SORAINEN

EUROPEAN LAW FIRM OF THE YEAR
Awarded by The Lawyer

BALTIC AND BELARUS TRANSFER PRICING CARD 2016

Effective 1 April 2016

ESTONIA

GENERAL RULES

- Transfer pricing (TP) regulations are in line with Organisation for Economic Cooperation and Development (OECD) TP Guidelines, while some provisions on TP documentation are borrowed from EU Joint Transfer Pricing Forum recommendations. OECD TP Guidelines can be used to implement domestic TP regulations as long as they are in line with tax law.

DEFINITION OF RELATED PARTY

- Persons are assumed to be related parties if they have common economic interests or if one person has a dominant influence over the other. The Income Tax Act lists persons that are related in any case, such as:
  - companies that are members of one group;
  - individual and legal persons where more than 10% of the share capital, votes or right to profits belong to the same individual;
  - related individuals, employers and employees, a company and a member of its controlling body;
  - legal persons where more than 50% of the share capital, votes or right to profits belong to one and the same person or associated persons;
  - persons who own more than 25% of the share capital, votes or right to profits in one and the same legal person;
  - legal persons where all management board members are one and the same.

TP DOCUMENTATION REQUIREMENTS

- Additional TP regulation documentation requirements apply to:
  - credit institutions, insurance, listed companies;
  - transactions with persons residing in low-tax territories.
- A company and a non-resident operating in Estonia through permanent establishment is also required to prepare comprehensive TP documentation on its operations if the consolidated results with related parties meet all of the following criteria during the taxation year:
  - annual sales exceed EUR 50 million;
  - total assets exceed EUR 43 million;
  - number of employees is at least 250.
- Local companies not reaching these thresholds are also required to prove the arm's length nature of related-party transactions.

MANDATORY TP DOCUMENTATION CONTENT

- Regulation No. 53 on TP provides the structure for TP documentation, which essentially follows the recommendations of the EU Joint Transfer Pricing Forum Code of Conduct on Transfer Pricing Documentation for Associated Enterprises in the European Union, ie documentation should consist of two parts – a master file and a country-specific file. In practice the required information on a group or a particular taxpayer can be provided in one TP documentation file.
- TP documentation must be presented within 60 days if requested by the tax authorities.

RECOGNISED TP METHODS

- TP methods in use: comparable uncontrolled price (CUP) method, resale price, cost plus, profit split, transactional net margin method (TNMM) or any other sufficiently substantiated method.

TAX AUDITS AND PENALTIES

- In the case of failure to file a declaration as required or failure to correct errors in the declaration, the tax authority can impose a fine of EUR 3,200. Fines can be as high as EUR 32,000 if a tax fraud is committed. Failure to submit information or submission of incorrect information is treated as a criminal offence if the tax liability avoided exceeds EUR 40,000 and may be punished by up to 5 years imprisonment. If audit by the tax authorities results in TP adjustments, late payment interest (0.06% per day, approx 22% per year) applies on the tax amount underpaid. Late payment interest is taxed with corporate income tax at the rate of 20/80 (25%) on the net payment.
- Tax audits can go back 3 years from the date tax becomes payable (5 years in the case of international tax audit).

EXTENT OF ENFORCEMENT

- If the Tax and Customs Board thinks a transaction is not at arm's length it will adjust the transaction values, determine the tax obligation and impose interest.
- There are not many TP cases to generalise as to what extent penalties are enforced in practice.

ADVANCE PRICING AGREEMENTS (APA)

- APAs are not available in Estonia.

LATVIA

GENERAL RULES

- Transactions with related parties should be arm's length. Transfer pricing (TP) rules are set in accordance with Organisation for Economic Cooperation and Development (OECD) TP Guidelines.

DEFINITION OF RELATED PARTY

- Under domestic tax law the arm's length requirement applies to transactions with:
  - foreign related companies:
    - with at least a 20% shareholding; or
    - controlling interest belongs to the same individual/-s (up to 10 individuals); or
    - controlling interest in the other party to the transaction belongs to a related individual (spouse, relatives up to 3rd degree);
  - domestic related companies which are members of a group as defined in corporate income tax (CIT) law;
  - domestic companies established in special economic zones, using special CIT rebates or other tax reliefs;
  - related individuals (spouses, relatives up to 3rd degree);
  - any other person/-s, if the main aim of the transactions is reduction of tax burden;
  - persons registered in low-tax or zero-tax territories.

TP DOCUMENTATION REQUIREMENTS

- As from 2013, taxpayers with an annual turnover exceeding EUR 1.43 million and having transactions with specified transaction partners exceeding EUR 14,300 must prepare TP documentation.
- TP documentation must be presented within 30 days after receipt of request from the State Revenue Service (SRS).
- Companies not reaching these thresholds must also be able to prove that their related-party transactions are arm's length in case of tax audit.

MANDATORY TP DOCUMENTATION CONTENT

- Mandatory TP documentation should include the following information:
  - industry analysis;
  - company analysis;
  - functional analysis;
  - economic analysis of transactions between related parties, including description of the transaction, selection of TP method, a benchmarking study (if applicable).

RECOGNISED TP METHODS

- Five TP methods recommended by OECD – comparable uncontrolled price (CUP) method, resale price, cost-plus, transactional net margin method (TNMM) and profit split – are recognised. OECD TP guidelines may be used for application of TP methods.

TAX AUDITS AND PENALTIES

- If no TP documentation is available, or the existing documentation is challenged and SRS makes TP adjustment, the fine for understated tax is either 20% or 30% of the understated amount depending on the amount of tax underpaid.
- Late payment penalty applies at 0.05% daily.
- TP adjustments made during audit might trigger value added tax (VAT) adjustments, without the right to adjust corresponding input VAT.
- Tax audits can be performed going back 3 years, except for TP transactions with persons that are not Latvian tax residents – 5 years.

EXTENT OF ENFORCEMENT

- If the SRS thinks that a transaction is not arm's length, it will adjust transaction values and impose penalties.
- When TP documentation and other supporting documents have been prepared, the SRS disputes the contents and applicability of the analysis.

ADVANCE PRICING AGREEMENTS (APA)

- Taxpayers whose annual turnover exceeds EUR 1.43 million have the option to enter into an APA with the SRS on determining the market price for a transaction or certain types of transaction with a related foreign company if the transaction amount (actual or planned) exceeds EUR 1.43 million annually.
- The SRS charges a fee of EUR 7,114 for evaluating a taxpayer's application for APA.

LITHUANIA

GENERAL RULES

- Lithuania follows the Organisation for Economic Cooperation and Development (OECD) transfer pricing (TP) Guidelines and provisions of double tax treaties. Taxpayers may follow OECD TP Guidelines unless these contradict domestic law.

DEFINITION OF RELATED PARTY

- The following parties are regarded as related for transfer pricing purposes:
  - an entity and its shareholders and members;
  - an entity and the members of its managing bodies;
  - an entity and the spouses, fiancés, cohabitees, relatives (up to the fourth degree) and in-laws (an individual's spouse's relatives (up to the fourth degree) and the relatives (up to the second degree) of the spouses of the individual's relatives (up to the second degree)) and the testamentary heirs of the members of the entity or the members of the entity's managing bodies;
  - the members of a group of entities;
  - an entity and the members of another entity if the latter entity and its members comprise one group of entities;
  - an entity and the members of the managing bodies of another entity if these entities comprise one group of entities;
  - an entity and the spouses, fiancés, cohabitees, relatives (up to the fourth degree) and in-laws (an individual's spouse's relatives (up to the fourth degree) and the relatives (up to the second degree) of the spouses of the individual's relatives (up to the second degree)) and the testamentary heirs of the members of managing bodies of another entity if both taxable entities make up one group of entities;
  - two entities if one of them directly or indirectly (through one or several entities or individuals) controls over 25% of the shares (ownership interests) in the other entity, or has over 25% of the voting rights in the other entity, or has an obligation to coordinate its business decisions with the other entity, or assumed the obligations of that other entity to third parties, or has assumed an obligation to transfer to that other entity all or part of its profits or has conferred on that other entity the right to use over 25% of its assets;
  - two entities if the same members or their spouses, fiancés, cohabitees, relatives (up to the fourth degree) and in-laws (an individual's spouse's relatives (up to the fourth degree) and the relatives (up to the second degree) of the spouses of the individual's relatives (up to the second degree)) and the testamentary heirs directly or indirectly control 25% of the shares (ownership interests) in each entity;
  - an entity and its permanent establishment; and
  - two entities if one of them has a decision-making right in respect of the other entity.
- TP rules also apply to transactions with associated parties, which are broadly defined as other entities having an influence on each other.

TP DOCUMENTATION REQUIREMENTS

- The obligation to prepare written TP documentation applies to companies which meet at least one of the following criteria
  - domestic companies and permanent establishments of foreign companies – if the taxpayer's annual turnover exceeds EUR 2,896,200 during the last tax year;
  - financial companies and credit institutions – irrespective of the level of turnover;
  - insurance companies – irrespective of the level of turnover.
- In the case of tax audit, TP documentation has to be prepared within 30 days as of a request by the tax authorities.
- The obligation to file form FR0528 with the tax authorities arises if the value or the total value during the tax year of transactions or economic operations with associated parties equals or exceeds EUR 90,000.

MANDATORY TP DOCUMENTATION CONTENT

- TP documentation should include:
  - industry analysis;
  - company analysis;
  - functional analysis;
  - economic analysis of transactions between related parties, including description of the transaction, selection of TP method, a benchmarking study (if applicable).

RECOGNISED TP METHODS

- TP methods in use: comparable uncontrolled price (CUP) method, resale price and cost-plus methods, transactional net margin method (TNMM) and profit split methods. Priority is given to transactional methods, ie the first 3 methods. A combination of methods may be used in all cases to support transfer prices.

TAX AUDITS AND PENALTIES

- Tax audits can be performed going back 5 years.
- A fine of 10-50% of underpaid tax is imposed.
- Late payment interest applies at 0.03 % daily.
- As of 1 April 2016, failure to file TP documentation attracts a warning or a fine of EUR 1,400 to EUR 4,300. Repeated failure to file TP documentation attracts a fine of EUR 2,900 to EUR 5,800.

EXTENT OF ENFORCEMENT

- Tax authorities mainly target companies with significant cross-border related party transactions.
- If the tax authorities think that a transaction is not at arm's length, they will adjust the transaction values and impose fines and late payment interest.

ADVANCE PRICING AGREEMENTS (APA)

- APAs are available at no charge.
- An application for an APA may be filed only in respect of a future transaction or an operation to be carried out after the application is filed provided that the situation and TP issues are complex.
- The deadline for issuing an APA by the tax authorities is 60 days, extendable by 60 days.
- APA binds tax authorities throughout the entire period of the transaction but no longer than 5 calendar years after the year in which the decision was adopted.
- The APA is not binding on the taxpayer.

BELARUS

GENERAL RULES

- The scope of transfer pricing rules has been extensively reviewed and now covers the following transactions:
  - transactions on sale or purchase of real estate, housing bonds, if the transaction price deviates by 20 % or more from the market price;
  - transactions with related parties or offshore residents and concluded in the course of foreign trade activity, including via a chain of transactions with an intermediary/unrelated party, if the transaction price (or the sum of transactions with one person) on sales or purchase of goods, works, services exceeds BYR 1 billion (approx EUR 43,300), net of indirect taxes;
  - transactions with Belarusian residents enjoying a special regime which grants them exemption from corporate income tax payments, if the transaction price (or the sum of transactions with one person) on sale or purchase of goods, works, services exceeds BYR 1 billion (approx EUR 43,300), net of indirect taxes;
  - transactions on sale/purchase of goods, services, works in the course of foreign trade activity of an entity which has sold/purchased strategic goods from the list established by the Government, if the transaction price (or the sum of transactions with one person) on sales or purchase of goods, works, services exceeds BYR 10 billion (approx EUR 433,000), net of indirect taxes;
  - transactions by a major taxpayer under Belarus law with one person, if the transaction price (or the sum of transactions with one person) on sale or purchase of goods, works, services exceeds BYR 10 billion (approx EUR 433,000), net of indirect taxes.

DEFINITION OF RELATED PARTY

- The definition of related party includes:
  - parties that are founders (shareholders) of one company;
  - a party that is a founder (shareholder) of another company, if its direct and (or) indirect participation share in that company is not less than 20%;
  - a party that subordinates to the other party in the way of its legal status or one party is directly or indirectly under the control of the other party;
  - companies, if one party directly and (or) indirectly participates in those companies and their participation share is not less than 20%;
  - individuals that are in marital relations, in relations of proximity of blood or in-law relationship, adoption or custody;
  - parties in relations of trust management.

TP DOCUMENTATION REQUIREMENTS

- TP documentation requirements include notifying and submitting an economic rationale of the transaction price and/or appropriate TP documentation.
- Taxpayers must notify the tax authority of controlled transactions by entering information on those transactions into an electronic invoice and sending the invoice by means of a special portal to the Ministry of Taxes and Duties.
- Taxpayers must file an economic rationale of the transaction price and/or appropriate TP documentation if they carried out major transactions, being transactions in excess of BYR 10 billion by major taxpayers or with strategic goods.

MANDATORY TP DOCUMENTATION CONTENT

- TP documentation should include eg:
  - description of the economic activity of the taxpayer and functions performed in the transaction being considered;
  - information on the field of taxpayer`s activity (tendencies, peculiarities of development);
  - information on the parties to the transaction;
  - information on prices of identical (similar) goods/works/services, including those posted on the web, where a link to the site or a screen shot of the page would suffice;
  - information on the interdependence between the taxpayer and party to the transaction and information on its activity, reputation, financial status;
  - description of the transaction subject, including the trade nomenclature of foreign trade activity;
  - other information that may prove that the transaction was carried out in accordance with the arm`s length principle.

RECOGNISED TP METHODS

- The following TP methods are used in Belarus:
  - comparable uncontrolled price method;
  - resale price method;
  - cost plus method;
  - comparable profits method;
  - profit split method (the method of last resort, has been introduced since 1 January 2016).

TAX AUDITS AND PENALTIES

- Tax audits are normally performed going back 3 years.
- No special liability is provided for breach of transfer pricing rules. General norms on administrative liability for non-payment of taxes are applicable. Amounts of administrative fines vary depending on the circumstances accompanying the administrative offence on non-payment of taxes and may be up to 20% of unpaid tax.

EXTENT OF ENFORCEMENT

- As a result of the new notification requirements, the tax authorities can monitor all controlled transactions carried out by taxpayers and decide on appointing an audit or requiring additional clarification from the taxpayer if prices in controlled transactions do not comply with the arm's length principle.
- If audit reveals that the tax base of CIT to be paid by the taxpayer is not in line with that calculated by the tax authorities under the arm`s length principle, the tax authorities may calculate additional amounts of tax and penalties to be imposed on the taxpayer.

ADVANCE PRICING AGREEMENTS (APA)

- Advance pricing agreements are not possible in Belarus.The APA is not binding on the taxpayer.

SORAINEN

ESTONIA LATVIA LITHUANIA BELARUS

SORAINEN has played a role in transfer pricing (TP) projects for local and international clients. Highlighted below are some recent cases on TP projects involving the firm:

- Preparing TP documentation for Technopolis Lietuva, a Lithuanian company of the multinational Technopolis group operating in the Scandinavian region. SORAINEN prepared the Technopolis group's TP documentation to demonstrate that pricing for intra-group services and financing transactions is in line with the arm's-length principle.
- Continuously advising **Gjensidige Baltic**, the Baltic subsidiary of the largest Norwegian non-life insurer, Gjensidige Forsikring, in developing the group's TP documentation for Baltic entities and assessing its compliance with tax law requirements in Estonia, Latvia and Lithuania. SORAINEN advised on minimisation of TP risks in the Baltic States.
- Developing TP policy **for a Lithuanian manufacturer and distributor of biomass boiler plants in the Baltic States and Ukraine**. SORAINEN prepared TP policy for justification of pricing applied for such intra-group transactions as manufacturing services, automation services, management and support services, sale of spare parts and provision of loans.
- Advising a **fast-food chain operator in Finland and Latvia** on TP issues in several types of related-party transaction.
- Designing and implementing TP policy document for accounting, advisory and financial services for a **fuel retailer in Latvia**.
- Assessing TP risks of a **Latvian company in an international retail chain involved in retail sale of household goods that operates in 35 countries and is a leader in the European market**. SORAINEN prepared an appeal against the Latvian tax authorities' decision after TP audit.
- Advising a **commercial bank in Lithuania** on tax and TP issues related to cash pooling arrangements.
- Advising **Nordic retail business operating department stores** on tax and TP issues regarding related party transactions.
- Advising **one of the largest banks in Lithuania** on TP issues, including drafting documentation and benchmarking of overnight deposits, correspondent accounts, derivatives and other funding arrangements.

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