, in one of which the husband is a member, and in the other – the wife, will be considered related.



Information for transfer pricing study

On top of internal comparables, information on comparable transactions between the taxpayer's related parties and non-related parties (external comparables) can be used to calculate the arm's length price range.

At the same time, the clause on the mandatory use of internal comparables in tax audits was excluded.



Use of median value of arm's length ranges

In addition to the minimum and maximum values of the arm's length price/margin range, the median value will also be used.

To determine it, the total number of values in the range will need to be divided by two, and:

- if the result is an integer, the median would be equal to the arithmetic mean of the value with a serial number equal to such result and the next one in an ascending order;
- if the result is not an integer, the median is equal to the value of the price/margin range with a serial number equal to the integer part of such result, increased by one.

Using the median value of the range can lead to a significant increase in adjustment amounts.

The amendments also introduce the "interquartile"

calculation of the range when stock quotes and data from information and pricing agencies are used: while under the existing rules the arm's length range is calculated as the range between the minimum and maximum prices of transactions made on the exchange/published by information and pricing agencies, the new rules require determining the minimum and maximum prices using the general interquartile range rule.

It is important to note that the taxpayers may still use the minimum/maximum value of the range instead of the median, if the adjustments are made voluntarily.

Thus, a voluntary adjustment will reduce the amount of potential additional assessments (in the absence of a voluntary adjustment, the tax authorities will assess taxes using the median value of the ranges).



Transactions with offshore entities

A list of transactions with offshore entities that will be treated as related party transactions was expanded to include transactions with foreign unincorporated entities, if such entity or one of its members (unit holders, principals, trustees, etc.) that benefit from

such entity is incorporated/tax-registered in a blacklisted state.

At the same time, the amendments will soften the effect of expanding the black list with all 'unfriendly' countries.

The following transactions will not be treated as controlled:

- transactions with independent export credit agencies and/or banks tax-registered in a country, the tax treaty with which was suspended by the August [Decree](#) of the President of Russia;
- transactions creating taxpayers' Eurobond-related debt;
- transactions with organizations tax-registered in a country, with which the tax treaty was suspended by the August [Decree](#) of the President of Russia, subject to meeting the following prerequisites:
 - agreements underlying these transactions were signed before 1 March 2022;
 - the pricing methodology and/or formula applied

in the transactions has not changed after 1 March 2022;

- transactions do not meet the controlled transaction criteria effective as at 1 March 2022.

With the [expansion](#) of the black list, all transactions worth over RUB 120 million that are made with unrelated parties located in 'unfriendly' states will be deemed as controlled.

As the Russian Ministry of Finance recently [clarified](#), the updated black list will apply as of 1 January 2024.

The amendments introduced by the law essentially clarify that, even after 1 January 2024, a number of transactions will be exempt from control, including the transactions under the pre-existing contracts that were not previously recognized as controlled.



Transfer pricing reports

The mandatory information to be included in **transfer pricing documentation** has been expanded to include:

- information on income and expenses, headcount, profit/loss, value of fixed assets and intangible assets of a foreign entity that is a party to a controlled transaction (for related-party transactions);
- documents confirming the information above, including financial statements, if their preparation is required by the foreign entity's personal law of (if financial statements cannot be presented with the documentation, they must be provided no later than within 12 months from the end date of the financial year in which the controlled transaction was made);
- documents attesting to the functions/risks of the parties to the transaction;
- documents containing registration data of the foreign person who is a party to a controlled transaction, or information about any person acting on behalf of such foreign person that the taxpayer is furnished with;
- an analysis of commercial and/or financial terms and conditions of the controlled transaction (such analysis will now be mandatory).

Transfer pricing documents must also be prepared for transactions that are equated to related-party deals (including, for example, transactions with independent entities located in offshore jurisdictions).

The tax authorities will be able to request transfer pricing documentation outside tax audits. If requested,

the documents must be provided within 30 days (however, the general rule that the request cannot be made before 1 June of the following year is still in force).

Another important change is that documents on controlled transactions in traded commodities (except those between Russian entities) must be filed simultaneously with the notification of controlled transactions without a specific request by the tax authorities. By way of transition period, documents for such transactions completed in 2024 can be provided until 1 December 2025.

Notifications of controlled transactions will be expanded with additional mandatory fields, including:

- transaction terms;
- for transactions involving goods – delivery terms and basis; date of shipment (date of title transfer / date of transaction income/expenses recognition);
- selected transfer pricing methods and sources of information on comparables;
- value chain data for traded commodities transactions between related persons (except when between Russian persons). According to the amendments, the taxpayer must take measures to obtain such information from its related persons; non-cooperation of a related party will not be accepted as a valid excuse.

Legal entities will be obliged to submit all notifications of controlled transactions via electronic channels only.

The rules for preparation of **country-by-country (CbC) reports** by multinational enterprise groups (MNE) were also amended.

The MNE criteria were expanded: now a company will be recognised as an MNE not only if it files consolidated reporting, but also if such consolidated reporting would [potentially] be prepared, if any company of the group were listed on an exchange.

It means that in most instances groups encompassing foreign entities will be treated as MNEs and will be subject to the CbC reporting requirements.

The FTS of Russia published a [draft list](#) of countries that consistently fail to automatically exchange CbC reports.

The draft includes 21 states (Austria, Australia, Belgium, Germany, Greece, Denmark, Ireland, Spain, Italy, Cyprus, Luxembourg, the Netherlands, Norway, Poland, Portugal, Romania, Slovenia, Finland, France, Sweden, and Japan) and one territory (Bermuda).

If the list is approved, Russian companies that belong to MNE groups whose ultimate parent companies are incorporated in the countries from this list will also have to prepare and submit CbC reports to the Russian tax authorities.

In some instances, according to the amendments, **information from the MNE’s consolidated financial statements and financial statements of the MNE group entities** will have to be provided.

If at least one MNE group entity, holding more than 50 percent of its assets in Russia, entered into a controlled transaction in traded commodities, the ultimate parent entity or a surrogate parent entity must file:

- information from such MNE’s consolidated financial statements;
- information from the financial statements of MNE’s constituent entities that entered into such controlled transactions or subsequent distribution arrangements or other transactions related to the controlled one, including the transportation, storage, packing, insurance, financing and marketing transactions.

Such information must be provided to the FTS of Russia electronically no later than within 12 months of the end date of the financial year in which the controlled transactions were carried out (the format to be approved later).

Advance pricing agreements

Not only the largest taxpayers will be able to apply for advance pricing agreements (APA), but also the taxpayers that are parties to controlled transactions in traded commodities, the total income/expense from which exceeded RUB 2 billion in a calendar year.

The period for which the APAs can be signed is extended for a total of five years: for the calendar year in which an APA application was filed and for two

preceding and two subsequent years.

Yet, an APA with a competent foreign tax authority can only be signed for a total of three years: for the calendar year in which it was requested and for two subsequent years.

The stamp duty for entering into an APA is decreased from RUB 2 to RUB 1 mln.

Safe harbour rates

The Russian Tax Code provides the so-called “safe harbour interest rates” for loans that meet the controlled transaction criteria.

The taxpayers may account for interest income/expense with reference to the effective loan rate, if:

- for expenses, the effective tax rate is below the interest rate cap;

- for income, the effective rate is above the interest rate floor.

If these prerequisites are not met, the taxpayers will have to prepare transfer pricing documentation to confirm that the interest rate is at arm’s length.

In 2022—2023, wider limits of the safe harbor range were in effect, but they will be revised as of 1 January 2024.

Currency	2022—2023 range	Range as of 2024
RUB	From 0% to 180% of the CBR’s key interest rate	From 10% to 150% of the key interest rate; the minimum value of the range cannot be under 2%
EUR	from 0% to STR + 7%	from 1% to STR + 7%

Currency	2022—2023 range	Range as of 2024
CNY	From 0% to SHIBOR + 7%	From 1% to SHIBOR + 7%
GBP	From 0% to GBP SONIA + 7%	from 1% to GBP SONIA + 7%
Swiss francs or Japanese yen	From 0% CHF SARON or JPY TONAR +5%	From 1% CHF SARON or JPY TONAR +5%
Other currencies	From 0% to USD SOFR+ 7%	From 1% to USD SOFR + 7%



Fines for transfer pricing breaches

Fines for transfer pricing breaches have surged dramatically:

Tax Code provisions	Breach	Fine	
		Existing provisions	Amendments
Article 129.3	Tax underpayment arising from non-arm's length controlled transactions with non-residents	40% of the amount of unpaid tax, but not less than RUB 30,000	The full amount of tax not paid on the income received by the foreign person as a result of TP adjustment*, but not less than RUB 500,000.
	Tax underpayment as a result of domestic non-arm's length controlled transactions	With the TP documentation in place substantiating the arm's length pricing, the company will be exempt from liability.	TP documentation will not exempt from liability. 40% of the unpaid tax amount, but not less than RUB 30,000. With the TP documentation in place, the company will be exempt from liability.
Article 129.4	Failure to timely notify of controlled transactions; misrepresenting information on such notification	RUB 5,000	RUB 100,000
Article 129.9	Failure to timely notify of participation in a MNE; misrepresenting information on such notification	RUB 50,000	RUB 500,000
Article 129.10	Failure to timely submit the CbC report; misrepresenting information on such report	RUB 100,000	RUB 1 mln
Article 129.11	Non-submission of the local file	RUB 100,000	RUB 1 mln
	Non-submission of the master file	RUB 100,000	RUB 1 mln
	Failure to timely submit documents for a particular transaction (group of similar transactions)	No fines	RUB 500,000
	Failure to timely submit information from the MNE's financial statements, financial statements of MNE constituent entities, or misrepresentation of such information.	There's no duty to submit such information	RUB 1 mln

*We believe that the provision concerns an underpaid amount of at-source tax assessed on the adjustment of price in a controlled transaction with a non-resident. Therefore, the penalty will amount to 15 percent % of the adjustment amount (a possible increase to 40 percent of the adjustment amount was earlier discussed). Considering that in some instances the payment of at-source tax on the adjustment amount can be avoided (e.g., if the amount of income received by the counterparty was returned to the taxpayer's account), fines can also be avoided.

Tightening transfer pricing rules will fundamentally change the taxpayers' approach to identifying controlled transactions and analyzing the prices used in them.

Naturally, non-arm's length controlled transactions will now "cost" much more.

The amendments will apply to transactions the income/expense from which will be recognized from 1 January 2024, regardless of the contract date.

The date when these amendments enter into force can yet be changed by a Presidential decree.

To prepare for the amendments, we recommend :

- analyzing the possible expansion of the controlled transactions scope (including due to the inclusion of all 'unfriendly' countries in the list of offshore jurisdictions);
- thinking over a strategy for preparing documents for transactions with independent parties;
- deciding for which transactions to prepare transfer pricing studies and other documents considering potential risks (including penalties);
- assessing the information that will need to be provided to the tax authorities and considering ways to collect it;
- introducing new/updated forms and formats for entering data into accounting systems (as they are approved);
- considering opportunities to automate completion of the new/updated forms;
- weighing the pros and cons of making voluntary TP adjustments, taking into account the new provisions on the median value;
- for transactions in which prices were confirmed using stock exchange quotations / price information agencies data, assessing potential risks and the need to revise your pricing approach in view of the narrowing ranges;
- considering the signing of APAs.

We would be happy to discuss with you the recent changes and help you address any issues that may arise.

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