

Ukraine's new transfer pricing rules expand taxpayer obligations

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Ukraine introduced comprehensive changes into its tax code affecting the transfer pricing rules through Law 466-IX, in force since May 2020, and Law 1117-IX, in force since January 1, 2021.

Key changes include a three-tier approach to transfer pricing documentation, new requirements for reasonable economic purpose, amended provisions on deemed dividends, and new rules on commodities transactions.

Three-tier approach to transfer pricing documentation

The changes adopt a three-tier approach to transfer pricing documentation in accordance with Action 13 of the OECD base erosion and anti-abuse project (BEPS). Namely, transfer pricing documentation shall consist of a master file, a local file, and a country-by-country (CbC) report.

In addition, Ukrainian entities of multinational companies will have to file a notification about participation in an international group of companies. This notification must be filed beginning in 2021 for the 2020 reporting year.

Under the new law, the tax authorities may request the master file for the first time in 2022 for the 2021 reporting year. International groups with consolidated turnover exceeding EUR 50 million (approximately USD 60 million) may be targeted with such requests.

In addition, 2021 is also the first year that taxpayers will be required to file country-by-country reports, provided that Ukraine enters the country-by-country multilateral competent authority agreement. This reporting will be mandatory for international groups with consolidated turnover of EUR 750 million (approximately USD 911 million) or more.

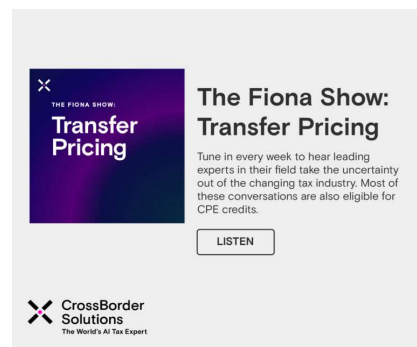
The law introduces new penalties for the failure to comply with the added reporting requirements, and the penalties can be substantial. The penalties are linked to subsistence wage amounts, which are gradually increased. The penalty for the failure to submit the country-by-country report, for instance, is 1,000 times the subsistence wage, which currently would amount to UAH 2,270,000 (around USD 81,890).

New set of rules on reasonable economic purpose

Law 466-IX established a set of rules enabling the tax authorities to require reasonable economic purpose for controlled transactions.

Law 1117-IX further clarified these new rules and extended their application to certain types of uncontrolled transactions. Namely, such rules will apply to uncontrolled transactions with non-residents for transactions involving royalty payments and for transactions with non-residents that either reside in a jurisdiction included in the list of "low tax" states or that have certain organizational forms included in a list adopted by the Cabinet of Ministers of Ukraine.

According to these rules, for tax purposes, a transaction with a non-resident is considered as not having a reasonable economic purpose in two circumstances. One, the transaction's principal aim or one of its principal aims is the non-payment or underpayment of taxes and/or decreasing the profit tax base.



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Two, in comparable circumstances, an entity would not sell or purchase such goods, works or services, intangible assets, or other items to or from an unrelated party.

The changes also introduced a new adjustment of the profit tax base. Under this change, the taxpayer shall increase the amount of taxable profit by the amount of expenses incurred in transactions with non-residents if such transactions lack business purpose.

In addition to non-recognition of a transaction for tax purposes, the tax authorities have the right to substitute the characteristics of the transaction between related parties with those of an alternative transaction that they deem commercially rational given the facts of the case.

The tax authorities technically bear the burden of proof in establishing a lack of business purpose under the law.

However, taxpayers will have to add to their transfer pricing documentation a justification of reasonable economic purpose for their transactions. Such justification should include an analysis of the alternative options available to the parties acting with commercial rationality if they were not related.

Hence, for the controlled transactions, the burden of proof of economic purpose effectively is levied on the taxpayer.

Deemed dividends

The law also expanded the definition of dividends. According to the expanded definition, the amount of a transfer pricing adjustment that increases the tax base in Ukraine may be treated as a deemed dividend distribution.

Such a dividend distribution would be subject to withholding tax in Ukraine under a regular withholding rate of 15% unless otherwise provided by applicable double tax treaties.

Special transfer pricing rules for commodities

The law introduces new rules for transactions with commodities. Namely, taxpayers will need to apply so-called "quoted prices" for transfer pricing analysis of some transactions with commodities. The quoted prices are defined as pricing data which includes exchange quotations, price indices published by recognized agencies, statistical and government agencies.

The list of commodities which are subject to these rules was adopted by the Resolution of the Cabinet of Ministers of Ukraine, effective January 1, 2021. The list is rather wide and covers most agricultural products originating in Ukraine, such as grains, rapeseed, barley, and seed-oils, as well as a number of imported agricultural products, such as coffee, tea, and fish. The list also specifies iron ores, petrol, coal, and mineral fertilizers.

The state tax service also published on its website a list of recommended sources of information where the quoted prices may be found. The state tax service recommends using the price analytics of international agencies, such as S&P Platts and Argus Media Ltd., as well as some national agencies.

This new set of rules will likely bring important changes to the transfer pricing of controlled transactions involving commodities. The new rules give the tax authorities potentially efficient instruments for direct price comparison of commodity transactions and will limit tax abuse opportunities for taxpayers.

Conclusion

The changes to the transfer pricing rules are aimed at improving the efficiency of tax administration and oversight. However, some of the instruments create serious new compliance burdens for taxpayers. In addition, they provide discretionary powers to tax authorities, such as establishing lack of reasonable economic purpose. As a result, there is a high risk of misapplication of these instruments without appropriate reform of the state tax service.

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