

UKRAINE

Comparables Selection Was Correct After All, Ukrainian Court Says

by Alexander F. Peter

The tax authorities cannot exclude comparables from stevedoring company Olympex's transfer pricing analysis to justify an adjustment, the administrative chamber of Ukraine's Supreme Court has held in the case's second and final judgment.

In its second decision in *Olympex Coupe International TOV v. State Tax Service*, published February 23, the Supreme Court finally indirectly confirmed the first instance court decision of 2022 and upheld the second judgment of the Fifth Administrative Court, which had reversed itself, holding for the taxpayer on remand from the Supreme Court.

"The courts in depth considered the parties' arguments and took into account the tax authorities' benchmarking creativity with a healthy dose of skepticism," Ivan Shynkarenko of KM Partners in Kyiv told *Tax Notes* on March 5. "However, I still believe that it should not have taken five court decisions to come to that conclusion."

Olympex, a Ukrainian limited liability company, is part of the Ukrainian GNT Group, which exports and stores agricultural products at its seaport terminals. Olympex's U.S. creditors, Argentem Creek Partners and Innovatus Capital Partners LLC, and the GNT Group are embroiled in extensive litigation over the group's outstanding payments on loans granted by their investors.

In audit years 2014 and 2015, Olympex performed grain cargo transshipments with several group companies in the United Arab Emirates and the Dominican Republic. To justify its related-party pricing, Olympex submitted a transfer pricing report selecting the transactional net margin method. It used a nine-step process to choose comparables. The tax authorities accepted only three of the 16 companies it chose for 2014 and two of 14 companies for 2015.

Olympex's calculated profit-level indicator in its larger sample was 7.42 percent in 2014 and 8.3 percent in 2015. The tax authorities' profitability

range varied between 13.37 percent in 2014 and 44.39 percent in 2015. Based on those findings, the tax authorities assessed Olympex additional tax of UAH 12.75 million (about \$340,000 in today's value), saying the company's profitability numbers, as compared with the tax authorities' profit-level indicators, did not comply with the arm's-length principle in article 39 of the Ukrainian Tax Code.

On appeal by the taxpayer, the Odessa District Administrative Court (Legal Proceeding No. P/420/19800/21, Case No. 420/19747/21) in 2022 stressed that the tax authorities must prove that the price established by the parties to the transshipment transactions was not arm's length. Based on that rule, it said, the audit report did not clearly show on what grounds the tax office accepted some medium-size companies in the sample while rejecting others, given that Olympex is considered to be a large company, as acknowledged by the tax authorities.

The court disagreed with the tax authorities' argument that geographical location should play a decisive role in the selection of comparable companies, noting that all the ports in the sample had the same accessible transport infrastructure. It therefore granted the taxpayer's appeal.

Appealing to the Fifth Administrative Court of Appeals, the State Tax Service claimed that the Odessa court had disregarded the capacity indicators of regular ports for cargo handling, asserting that their technical characteristics and the types and sizes of ships that can enter the ports are completely different from deep-sea ports like Odessa and Pivdennyi. Only in deep-sea ports can companies create cost advantages by loading large-tonnage vessels at the berth, resulting in lower freight rates with a simultaneous price increase for the transshipped product, the tax authorities said.

In December 2022 the appeals court (Legal Proceeding No. 854/4738/22) rejected that argument, saying that all relevant ports provide the same services, the same transport infrastructure access and weighted average port depths, and similar transshipment grain rates.

The appeals court noted that the first instance court had focused only on the number of employees without taking into account the size of the enterprises' fixed and intangible assets. Thus,

the Odessa court's conclusion that the tax authorities unjustifiably excluded some enterprises chosen by the plaintiff was erroneous because the assets at a company's disposal matter for comparability. However, the Odessa court's holding could still stand because the tax office should not have put weight on the port's geographical location, the appeals court held.

Both parties appealed to the Supreme Court.

The Supreme Court in an August 2023 decision (Legal Proceeding No. K/990/37481/22) rejected the appeals court's approach of leaving the first instance court's holding unaltered but changing the reasoning. If the tax authorities provided sufficient arguments in accordance with Tax Code article 39.3.2.4, 39.3.2.5, and 39.3.2.6 for their profit-level indicator and gave a meaningful explanation for their conclusion that geographical location makes a difference, the appeals court needs to weigh that aspect and investigate all other circumstances that could lead to a conclusive decision, the Court said, remanding the case to the second instance court.

On remand, the Fifth Administrative Court of Appeals in December 2023 (Legal Proceeding No. 854/8301/23) expanded its reasoning on the geographical location issue, saying that a legal definition of deep-water ports does not exist. The provided information showed that the rates in the Ukrainian ports did not significantly differ from the prices charged at other ports where Olympex conducted its activities. Therefore, the transfer pricing analysis was not skewed by taking those ports into account, or, put differently, they could not be excluded based on that argument, the court ruled.

Moreover, the appeals court looked in detail at the comparables data and concluded that it now agreed with the first instance court that the tax authorities had not made it clear in their audit report why some medium-size companies were left in the sample and some were not. It would have made sense for them to focus only on large companies, but they did not, the court said, dismissing the tax authorities' appeal on remand.

In its February decision (Legal Proceeding No. K/990/675/24), the Supreme Court agreed with the appellate court regarding the geographical location criterion without adding additional reasoning. It stated that the first instance and

appeals courts extensively analyzed all issues, noting that the State Tax Service's appeals brief in the second round included no new arguments, despite the Court's recommendation to the tax authorities. Hence, the appeal was dismissed by the Court. ■