Swiss Quality Consulting Services in Russia.

Transfer Pricing in Russia – methods, trends, outlook

14 October 2020
What we stand for.

Quality partners are highly motivated consultants who strive for excellent, client-oriented, tailor-made, flexible and reasonable solutions.

Our values

- The client is always top priority.
- Quality partners go the extra mile.
- Quality partners offer solutions.
- Quality partners act reasonably and responsibly.
- Quality partners treat everyone with respect.
Locations.

st. petersburg

moscow
Your team.

- Andreas Bitzi, Managing Director
- Irina Krasheninnikova, VP HR
- Olga Konovalova, VP Finance
- Tatyana Nuridinova, Finance Team Leader
- Irina Saadueva, VP Legal

+ 20 more colleagues in Moscow and St. Petersburg
Andreas Bitzi.

Founder/Managing Director

- 12 years of experience in consulting market in Russia, supporting foreign business.
- Founded quality partners end of 2017.
- Track record in finance, tax & ERP in industrial companies and a leading global IT company.
- Procurement, project & process analysis, optimization, financial planning & analysis, budgeting, tax planning, liquidity planning, project valuation, stock optimization, refinancing projects.
- Master of Science in business administration, University of Bern
- Passed level II of the Chartered Financial Analyst (CFA) Exam.
- Languages: RU, EN, DE, FRA, ESP.

External presence:
- Chairman of the SME Committee of the Association of European Businesses (AEB)
- Deputy Chairman of the AEB in the Northwest.
- Board Member JCC Joint Chambers of Commerce Switzerland/CIS + Head of Russia Chapter
- Board Member of Graduate School of Management Int. Bachelor Programme, SPb University.
- Guest lecturer at SPb University on practical business issues and macroeconomics.
- Frequent speaker at events on business in Russia with AEB, AHK, Gim-Unimpresa, Switzerland Global Enterprise, etc.
- Member of compliance committee of AHK
Member of the Management Team, VP HR

- Advisory and guidance on HR matters to top-management (including T&D, C&B and HR Operations matters);
- Building and maintaining corporate culture with focus on key values: efficiency, teamwork and constant personal development.
- Advice and guidance on HR, Payroll, Development matters, migration.
- HR audits and efficiency analysis, policies implementation & optimization
- Onboarding, adaptation, retention, mediation.
- Performance management (incl. 360 degrees, SMART goals assessment);
- Recruiting (Finance, Admin, Sales, BD, General management, Top management).
- Irina is supported by an HR Expert.
- Languages: RU, EN.

External presence:
- Chairperson of the Saint-Petersburg HR Committee at AHK.
- Member of the Education programs’ Board at the SPb University.
- Invited tutor at the Saint-Petersburg State University.
Member of the Management Team, VP Finance

- 15+ years of experience in accounting, finance, taxation and internal auditing.
- 10+ years of experience in managing accounting department.
- Responsible for accounting outsourcing department (13 colleagues under direct/indirect supervision).
- Full accounting outsourcing projects.
- Projects on optimization of accounting / finance departments.
- Accounting and tax consulting of companies from trade (including retail), construction, food and beverages production sectors.
- Accounting of manufacturing companies.
- Consulting clients as CFO.
- Interim CFO mandates.
- Languages: RU, EN, DE.

External presence:
- Speaker at committees, working groups of AHK and quality partners’ seminars.
Member of the Management Team, Finance Team Leader

- IFRS reporting, international GAAP reporting.
- Recovery of commercial and tax accounting.
- Representation in tax authorities.
- 1C / other software (e.g. SAP) data interchange development, analysis, optimization.
- Import / export operations.
- Accounting software implementation and maintenance in production.
- Accounting processes optimization.
- Financial statement analysis.
- Bilateral, multilateral, chain deals analysis, optimization, development.
- Localization structure development.
- Finance, accounting, tax due diligence, treasury, hedging.
- 2 colleagues under supervision.
- Languages: RU, EN.

External presence:
- Speaker at committees quality partners' seminars.
Member of the Management Team, VP Legal & Tax

• Manages the legal Department of the company in Moscow and St. Petersburg.
• Specializes in projects for localization of production in Russia, especially German, Swiss and Italian companies in the field of automotive, chemical production and pharmaceuticals.
• Expert in contract law with a focus on contractual manufacturing agreements, license agreements, distribution contracts.
• Irina has eight years of experience in international companies in Russia, especially in the field of consulting services.
• Dipl. Lawyer with specialization on contract law, family and inheritance law, graduated from law faculty of Humboldt University of Berlin (Germany).
• 3 colleagues under supervision in both legal and tax.
• Languages: RU, EN, DE, ITA.

External presence:
• Coordinator of the subdivision in St. Petersburg of Association of Italian Business in Russia - GIM Unimpresa.
• Speaker at committees and quality partners’ seminars.
Services overview.

- business set-up
- legal consulting
- tax compliance & consulting
- accounting, payroll & reporting
- HR consulting, coaching, personnel development, HR audits
- recruiting
- interim or long-term management
- support of localisation of manufacturing
- import & trade
- IT support
- internal audit
Business set up.

- market research
- structuring advisory / optimal structuring
- registration of legal entity
- bank accounts opening
- expat consulting
- general business advisory
- recruiting of personnel
- office sublease or office search
- organisation of processes in banking, tax, migration, HR
Legal and tax services.

- corporate law
- contract law
- labour law
- migration law
- license law
- compliance
- tax consulting
- tax structuring
- tax optimisation
- transfer pricing
Accounting, payroll, tax compliance.

- full or partial accounting outsourcing, with modular solutions
- chief accountant outsourcing
- reporting to state authorities
- reporting to HQ according to internal guidelines
- communication with tax authorities / other authorities
- consulting in accounting, payroll & tax

quality partners.

business solutions partners.
Business representation.

- office sublease
- legal address
- business address
- business representatives
- business process & back office outsourcing
- outsourcing of management positions
HR & personnel.

- HR & payroll audits
- HR director outsourcing
- personnel development
- coaching
- labour law consulting
- recruiting
- leadership skills seminars
- lean management seminars
- internal rules & regulations
- support before/during/after labour inspections
- hiring & dismissal

quality partners.
Interim or long-term management.

- general director outsourcing
- CFO outsourcing
- chief accountant outsourcing
- HR director / HR manager outsourcing
- board of directors representation
- outstaffing of personnel
- company management ad interim or long-term
- general business consulting

quality partners. business solutions partners.
Localisation of manufacturing.

- location search
- legal support: foundation, purchase, registration, business partner check
- contract manufacturing agreement
- shareholder agreement, JV agreement, licence agreement
- import support
- Compliance with localisation requirements
- communication with authorities
- interim management, support by experienced industrial managers

quality partners.

business solutions partners.
Our clients.
Memberships.
Contacts.

www.q.partners
info@q.partners
+7 812 332 28 66
+7 495 796 88 75

Moscow office
German Centre for Industry & Trade
Pr. Andropova 18, K.6
Office 5-05
115432 Moscow

St. Petersburg office
Business Centre Nevsky Plaza
Nevsky Prospekt 55
Office 4.03
191025 St. Petersburg
Quality partners’ webinars series.

- 14 SEP 2020
  Taxation in Russia – Corporate income tax, VAT, property tax, other taxes

- 30 SEP 2020
  Accounting & reporting

- 14 OCT 2020
  Transfer pricing – overview, experience
Quality partners’ webinars series.

- Registration of legal entities; LLC, rep. Office, branch office
- General director, board of directors
- Legal address, 1-1-1 rule
- Financing of a legal entity
- Import solutions
- HR issues, hiring, internal documents
- Labour safety measures in office practice, office solutions, flex desk
- Remote work from a legal standpoint
- Remote control of employees
- Migration issues, work permit, visa
- Cultural differences Russia vs. west
- HR Trends 2020/21, labour market overview
Quality partners’ webinars series.

- Royalties, trademarks, IP protection
- Licences, sublicences agreements
- Distribution concepts
- Sanctions overview, sanctions checks
- Sanctions clauses in agreements in practice
- Due diligence – finance, tax, legal
- Typical corruption schemes to be aware of
- Currency controls regulations
- Local manufacturing – what does it mean in practice?
Content:

- Affiliation, controlled transactions
- TP notification
- TP documentation
  - In general
  - Methods
  - Profitability
  - Intervals
  - corrections
- Audits
- APA, CbC
- Focus points of tax authorities
- Outlook
Situation.
Affiliation, controlled transactions.
Affiliation.

- Within RU: 1 b. RUR
- Cross border: 60 m. RUR

Influence
- Share in capital
- GD, Board of Directors
- Relatives
- Other influence
Affiliation.

- Direct share in capital
- Sister company

Affiliated company

Foreign LLC

Russian OOO

Non-Russia

Russia

Share >25%
Affiliation

- Indirect share in capital

Foreign LLC

Non-Russia
Russia

Share 100%

Share >25%

Affiliated company

Russian OOO
Affiliation.

influence
- Indirect share in capital

- Share >25%

- Share 100%

Foreign LLC

Affiliated company

Russian OOO

Non-Russia
Russia
Affiliation

- Indirect share in capital
- Share >50%

Foreign LLC

- LLC 1
- Share >50%
- LLC 2
- Share >50%
- LLC 3
- Share >50%

Russian OOO

Non-Russia

Russia

quality partners.
business solutions partners.
influence
• Similar BoD directly
Influence
- Similar BoD indirectly

DEF LLC

ABC LLC

Russian OOO

Non-Russia

Russia
influence
• Similar GD directly

Affiliation.

ABC LLC

Russian OOO

Non-Russia

Russia

quality partners.
business solutions partners.
Affiliation.

influence

• Similar GD indirectly

DEF LLC

ABC LLC

Russian OOO

Non-Russia

Russia
Affiliation

influence
• Similar GD & ownership directly

ABC LLC

Share >25%

Russian OOO

Non-Russia
Russia

quality partners. business solutions partners.
Affiliation

influence
• Similar GD >50% directly

ABC LLC

Russian OOO

Non-Russia
Russia

gd a
gd b
gd c
gd a
gd b
gd e

quality partners.
influence
• Similar GD >50% indirectly
Affiliation.

influence
• Similar GD >50% directly

ABC LLC

Russian OOO

Non-Russia
Russia

quality partners.
business solutions partners.
influence
• Similar GD >50% indirectly

DEF LLC

ABC LLC

Russian OOO

Non-Russia Russia

quality partners. business solutions partners.
influence
• Similar GD >50% directly

ABC LLC

Russian OOO

quality partners.

Non-Russia

Russia
Affiliation

- Spouses
- Brothers
- Children/parents

influence

Spouse 1
Share >25%

Spouse 2
Share >25%

ABC LLC

Russian OOO

Non-Russia
Russia

quality partners.

business solutions partners.
Affiliation.

influence
• Subordinates

GD a
GD b

ABC LLC

Russian OOO
Affiliation.

influence
• Subordinates
Affiliation

- Influence
  - Subordinates

ABC LLC → Russian OOO
Affiliation.

- **influence**
  - Other

Diagram:
- ABC LLC
- GD a
- GD b
- Russian OOO
Affiliation.

Other
- Tax havens

Foreign LLC in BVI

No influence / ownership

Russian OOO
Affiliation.

Other

- Self declaration

Foreign LLC

Russian OOO
Other
• Based on court decision in the absence of formal criteria
  - Factual influence
  - Deal is not arm’s length
Controlled transactions.

- Goods
- Services
Controlled transactions within RU.

preconditions

- affiliates
- Different corporate profit tax rates
- Mineral extraction taxes, hydrocarbon taxes
- Special tax regime connected to the specific transaction(s)
- Tax exemption
- Resident of Skolkovo Innovation Center
preconditions

- Legal entities or branch offices
- 60 m. RUR contract value if cross border
- 1 b. RUR contract value if within RU*
- Affiliated companies
- Electronically (in paper it might be hundreds of thousands of pages...)
- 1C software modules exist; excel/access based solutions - XML
Failure to submit notification

- Easy to check for tax authorities
  - counter-check between two parties if within RU
  - By transactions passports if cross border
- Penalties 300 – 500 RUR for GD/CA, 5,000 RUR to the company
  … looks ridiculous…?

Bear in mind

- Incompliancy key argument for TP audits in the future
- Harm the reputation of the GD / responsible person
- Possible visa-extension difficulties in case GD / responsible person is a foreigner
- Too many penalties can have negative effects
TP Notifications.

См. данную машиничитаемую форму в формате TIF, рекомендованную ФНС России, размещенную на сайте АО "ГНИВЦ" www.gnivc.ru.

См. данную машиничитаемую форму в формате PDF, подготовленную на основании TIF-шаблона АО "ГНИВЦ" и доступную для заполнения в программе Adobe Reader (программа размещена на сайте www.adobe.com).

- Strictly pre-described format
TP Notification

content

- Subject of transactions and codes thereof (TN VED, OKP, OKVED, OKATO)
- Country of origin
- Shipping & delivery address
- Parties to the transactions
- Proceeds received / paid
- Quantity and price per unit
- Currency code

- Similar goods can be grouped
TP Documentation.
If transactions of 60 m. / 1 b. between affiliated companies...

- Organisational structure
- Business description: market conditions, main competitors, market segments, etc.
- Peculiarities of pricing policies in the company and the group
- Functional analysis
- Choice of method of TP
- Market analysis
- Comparison of margins with market margins
- Calculation of changes in tax base / taxes due, if applicable
TP Documentation.

inspections

- TP doc. can be requested 01 June for the previous year
  - 30 days to provide
- Cameral inspection
- Start up to 2 years after notifications of controlled transactions
- Duration: 6 months
  - Extension max. 21 months
- Penalties: 40% from underpaid tax + late payment interest
Functional analysis

The more functions, risks and assets in the company, the higher the expected income

• What functions does the company fulfill
• What commercial risks are there and who bears them
• What assets are used and who is the economic owner
Functional analysis – manufacturing

- Toll manufacturing
- Contract manufacturing
- Full fledged manufacturing

TP Documentation

functions + risks + assets
Functional analysis – sales organisation

- Agent, commission
- Distributor with limited risks
- Distributor with extended functions & risks

profitability

functions + risks + assets
**TP Documentation.**

**Functional analysis – sales & services organisation**

<table>
<thead>
<tr>
<th>Functions, risks, activities</th>
<th>seller</th>
<th>buyer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main functions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufacturing, R&amp;D</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Marketing, advertising</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Decisions on contract volumes</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Price setting</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Logistics</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Quality control of finished goods</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td><strong>Main risks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution risks</td>
<td>(+)</td>
<td>(+)</td>
</tr>
<tr>
<td>Quality of goods, guarantee risks</td>
<td>(+)</td>
<td>(+)</td>
</tr>
<tr>
<td>Transport risks</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Currency risks</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Credit risks, counterparty risks</td>
<td>(+)</td>
<td>-</td>
</tr>
<tr>
<td><strong>Main assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangible assets</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Intangible assets</td>
<td>(+)</td>
<td>(+)</td>
</tr>
</tbody>
</table>
Methods.

Direct methods
- Comparable uncontrolled price method (CUP)
- Resale price method (RPM)
- Cost-Plus method

Transactional profit methods
- Transactional net margin method (TNMM)
- Profit split method (PSM)
Methods

Priorities

1. Comparable uncontrolled price method (CUP)
2. Resale price method (RPM)
3. Cost-Plus method
4. Transactional net margin method (TNMM)
5. Profit split method (PSM)
Comparable uncontrolled price method (CUP)

- Highest priority
- If information from financial markets is available
- Information on exactly the same transaction
- When is a transaction really comparable?
Methods.

Resale price method (RPM)

- Priority for purchase and resale to 3rd party
- If no IP is involved at distributor
- Preparation of goods for resale and for transport
- Mixing goods / semi-finished goods in case the resold goods’ characteristics does not strongly differ from the characteristics of the semi-finished goods (similarity)

![Diagram of the resale price method (RPM)]

Price: (resale price) – (profit margin)

Affiliated manufacturer

Deliveries

Affiliated distributor

Resale price

3rd party
Cost-Plus method

- Services, contract manufacturing
- Usage of intangible assets
- Long-term agreements for sales
Methods.

Transactional net margin method (TNMM)

- Most often used method in practice
- Services
- Resale of goods
- Manufacturing without big capital investments
- Limited risks (comm./econ.) on reseller’s side
- No IP in use on reseller’s side
- Reseller’s business smaller than aff. manuf.
- Accounting data is used to calculate the profit margin intervals
**Methods.**

Transactional net margin method (TNMM)

- Gross margin
- Gross cost margin
- Net margin
- Net cost margin
- Berry ratio (gross profit / comm. + admin costs)
- Asset profitability

Based on accounting data (publicly available)
Profit split method (PSM)

- If none of the other methods is applicable
- If there is a considerable amount of IP in use which significantly influences the profitability, in the absence of similar transactions with 3rd parties
Methods.

Source priority

1. Local and foreign exchanges, customs statistics, official information from state and municipal authorities, information + rating agencies, taxpayers’ information / transactions
2. Public editions & information systems, official financial and statistics reporting information, appraisal reports, other information acc. to the Russian Tax Code
3. Courts can consider any relevant information & facts
Market profitabilities.

1. List of companies according to OKVED activities code
2. Exclude
   • negative assets
   • More than 1 year of negative gross profit
   • Exclude affiliated companies
3. Analysis of activities of the organisations

Analyse data of the previous 3 years
Intervals of profitability.

There must be at least 4 margin numbers.

Interval: $I_{\text{Min}} \leq X \leq I_{\text{Max}}$
Intervals of profitability.

There must be at least 4 margin numbers.

Lower end

- If $N / 4 = T$   \quad \text{where } N \text{ is the number of profitabilities found}

  - $T$ is a whole number
    \quad \frac{N_T + N_{T+1}}{2} = I_{\text{Min}}$

  - $T$ is a fraction
    \quad N_w + 1 = I_{\text{Min}} \quad \text{where } w = \text{the whole part of the fraction}
Intervals of profitability.

There must be at least 4 margin numbers.

Upper end

- \( N \times 0.75 = T \) \textit{where} \( N \) \textit{is the number of profitabilities found}

  - \( T \) \textit{is a whole number}
    \[ \left( N_T + N_{T+1} \right) / 2 = I_{\text{Max}} \]

  - \( T \) \textit{is a fraction}
    \[ N_w + 1 = I_{\text{Max}} \quad \text{where} \ w = \text{the whole part of the fraction} \]
Intervals of profitability.

Corrections

- Only the part that concerns controlled transactions
- Check profitability of the CT
- Is the profitability of the CT between $I_{\text{Min}}$ and $I_{\text{Max}}$?
- How does it impact my taxable profit?

- Profit $>$ $I_{\text{Max}}$
- Profit $<$ $I_{\text{Min}}$

Corrections for foreign affiliate can usually not be made!
### Приложение №2 к Листу 02 (продолжение)

<table>
<thead>
<tr>
<th>Показатель</th>
<th>Код строки</th>
<th>Сумма в рублях</th>
</tr>
</thead>
<tbody>
<tr>
<td>Убытки, приравниваемые к внеоборотным активам — всего</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>в том числе:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>убытки прошлых налоговых периодов, выявленные в текущем отчетном (налоговом) периоде</td>
<td>301</td>
<td></td>
</tr>
<tr>
<td>суммы безнадежных долгов, а в случае, если налогоплательщик принял решение о создании резерва по сомнительным долгам, суммы безнадежных долгов, не покрытые за счет средств резерва</td>
<td>302</td>
<td></td>
</tr>
<tr>
<td>Корректировка налоговой базы на выявленные ошибки (искорректировано), относящиеся к прошлым налоговым периодам, приводящие к корректировке уплате налога, всего</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>в том числе за:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>401</td>
<td></td>
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<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td>403</td>
<td></td>
</tr>
</tbody>
</table>
Audits.
Audits

Tax authorities

- Cameral checks & on-site checks
- More and more activity

- Who is checked?
  - In the first place: large tax payers
  - Commodities dealers
  - Those who miss notifications
  - Selection during routine audits
  - Risk-based audit approaches (not only TP)
Audits.

Issues

• Tax authorities want lower import prices
• Customs want higher import prices

• Methodology
  ➢ Is the chosen method correct?
  ➢ Often TNMM due to lack of alternatives. Really?
    - Chemicals
    - Commodities
    - Comparable transactions?
  ➢ Incorrect choice of comparable companies
  ➢ Too wide range of size of business
  ➢ Difference in analysis period (signature date vs. delivery)
Parallel issues – non TP – that often come up during audits

- Intermediaries
  - One-day companies
  - Conduits (transit character of payments)
  - Fake trading companies
- Duplication of functions
  - Division of business
  - Purchasing of services though could be done internally
  - Cloning legal entities
- Illogical business
  - Too small sales prices
  - Too high purchase prices
  - Surreal losses
  - Financing “not necessary” / debt vs. equity
APA, CbC.
Advance Price Agreement

• Only for large tax payers
• Fee 2 m. RUR
• 3 years (+2 years), starting following 01 January
• Since 2018 multilateral agreements: FNS in cooperation with foreign authorities
• Agreement
Reporting requirements

- Being part of MNE if >50 bln. RUR / 750 mln. EUR
  - by companies belonging to foreign MNE, by 31 AUG
  - penalties: 50k RUR
- Revenues of MNE group by country
- Amounts of taxes paid
- Amount of capital
- Accumulated earnings
- Number of employees
- Tangible asset values
- Identification of each MNE company

To be filed by Russia based MNEs
Reporting requirements

- Master file
  - Within 3 months upon request by TA

- Local file
  - Within 30 days upon request by TA

- CbC
  - Within 3 months upon request by TA
  - Or 12 months after year-end if Russian group

*M./L.-file*: penalties 100k RUR for failure to submit
Current focus points.
Intra-group services

• Intra-group pricing in RU below threshold: tax abuse

• Intra-group services: avoidance of cost-sharing / cost allocation to Russian tax payers; this concept is not acceptable in Russia
  ➢ Challenging service fees
    - Lack of details
    - No tangible documents as evidence of service and their results
    - Prove that services were aimed at income generation
  ➢ Service fees considered hidden dividends
Current focus points.

**Intangibles**

- Strong focus on allocations of functions and risks to the intangibles
- Denials of royalties payments in case of lack of substance
- No differentiation between legal and economic owner of intangibles
- Move from CUP to profitability based methods, which show the return after royalties

- Growing dispute potential, also conflicting globally
  - Critical: dispute resolution (BEPS 14)
  - Mutual Agreement Procedures (MAP) launched
Current focus points.

Commodities export
- Foreign affiliated traders
- CUP
- Analysis of supply chains
  - Value created by each part of the chain
  - Often lack of substance by group traders
  - Challenging methods

CUP as the preferred method for commodities.
Outlook.
Growing importance, evolving TP system

- Further development in line with global trends
- Further implementation/enforcement of actions from BEPS action plan
- Authorities with experience & competence
- More focus on substance and creation of value
- Increased complexity of TP audits
- Increased focus on services, royalties, inbound business
- More technology focus in tax authorities in general
- More cooperation / joint audits with foreign tax authorities, more bilateral APA / MAP