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B: The future of transfer pricing

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Summary and conclusions

Historically, Ukrainian transfer pricing (TP) regulations at the level of laws have existed for a long time; however, the provisions were rather basic. In September 2013, a tax reform was launched, which introduced more detailed and full-fledged TP regulations which are generally based on OECD TP guidelines.

According to Ukrainian TP regulations, only cross-border transactions of Ukrainian taxpayers can be potentially qualified as controlled transactions falling under the scope of TP control, while intra-Ukrainian transactions between Ukrainian taxpayers are outside the scope of the regulations. Importantly, not only cross-border transactions with related non-residents can fall within the scope of TP control, but also transactions of Ukrainian taxpayers with non-related non-residents from "low-tax" jurisdictions and some others.

If a Ukrainian taxpayer was involved in controlled transactions during a reporting period then it has to (a) submit a report on controlled transactions and (b) provide TP documentation (i.e. local file) upon separate request of tax authorities. As of now, there is no requirement for the preparation and provision of master files or country-by-country reports (CbCR); however, it is expected that such requirement may be introduced into Ukrainian TP regulations soon.

Although the full-fledged TP regulations have been already amended several times after they were implemented in Ukraine in 2013, there are still many gaps and issues which are not addressed. In particular, Ukrainian TP regulations in their current state do not contain a separate definition of intangibles for TP purposes; special rules for recognition of transactions with intangibles; special rules on DEMPE[1] functions in relation to intangibles; rules for identification of group synergies; rules on the valuation of hard-to-value intangibles (HTVI), rules on cost contribution agreements (CCAs), rules regarding control of the return on capital or compensation for the assumption of risk; and special rules on the application of the profit split method in the context of value chains. There is no information about whether any of these issues will be addressed with the next round of amendments into Ukrainian TP regulations.

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1 Development, enhancement, maintenance, protection, and exploitation.

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That said, the Ukrainian TP regulations contain special rules in relation to controlled transactions on the import/export of certain commodity goods (i.e. the so-called sixth method). Particularly, there is a separate list of commodity goods in relation to which prices should be verified with the comparable uncontrolled price (CUP) method based on prices from international commodity exchanges.

The next round of amendments to Ukrainian TP rules and the next leap forward is expected with the implementation of the concept of the "deoffshorization" tax reform. The reform is heavily influenced by the base erosion and profit shifting (BEPS) project and it was announced by Ukrainian government in May 2016 in the form of a presentation. It is expected that the draft law for its implementation will be made public by the end of 2016.

This may introduce a number of TP changes in the Ukrainian TP regulations which are mostly driven by TP actions of the BEPS project, particularly Actions 8–10 and 13. Among the most important changes will probably be the introduction of master files and CbCR, further detail and clarification of the rules applicable to export/import transactions with commodities and the introduction of special rules for intra-group low value-adding services (the list of expected changes is not exhaustive). The issue of automatic exchange of tax information with the tax authorities of other countries is also raised by the reform and may be implemented.

It should be noted that besides TP related changes driven by TP actions of the BEPS project, the reform should also introduce other non-TP related changes which, however, are also driven by the BEPS project. The most significant of them are introduction of controlled foreign corporation (CFC) rules, rules introducing limitations on deduction of interest and other financial payments with related non-resident companies, measures on preventing the granting of double tax treaty benefits in inappropriate circumstances and measures on preventing the artificial avoidance of permanent establishment status.

Summarizing, it should be noted that there has been no actual effect of the BEPS project as of the date of this report either on Ukrainian tax legislation in general, or on its TP regulations in particular. However, it is expected that the BEPS driven changes may be introduced in Ukrainian legislation by the end of 2016 with the implementation of the tax reform.

1. Current TP regulation and practice in Ukraine

Historically, Ukrainian TP regulations at the level of laws have existed for a long time; however, the provisions were rather basic. In September 2013, a tax reform was launched, which introduced more detailed and full-fledged TP regulations. Ukrainian TP regulations are generally in line with OECD TP guidelines.

As of now, the major TP source in Ukraine is article 39 of the Tax Code of Ukraine (TCU). Article 39 became effective on 1 September 2013 and underwent a number of amendments afterwards. The latest major amendment was introduced in August 2015. Along with that, a set of TP matters are addressed in various by-laws adopted pursuant to article 39 of the TCU and with the purpose of detailing of its provisions. The list of the most important by-laws is provided in the annex.

As of the date of this report the following types of cross-border[2] transactions may be qualified as controlled for the purposes of the TP regulations:

- between residents and related non-residents;
- between residents and non-residents[3] registered in "low-tax" jurisdictions (the list of such jurisdictions is adopted by the Cabinet of Ministers of Ukraine);[4]
- on sales of goods through non-resident commissionaires;
- with related non-residents or non-residents registered in "low-tax" jurisdictions involving non-related intermediaries which do not perform essential functions, do not use essential assets and do not bear essential risks.[5]

These types of transaction can be qualified as controlled only if the following thresholds are simultaneously exceeded:

- the annual income of the Ukrainian taxpayer from any activity exceeds UAH 50 million/approximately €1.7 million; and
- the annual amount of transactions of the Ukrainian taxpayer with qualified counterparties exceeds UAH 5 million/approximately €179,000.[6]

Once these thresholds are exceeded and a transaction is qualified as a controlled one for TP purposes, a Ukrainian taxpayer is required to comply with the following requirements:

(a) to submit a report on controlled transactions before 1 May of the year following the reporting year;

(b) upon the request of the tax authorities to provide TP documentation in relation to controlled transactions for the reporting year within one month from the date of receipt of the request.

Ukrainian legislation provides for the following methods of evaluation of transfer prices within the controlled transactions:

- the comparable uncontrolled price (CUP) method;
- the resale price method (RPM);
- the cost plus method (CPM);
- the transactional net margin method (TNMM);
- the profit split method (PSM).

[2] After the introduction of the Ukrainian TP rules in 2013, the transactions of Ukrainian residents with other Ukrainian residents, which satisfy certain criteria, were also within the scope of TP control and could potentially be qualified as controlled transactions. However, these provisions were later amended and transactions between Ukrainian residents were excluded from the scope of TP control.

[3] Even if a Ukrainian resident and a non-resident are not related parties.

[4] Currently, the criteria for the Cabinet of Ministers of Ukraine to include jurisdictions into the list are as follows: (a) the general corporate profit tax rate in jurisdiction is 5 per cent lower than in Ukraine (i.e. 18 per cent); (b) there are no international agreements concluded between this jurisdiction and Ukraine on the exchange of information.

[5] As of now, there is a draft law No. 5368, On amending the Tax Code of Ukraine (regarding improving the investment climate in Ukraine) dated 7 November 2016 which, if adopted, will include within the scope of TP control the following: transactions on the purchase of goods through non-resident commissionaires and transactions with non-residents (i.e. including those non-related) which do not pay corporate profit tax or are exempt from it.

[6] As of now there is a draft law No. 5368, On amending the Tax Code of Ukraine (regarding improving the investment climate in Ukraine) dated 7 November 2016 which, if adopted, may increase thresholds to UAH 150 million (approximately €5.3 million) and UAH 10 million (approximately €359,000) respectively.

A taxpayer may select any method that it considers on a reasonable basis to be the most appropriate one (a combination of two and more methods is allowed). However, the method hierarchy is as follows:

- if it is possible to apply the CUP method and any other method, the CUP method is preferable;
- if it is possible to apply RPM/CPM and TNMM/PSM, RPM/CPM is preferable.

There are also special rules in relation to controlled transactions on the import/export of certain commodity goods (i.e. the so-called sixth method). A detailed description of those rules is provided in section 2.4.1 of this report.

According to recent statistics provided by the State Fiscal Services of Ukraine in relation to the 2015 fiscal year,[7] the tax authorities have reviewed more than 1,900 reports on controlled transactions, have requested 41 taxpayers to provide TP documentation and have conducted three TP audits. It is expected that the number of TP audits will increase by the end of 2016 and in the following years.

The court practice on TP matters is currently not large and is under development. This is explained by the relatively recent introduction of full-fledged TP regulations and by the relatively low number of TP audits conducted. Given that the majority of court cases on TP matters which are now available mostly relate to basic technical issues such as identification of controlled transactions and the necessity to submit reports on them.

As of the date of this report, no recommendations of the BEPS project have been introduced in Ukrainian legislation. However, in May 2016 the Ukrainian government announced the concept of the "deoffshorization" tax reform, which is highly influenced by the BEPS project. The reform was announced in the form of a presentation prepared by the working group within the government and contains the list of expected changes and their main points. It is expected that the draft law for implementation of the reform will soon be made public.

2. The impact of the BEPS project on TP

2.1. Introduction

Although Ukraine is not a member of the OECD, the development of the BEPS project was closely monitored by the Ukrainian tax professional community since its very beginning in 2012.

One of the first attempts to introduce BEPS driven changes in Ukrainian TP legislation was proposed in 2015 in the draft law on the tax reform[8] prepared by the Ministry of Finance. Among a number of changes proposed by the 2015 Reform Draft Law, the following were related to TP:

7 Report on completion of the Work Plan of the State Fiscal Service for 2015, http://sfs.gov.ua/data/files/131201.pdf.

8 Draft law No. 3630, On the creation of competitive terms for the taxation and enhancement of business activity in Ukraine, dated 11 December 2015.

- the introduction of a three-tier system of reporting (i.e. in addition to local documentation, qualifying taxpayers were required to prepare and provide the master file and CbCR; and
- the introduction of special rules for low value-adding services.

However, the 2015 Reform Draft Law was not adopted by the Ukrainian Parliament.

On 21 March 2016, the National Bank of Ukraine, the State Fiscal Service of Ukraine and the Anti-Monopoly Committee of Ukraine discussed a combined strategy on TP and deoffshorization initiatives and mentioned the BEPS project in this regard.[9] In particular, the Head of the National Bank of Ukraine commented that it was very important to discuss the deoffshorization model which would result in an increase of transparency and identification of beneficial owners, and that this direction had already been chosen by EU countries in accordance with the BEPS project developed by OECD.

The next step of discussion of the BEPS project by Ukrainian society was triggered by the "Panama Papers" leak which happened in April 2016 and caused huge anti-offshore discussion in Ukraine.

Subsequently, few draft laws suggesting various deoffshorization initiatives, which included some BEPS-driven recommendations, were registered in the Ukrainian Parliament during April and May of 2016.[10] None of them was approved by the Ukrainian Parliament.

On 28 April 2016, the President of Ukraine signed the Decree, On actions concerning countering BEPS, calling for the creation of a special working group with a mission to draft laws embodying a comprehensive reform by mid-June 2016. As a result, the Ukrainian government announced the concept of the "deoffshorization" tax reform in May 2016.

This was announced in the form of a presentation prepared by the working group within the government and contained the list of expected changes and their main points. Besides a number of changes which did not relate to TP, a number of changes were suggested in the Ukrainian TP regulations, particularly:

- the recognition of transactions between non-residents and their Ukrainian-based permanent establishments as controlled subject to TP control (if certain thresholds were exceeded);
- the introduction of the requirement for Ukrainian-based permanent establishments of non-residents to submit reports on controlled transactions and TP documentation (once TP control is applicable);
- the introduction of the requirement to submit CbCR once certain conditions are met;
- the introduction of the requirement to submit the master file once certain conditions are met;
- further detail and clarification of rules applicable to export/import transactions with commodities;
- the introduction of the requirement to disclose in TP documentation (i.e. local file) (a) information on transactions with intangibles and (b) information on

9 https://www.bank.gov.ua/control/uk/publish/printable_article?art_id=28946015&showTitle=true.

10 Particularly, draft laws No. 4380 as of 12 April 2016, No. 4381 as of 12 April 2016 and No. 4636 as of 11 May 2016.

the calculation and allocation of income/expenses which are influenced by transactions with controlled parties if such income/expenses are taken into account upon calculation of the profit level indicator in the controlled transaction analysed;
- the introduction of special rules for intra-group low value-adding services which are supplied and received within a group;
- an increase of fines for failure to report controlled transactions in the TP report and for failure to submit TP documentation.

As of October 2016, no draft law implementing the provisions of the reform had been registered in the Ukrainian Parliament. However, it is generally expected that this draft law will be announced by the end of 2016.

In October 2016, the Head of the National Bank of Ukraine commented that she considers the BEPS project to be one of the most important conditions for currency liberalization in Ukraine and confirmed that the government intended to implement 10 of the 15 BEPS measures.[11]

Summarizing, it should be noted that as of the date of this report there has been no actual effect of the BEPS project either on Ukrainian tax legislation in general, or on its TP regulations in particular. However, it is expected that BEPS driven changes may be introduced in Ukrainian legislation by the reform, which is expected to be adopted by the end of 2016.

2.2. Challenges of transactions with intangibles

2.2.1. Definition of intangibles

Currently there is no special definition of intangibles for TP purposes in Ukrainian legislation, and the general tax definition of intangibles provided in the TCU should be used also for TP purposes.

The definition is provided in the TCU and is as follows:[12]

> “intangibles are ownership of the results of intellectual activity including industrial ownership and other similar rights recognized as objects of property rights (intellectual property), the right to use taxpayer’s property and property rights according to the law including the rights to use natural resources, property and property rights acquired according to the law…”

Separately, the TCU also identifies goodwill as a specific intangible asset which is subject to special tax treatment.

The definition of intangibles provided in the TCU also refers to and includes the definition of objects of intellectual property provided in the Civil Code of Ukraine including the following:[13]
- literary and art works;
- software;
- compilations of data (databases);

11 http://biz.nv.ua/bizinterview/valjutnogo-regulirovanija-bolshe-ne-budet-emu-na-smenu-pridet-nalogovoe-gontareva-236060.html.
12 Para. 14.1.120 of the TCU.
13 Art. 420 of the Civil Code of Ukraine.

- performances;
- phonograms, films, sound recordings and broadcasts;
- scientific discoveries;
- inventions, utility models, industrial designs;
- topographies of integrated circuits;
- rationalization proposal;
- plant varieties, animal breeds;
- trade names, trademarks, geographical indications;
- commercial secrets.

It can be concluded that the definitions of intangibles provided in Ukrainian tax law and in Ukrainian civil law are too narrow for TP since they do not capture/recognize specific intangibles[14] which may be important from a TP perspective.

Given that, Ukrainian legislation provides for a different definition of intangibles for accounting purposes. This definition is provided in the Ukrainian Accounting Regulation (standard) no. 8, Intangibles[15] and is as follows: "An intangible is a non-monetary asset which does not have a material form and can be identified."

Obviously, the accounting definition of intangibles is too broad for its proper application for TP purposes.

Therefore, Ukrainian TP regulations do not contain any special definition of intangibles for TP purposes. Instead, the general tax definition (which also refers to civil law definition) should be used, though it does not capture/recognize some specific intangibles which may be relevant for TP purposes.

As of now, there is no information about whether any separate definition of intangibles for TP purposes or any changes in present tax definition of intangibles aligned with Actions 8–10 of the report will be introduced in the Ukrainian legislation with the implementation of the reform.

2.2.2. Transactions with intangibles

There are no special rules on the identification of transactions with intangibles in Ukrainian TP regulations.

That said, transactions with intangibles are covered by general TP rules which provide that, among other things, the following business transactions should be recognized for TP purposes:[16]

- transactions with goods, such as raw materials, finished products, etc.;
- transactions on the provision of services;
- transactions with intangibles, such as royalties, licences, payment for use of patents, trademarks, knowhow, and any other intellectual property objects;
- financial transactions, including leasing, participation in investment, credits, commission and guarantee, etc.;
- transactions on the purchase or sale of participatory interests, shares and other investments, purchase or sale of long-term tangible and intangible assets.

[14] In particular, the special knowledge of employees/management, databases of clients, contractors of subcontractors, etc.

[15] Order of the Ministry of Finance of Ukraine No. 242, On adoption of Provision (standard) of accounting, dated 18 October 1999.

[16] Para. 39.2.1.4 of the TCU.

These listed transactions should be recognized for TP purposes regardless of whether they are documented or not. Therefore, confirmation of transactions by documents is not decisive for their recognition for TP purposes.

Given that, the reform may introduce some additional rules in the Ukrainian TP regulations which would allow the tax authorities to identify transactions with intangibles.

First of all, the Concept may introduce a requirement to indicate additionally in TP documentation (i.e. the local file) information in relation to intangibles, particularly:

- information about the involvement of a taxpayer in business restructuring or transfer of intangibles during the reporting or preceding period, with an explanation of the transactions;
- a description of transactions on the acquisition of services, intangibles and other business objects different from goods, including a description and justification of their economic feasibility and business purpose (in the absence of such justification it is considered that the value of the transaction is zero).

Also, the reform is expected to introduce a requirement for multinational companies (MNEs) to provide a master file (as described in detail below). The following information on intangibles used by MNEs in their activities should be provided in the master file:

- a general description of the R&D strategy of the MNE;
- a list of intangibles (or their groups), which are owned by the MNE, indicating company owners;
- a list of the most essential intra-group agreements in relation to intangibles (including licence agreements) and the TP policies of MNEs in relation to transactions with intangibles and transactions related to R&D;
- information on the transfer of essential intangibles (also for use) during a reporting year, indicating companies, jurisdictions and compensation.

That said, these expected changes will serve as a tool for identification of transactions with intangibles. There is no further information about whether the reform will introduce any specific rules on the identification of transactions with intangibles.

2.2.3. "Substance-over-form" approach towards intangibles

There are no special "substance-over-form" approach rules in Ukrainian TP regulations in relation to transactions with intangibles. However, such an approach for TP purposes should be applicable by default, as it follows from general TP principles established by the Ukrainian TP regulations.

The following in particular implies the priority of the "substance-over-form" approach for the application of TP in Ukrainian TP regulations (also in relation to controlled transactions with intangibles):

- the arm's length principle as the core of Ukrainian TP regulations, which should be used for determination of the taxable profit of a controlled taxpayer;[17]
- a comparability analysis, which is required for correct application of the arm's length principle, and which includes comparability of functions, assets and risks (FAR);[18]

[17] Para. 39.1.1 of the TCU.
[18] Para. 39.2.2.2 and 39.2.2.3 of the TCU.

- a FAR analysis with a focus on actually performed functions, undertaken risks and used assets, which *inter alia* mentions such functions as development, marketing, etc.;[19]
- last but not least, provision that both documented and non-documented transactions should be recognized for TP purposes.[20]

Therefore, although Ukrainian TP regulations do not directly contain such a requirement, application of the “substance-over-form” approach in transactions with intangibles based on these principles from a TP perspective is a must, and an analysis beyond simple legal ownership is required. Similarly, it may be necessary to analyse DEMPE functions[21] in relation to transactions with intangibles, since this is required for the correct application of the arm’s length principle (although DEMPE functions are not directly mentioned in Ukrainian TP regulations and there is no direct requirement to analyse them).

Moreover, the necessity to apply the “substance-over-form” approach for TP analysis in transactions with intangibles is also supported by the approach of the tax authorities in relation to non-TP related tax issues.

In particular, the “substance-over-form” approach is one of the doctrines which should be used by Ukrainian tax authorities for the scrutiny of various transactions for tax purposes. A detailed instruction regarding its application is provided in the Letter of State Tax Service of Ukraine[22] No. 3848/7/10-1017/575 dated 15 February 2013. In particular, the letter clarifies that the “substance-over-form” approach requires the tax authorities to take into account the economic results of business transactions regardless of the documentation.

The “substance-over-form” approach is also widely used by Ukrainian courts for the resolution of tax disputes. The latest examples of the application of this approach can be found, for example, in the following cases by the High Administrative Court of Ukraine.[23]

In all these cases, the courts followed the “substance-over-form” approach. There is also a sign of the application of this approach by the Ukrainian courts in TP-related disputes.[24]

To sum up, there are no separate “substance-over-form” approach rules in the Ukrainian TP regulations as of now in relation to transactions with intangibles. The status of DEMPE functions in relation to intangibles is not mentioned directly, either. However, the “substance-over-form” approach may be applied and DEMPE functions may and should be analysed in the transactions with intangibles based on the general provisions of Ukrainian TP regulations. That said, there is no information on whether any more specific and detailed rules in this regard will be introduced in Ukrainian TP regulations with the implementation of the reform.

19 Para. 39.2.2.4 and 39.2.2.5 of the TCU.
20 Para 39.2.1.4 of the TCU.
21 Development, enhancement, maintenance, protection and exploitation.
22 Former name of the State Fiscal Services of Ukraine.
23 Court cases No. 814/5234/13-a, No. 821/354/16, No. 826/17720/14 and No. 2a/0370/3879/12.
24 Court case No. P/811/2372/15.

2.2.4. Comparability and group synergies

Comparability issues, as well as the need for comparability adjustments, can also arise because of the existence of MNE group synergies.[25]

Currently, Ukrainian TP regulations do not provide any specific rules for the identification of group synergies for TP purposes.

According to the general provisions of Ukrainian TP regulations[26] controlled transactions are considered comparable with uncontrolled transactions provided:

- there are no significant differences between them which can essentially affect the financial results during the application of a particular TP method; or
- such differences may be eliminated by adjusting the terms and financial results of uncontrolled transactions aiming to eliminate any impact on comparability.

Ukrainian TP regulations provide for the following list of elements for the comparability analysis of controlled and uncontrolled transactions:[27]

- the characteristics of goods/services which are the subjects of the transaction;
- the functions which are performed by the parties to the transactions, assets used by them, terms of allocation of risks and benefits between the parties, allocation of responsibilities and other conditions of transactions;
- the established practice of relations and terms of agreements, which essentially influence the prices of goods/services;
- the economic conditions of activity of the parties including analysis of the markets of goods/services which essentially influence the prices of goods/services;
- the business strategies of the parties (if any) which essentially influence the prices of goods/services.

Therefore, group synergies are not mentioned directly for the purposes of comparability analysis.

As of now, there is no information as to whether any separate rules in relation to the identification of group synergies will be introduced in the Ukrainian TP regulations with the implementation of the reform.

2.2.5. HTVI

Currently, Ukrainian TP regulations do not contain any special provisions for the valuation of HTVI. As of now, there is no information on whether any specific rules in this regard will be introduced in the Ukrainian TP regulations with the implementation of the reform.

2.2.6. CCAs

Currently, CCAs are not recognized in Ukraine as a concept. As a basic accounting rule in Ukraine, costs should be allocated with respect to incomes which were gen-

[25] Para. 1.157 s. D.8, chapter I of the OECD TP guidelines (amended by the BEPS final reports 2015 on Actions 8–10).
[26] Para. 39.2.2.1 of the TCU.
[27] Para. 39.2.2.2 of the TCU.

erated by these costs. Any contribution of costs breaking the above-mentioned rule will be very strictly scrutinized by the Ukrainian tax authorities and such deductions may be potentially limited. Moreover, the general approach of the Ukrainian tax authorities is that all costs have to be confirmed by appropriate tangible evidences (i.e. depending on the nature of services at issue) and supported by primary documents.

Also, as of now there is no information about whether any separate rules in relation to CCAs will be introduced in the Ukrainian TP regulations with the implementation of the reform.

2.3. Risk and capital

Ukrainian TP regulations do not contain any special provisions regarding control of the return on capital or compensation for the assumption of risk. As of now, there is no information on whether any separate rules in this regard aligned with Actions 8–10 of the report will be introduced in the Ukrainian TP regulations with the implementation of the reform.

2.4. High-risk transactions

2.4.1. CUP and quoted prices for cross-border commodity transactions

Currently, Ukrainian TP regulations contain special rules in relation to controlled transactions on the import/export of certain commodity goods (i.e. the so-called sixth method).[28]

In particular, the Cabinet of Ministers of Ukraine approves the list of commodity goods which are subject to these special rules.[29] Prices in qualifying transactions should be verified by the CUP based on the prices for the commodity goods in question from international commodity exchanges, the list of which is also approved by the Cabinet of Ministers of Ukraine.[30] The range of prices should be calculated based on the prices quoted for the commodity goods for the decade preceding the date of the controlled transaction.

Should the taxpayer decide to use another TP method for the verification of the prices in such a controlled transaction,[31] it must provide information on all related parties, which were engaged in the supply chain of the commodity goods traded in the controlled transaction, up to the first non-related party, and indicate their profit level indicators according to the applied TP method. This information should be submitted before 1 May following the reporting year. If this information was not provided or was partially provided by the taxpayer, the tax authorities can verify the prices in the controlled transaction at issue using CUP.

[28] Para. 39.2.1.3 of the TCU.

[29] Regulation of the Cabinet of Ministers of Ukraine No. 616 dated 8 September 2016, On adoption of the list of goods which have stock exchange quotations, and of international stock exchange markets for verification if conditions of controlled transaction comply with arm's length principle.

[30] *Ibid.*

[31] Particularly RPM, CPM, TNMM or PSM.

It is expected that implementation of the reform will elaborate and detail the above rules in relation to transactions with commodities, particularly in that part of the provisions regarding disclosure of information on related companies involved in the supply chain of such goods (up to the first non-related company). Separate penalties for non-disclosure may be introduced.

2.4.2. Intra-group services

Historically, intra-group services were always the focus of Ukrainian tax authorities and were usually scrutinized.

In this regard, intra-group services transactions are usually tested from the perspective of the "business purpose" doctrine, the "reality of a transaction" doctrine and some others, which are listed in the Letter of the State Tax Service of Ukraine[32] No. 3848/7/10-1017/575 dated 15 February 2013. In particular, the "business purpose" doctrine provided that a transaction must have a business purpose, meaning that a taxpayer was expected to obtain a positive economic effect as a result of the transaction (i.e. increase or retention of the asset's value or the creation of conditions allowing this to be achieved in the future). In turn, the "reality of a transaction" doctrine provides that only business transactions actually performed are recognized for tax purposes, not transactions which are only executed "on paper".

The Ukrainian tax authorities also usually review that all costs incurred in relation to a transaction should be confirmed by primary documents and appropriate tangible evidence (i.e. depending on the nature of services at issue).

It should be noted that Ukrainian TP regulations do not contain any special provisions regarding intra-group services. As of now, the concept of low value-adding intra-group services is not reflected in Ukrainian TP regulations either.

In the past, however, there was an attempt to introduce special rules for the low value-adding services into Ukrainian TP regulations. A 2015 Reform Draft Law was prepared by the Ministry of Finance. The proposed rules were generally in line with the final report on Actions 8–10 of the BEPS project. In particular, they allowed taxpayers to prepare simplified TP documentation in relation to transactions with qualifying services.

According to the 2015 Reform Draft Law the use of special rules for low value-adding services was allowed only under the following conditions:

(a) the services at issue should be qualified as "low value-adding services",[33] providing that the following criteria should be satisfied:
   - the services are of a supportive nature;
   - the services are not part of core business of the recipient;
   - the services do not require the use of unique and valuable intangibles and do not lead to the creation of such intangibles;
   - the services do not involve significant risks and do not lead to the creation of significant economic risks;

(b) in case of application of CPM, RPM, TNMM the profit level indicator in such transactions should be equal to 5 per cent (based on an appropriate cost base).

[32] Former name of the State Fiscal Services of Ukraine.

[33] Some examples of low value-adding intra-group services are: accounting, internal audit, management of accounts receivable/payable, human resources, protection of the environment, IT support (except for services in software development), legal and tax, etc.

The 2015 Reform Draft Law indicated that the simplified TP documentation according to special rules should not be applicable to the following activities:

- services constituting the core business of the taxpayer or its counterparty;
- R&D services (including software development);
- manufacturing services (including the manufacturing of products upon request with the use of the raw materials of the customer or service provider);
- purchasing activities relating to raw materials or other materials that are used in the manufacturing process;
- marketing and sales promotion activities;
- financial transactions;
- services for the search, exploration or extraction of natural resources;
- insurance and reinsurance;
- management services involving senior management which takes key decisions for the taxpayer's activity.

The 2015 Reform Draft Law with the described special rules for low value-adding services was not adopted by the Ukrainian Parliament. However, it is expected that similar rules in relation to low value-adding services will be introduced with implementation of the reform.

2.4.3. Profit splits in the context of value chains

There are no special rules in Ukrainian TP regulations regarding the application of the profit split method in the context of value chains. As of now, there is no information about whether any BEPS-driven changes in relation to PSM in the context of value chains will be introduced in the Ukrainian TP regulations by the reform.

That said, Ukrainian TP regulations contain some provisions regarding the application of the PSM, in particular:

- it provides for the allocation to every party to a controlled transaction of a part of combined profit and loss realized in the controlled transaction which would be realized by non-related party in a comparable uncontrolled transaction;
- if the parties to controlled transaction(s) maintain their accounting and financial reporting according to different standards and methods, their reporting should be brought into accordance with single methodological accounting standards for the purpose of application of the PSM;
- the PSM is most appropriate in the following situations (not exclusively):
  - when controlled transactions are closely related to other transactions performed by the parties to the controlled transactions;
  - when parties to a controlled transaction own (or use) intangibles which essentially affect the profitability level;
- the allocation of profit between the parties to a controlled transaction(s) is performed based on estimated results of their contribution to the combined profit. This allocation is performed according to the criteria based on objective data and is confirmed by information in comparable transactions and/or internal data of parties to the controlled transaction(s) taking into account the functions performed, assets used and economic (commercial) risks borne;
- the combined profit of the parties to a controlled transaction(s) is defined as a sum of profit of the parties to such transaction(s), while residual profit (loss)

is defined as a difference between combined profit (loss) from the controlled transaction(s) and the amount of profit (loss) of parties to controlled transaction(s) calculated in accordance with other TP methods (CUP, RPM, CPM, TNMM) based on a FAR analysis;
- for the allocation of combined or residual profit (loss) between the parties to a controlled transaction(s) the following factors may be used (not exclusively):
  - the amount of expenses of each party in relation to the development of intangibles, whose use influences the amount of actual profit (loss) of the controlled transaction(s);
  - the characteristics of personnel engaged by each party to a controlled transaction(s) which influence the amount of actual profit (loss) of the controlled transaction(s) including the number of such personnel, qualification, time actually spent, payroll costs;
  - the market value of assets used by each party to a controlled transaction(s) and which influenced the amount of actual profit (loss) of controlled transaction(s);
  - other factors which are related to the performance of functions, use of assets, undertaking of commercial risks and the amount of profit (loss) actually received by each party to the controlled transaction(s).

2.5. TP documentation

2.5.1. CbCR

As of now, preparation/submission of CbCR are not required by the Ukrainian TP regulations.

In the past, there was an attempt to introduce a three-tier system of reporting into Ukrainian TP regulations requiring submission of CbCR and the master file in addition to local TP documentation package by the 2015 Reform Draft Law prepared by the Ministry of Finance of Ukraine. As of the date of this report, however, has not been adopted by Parliament.

Now it is expected that CbCR will be introduced into the Ukrainian TP regulations with the implementation of the reform. Brief outlines of expected CbCR rules are as follows:
- Alongside submission of report on controlled transactions, a Ukrainian taxpayer, which is a member of MNE, is required to submit a notice of being a member of an MNE.
- A Ukrainian taxpayer, which is a member of MNE, is required to submit CbCR if the annual turnover of the MNE for the previous year exceeded €750 million. There is also a lower threshold of €50 million in cases where the MNE has a strong relation with Ukraine, particularly:
  - 50 per cent or more of the MNE’s shares are held by Ukrainian tax residents or citizens; or
  - 50 per cent or more of the MNE’s employees are located in Ukraine; or
  - 50 per cent or more of the book value of the MNE’s fixed assets are located in Ukraine; or
  - 50 per cent or more of consolidated income of the MNE is derived from Ukraine.

- CbCR is to be submitted to the Ukrainian tax authorities within 12 months after the end of the financial year of the MNE's HQ (or the end of the calendar year).
- The report may be submitted in English without translation into Ukrainian.
- The CbCR must include the following information in relation to each country where MNE company(ies) are registered:
  - the country of tax residency;
  - the amount of income from the sale of goods/services (separately to related and to non-related parties);
  - the amount of taxable profit;
  - the corporate profit tax due and paid in the reporting year;
  - the amount of charter capital;
  - the amount of undistributed profits at the end of the reporting year;
  - the average number of employees for the reporting year;
  - the balance value of fixed assets except for (a) funds and their equivalents, (b) intangible assets and (c) financial assets;
  - the country of registration (if this country and tax residency are different);
  - the main types of activity;
  - other information at the discretion of the taxpayer.
- Fines in relation to CbCR are as follows:[34]
  - the fine for late submission or failure to submit CbCR is approximately €150,000;
  - the fine for failure to include an MNE's income in CbCR is 1 per cent of the amount of such income but not more than approximately €495,500;
  - the fine for failure to submit CbCR within 10 days after the deadline for payment of the fine for failure to submit CbCR is approximately €495 accruing daily for each further day of non-submission.

It is expected that the above rules in relation to CbCR will be introduced in the Ukrainian TP regulations in line with the announced reform. A draft law is expected by the end of 2016.

In regard to the legal infrastructure for implementation of automatic exchange of CbCR, it should be noted that Ukraine has been a participant in the Convention on Mutual Administrative Assistance in Tax Matters starting from 2009.

However, as of now Ukraine has not joined the Multilateral Competent Authority Agreement on the Exchange of CbC Reports (MCAA CbC) yet, which is required for implementation of automatic exchange of CbCR.

Bilateral treaties on the automatic exchange of TP information have not been signed by Ukraine so far. It should also be noted that Ukraine has not joined the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information (MCAA CRS) either.

That said, the Ministry of Finance of Ukraine and the State Fiscal Service of Ukraine have declared[35] their intention of signing the MCAA CRS within the course of the implementation of the reform. Despite that, the Ukrainian authorities have been silent regarding their intention of signing the MCAA CbC. It is possible that after implementing the CbCR rules into the Ukrainian TP regulations and sign-

[34] Amounts of fines are indicated for 2016.

[35] http://sfs.gov.ua/media-tsentr/novini/249180.html; http://www.kmu.gov.ua/control/uk/publish/article?art_id=249002412&cat_id=244276429.

ing the MCAA CRS, the next step will be the signing of the MCAA CbC for the implementation of automatic exchange of CbCR.

2.5.2. Master and local files

Currently, Ukrainian TP regulations only provide for a one-tier system of reporting requiring taxpayers to prepare TP documentation consisting of a local file.

A brief description of effective rules regarding TP documentation (i.e. local file) is as follows:

- TP documentation is provided by Ukrainian taxpayers upon the request of the tax authorities within one month from the receipt of the request (the tax authorities may request TP documentation only after 1 May of the year following the reporting one);
- TP documentation is submitted in the Ukrainian language and must include the following information:
  - information about related parties, particularly parties to controlled transactions and persons which own 20 per cent or more of taxpayer's shares;
  - a general description of activity of MNE (including HQ and subsidiaries), organization chart, description of its business activity, TP policy;
  - a description of controlled transactions and their terms (price, terms for payment and other essential terms of agreements);
  - a description of goods/services including physical characteristics, quality and reputation on the market, country of origin and manufacturer, use of trademarks and other related information;
  - the settlement terms of transactions;
  - the factors which influenced the pricing;
  - information about the functions, assets and risks of the parties to controlled transactions;
  - economic analysis, which includes TP methods used for the verification of the terms of controlled transactions and justification of their selection, amount of income (profit) and expenses (loss) resulting from controlled transactions, profitability level, calculation of arm's length level of prices/profitability, sources of information, etc;
  - comparability analysis results in relation to commercial and financial terms of transactions;
  - information of self-adjustment and proportional adjustment of the taxable profit and tax performed by the taxpayer (if any).
- the fine for late submission or failure to submit TP documentation is 3 per cent of the amount of controlled transactions (in relation to which documentation was not submitted) but not more than approximately €10,000.[36]

This being said, the reform may introduce some changes in relation to TP documentation. In particular, the following additional information should be included in TP documentation (i.e. local file):

- a description of management structure of a taxpayer, and its organizational chart;

[36] The amount of fine is indicated for 2016.

- a description of the activity and business strategy of a taxpayer including the economic conditions of activity and analysis of the markets for goods/services and the main competitors;
- information about the involvement of a taxpayer in business restructuring or the transfer of intangibles during the reporting or preceding period with an explanation of such transactions;
- a description of transactions on acquisition of services, intangibles and other business objects different from goods including description and justification of their economic feasibility and business purpose (in the absence of such justification, it is considered that the value of such transactions is zero);
- information on the calculation and allocation of income/expenses which are influenced by transactions with controlled parties if such income/expenses are taken into account upon calculation of the profit level indicator in the controlled transaction analysed;
- the introduction of an additional fine in relation to TP documentation; in particular, a fine for failure to submit TP documentation within 10 days after the deadline for payment of the fine for failure to submit TP documentation is approximately €495 accruing daily for each further day of non-submission.[37]

Adoption of all these changes in Ukrainian TP regulations regarding TP documentation is expected within implementation of the reform.

Speaking about the master files, their preparation/submission are not required by Ukrainian TP regulations as of now. As mentioned in section 2.5.1, there was an attempt in the past to introduce a three-tier system of reporting into Ukrainian TP regulations requiring the submission of CbCR and the master file in addition to the local TP documentation package (the 2015 Reform Draft Law has not been adopted by Parliament as of the date of this report).

Currently, it is expected that the requirement to provide the master file will be introduced in Ukrainian TP regulations with implementation of the reform. Brief outlines of the expected rules regarding master files are as follows:

- a Ukrainian taxpayer, which is a member of MNE, is required to provide the master file if the annual turnover of the MNE for the previous year exceeded €50 million;
- the master file is provided upon request of the tax authorities within 12 months after the end of the financial year of the MNE's headquarters (or the end of the calendar year) but not earlier than 60 calendar days from the day of receipt of such request;
- the master file is submitted in English with a translation into Ukrainian (no certification is required). In the case of discrepancies between the Ukrainian and English texts the English text will prevail;
- the master file must include the following information:
  - an organizational chart of the MNE including owners, percentage of ownership and jurisdictions;
  - a general description of the MNE's business activities including (a) a description of supply and value creation chains of up to five types of goods/services of MNE, which generate the major part of its income, as

[37] The amount of fine is indicated for 2016.

well as other types of goods/services, the part of which exceeds 5 per cent of its overall income; (b) a description of the most essential goods/services of MNE; (c) a description of the main markets in which the MNE operates; (d) the factors which influence the MNE's profit; (e) a brief description of the main intra-group service agreements, except for intra-group R&D services (including the TP policy of MNE with an algorithm of allocation of costs and the actual amount of costs); (f) a brief description of the FAR analysis which includes main functions, risks and assets of companies of MNE; (g) information about restructuring of MNE in the reporting year (if any);
  - information about intangibles used by MNE companies in their activities including: (a) a general description of the R&D strategy of the MNE; (b) a list of intangibles (or their groups) which are owned by MNE, indicating company owners; (c) a list of the most essential intra-group agreements in relation to intangibles (including licence agreements) and the TP policies of the MNE in relation to transactions with intangibles and transactions related to R&D; (d) information on the transfer of essential intangibles (also for use) during the reporting year indicating companies, jurisdictions and compensation;
  - information about the intra-group financial transactions of the MNE, including: (a) a general description of the strategies of the financing of the MNE's companies; (b) the role of the company(ies) of the MNE which perform a treasury function; (c) the TP policy of the MNE in relation to financial transactions;
  - information on the financial condition of MNE including consolidated financial statements for the reporting period (if available);
  - information about advance pricing agreements concluded by the MNE's companies, as well as about tax rulings obtained regarding the allocation of profit between the MNE's companies which perform activities in different jurisdictions;
- the fines in relation to master files are as follows:[38]
  - the fine for late submission or failure to submit the master file is approximately €150,000;
  - the fine for failure to submit the master file within 10 days after the deadline for payment of fine for failure to submit the master file is approximately €495 accruing daily for each further day of non-submission.

It is expected that the above rules in relation to master files will be introduced in Ukrainian TP regulations in line with the announced reform. A draft law is expected by the end of 2016.

2.5.3. Compliance costs

As of now, Ukrainian TP regulations have not been changed as a result of the BEPS project. Therefore, the compliance costs have not changed.

Potential changes to the Ukrainian TP regulations described in this report, such as introduction of CbCR and master files, may increase the compliance costs for

[38] The amounts of fines are indicated for 2016.

MNEs. However, this increase should not be significant for the majority of qualifying MNEs (if any at all) since most probably they already prepare them in compliance with the TP regulations of other countries.

The potential BEPS-driven implementation of CbCR and master files could increase the compliance costs.

2.6. TP-related measures in other BEPS actions and other measures against BEPS

As of now, TP changes inspired by the BEPS project, which are discussed and expected for implementation in Ukrainian legislation, are provided by the reform. These TP changes are mostly driven by the TP actions of the BEPS project and are listed in section 2.1 and described in detail in the appropriate sections of this report. Among them, there are no pure TP measures which are explicitly driven by non-TP actions of the BEPS project.

That said, it is expected that the reform will also introduce some other non-TP related changes which, however, are also driven by the BEPS project. The most significant of them are mentioned below:

- CFC rules: this measure is driven by Action 3 of the BEPS project. In this regard, CFC rules may be viewed as another anti-avoidance tool, which are compatible with TP rules, and the adoption of which allows a synergy with TP;[39]
- rules introducing limitations on deduction of interest and other financial payments with related non-resident companies. This measure is driven by Action 4 of the BEPS project;
- measures on preventing the granting of double tax treaty benefits in inappropriate circumstances. This measure is driven by Action 6 of the BEPS project;
- measures on preventing artificial avoidance of permanent establishment status. This measure is driven by Action 7 of the BEPS project.

2.7. Can BEPS work in favour of MNEs?

As of the date of this report, no BEPS-driven initiatives on information gathering have been introduced into Ukrainian legislation. Automatic exchange of tax (and particularly TP) information is not implemented either. Therefore, there is no possibility currently for Ukrainian taxpayers to obtain any information within the framework of the automatic exchange of tax information.

That said, the reform dis not expected to contain any statements either with regard to the possibility of making public the tax information which was received by Ukrainian tax authorities within the framework of the automatic exchange of tax information.

[39] Para. 8, chapter 1, Action 3: 2015 final report OECD/G20 BEPS.

3. What is the future of TP?

As can be seen from previous sections of this report, TP regulations began to play an important anti-avoidance role in Ukraine starting from 2013 and their importance is expected to increase further, especially in the light of recognition of the BEPS project by the Ukrainian government.

Since implementation in 2013, the Ukrainian TP regulations have been already amended several times. They are constantly developing and it is expected that the next leap forward for Ukrainian TP regulations, which is expected with the implementation of the reform, will be heavily influenced by the BEPS project. Indeed, as can be seen from this report, the BEPS project may serve a basis for the next updates of Ukrainian TP regulations. This comes as no surprise, taking into account TP focus of the BEPS project and its worldwide recognition.

In this regard, the following changes in Ukrainian TP regulations are expected to be introduced with implementation of the reform:

- the recognition of transactions between non-residents and their Ukrainian-based permanent establishments as controlled transactions subject to TP control (if respective thresholds are exceeded);
- the introduction of the requirement for Ukrainian-based permanent establishments of non-residents to submit reports on controlled transactions and TP documentation (once TP control is applicable);
- the introduction of the requirement to submit CbCR once certain conditions are met;
- the introduction of the requirement to submit the master file once certain conditions are met;
- the introduction of the requirement to additionally provide in TP documentation (i.e. local file) (a) information on transactions with intangibles and (b) information on calculation and allocation of income/expenses which are influenced by transactions with controlled parties if such income/expenses are taken into account upon calculation of the profit level indicator in the controlled transaction analysed;
- further detail and clarification of rules applicable to export/import transactions with commodities;
- the introduction of special rules for intra-group low value-adding services which are supplied and received within a group;
- an increase of fines for failure to report controlled transactions and for failure to submit TP documentation.

That said, the practice of application of TP in Ukraine is still emerging which is explained by the relatively recent introduction of full-fledged TP regulations and the novelty of the topic for Ukrainian tax authorities and courts. In this regard, the progress of Ukrainian tax authorities in becoming familiar with TP practices should be recognized. Taking into account the announcements of the government's intention to implement the BEPS-influenced reform, further familiarization of Ukrainian tax authorities with the most recent TP practices will most probably continue. As regards the courts, the first court practice in Ukraine regarding TP matters has already started to emerge and its further development is also expected to be driven by the increasing importance of TP in Ukraine's life.

Annex

By-laws adopted pursuant to article 39 of the TCU and with the purpose of detailing the TP provisions:

- order of the Ministry of Finance of Ukraine No. 8 dated 18 January 2016, On the adoption of the form and procedure for preparation of the report on controlled transactions;
- resolution of the Cabinet of Ministers of Ukraine No. 977-r dated 18 September 2015, On the adoption of the list of states (territories) which satisfy the requirements of subparagraph 39.2.1.2 of subpara 39.2.1 of para. 39.2 of article 39 of the Tax Code of Ukraine (i.e. list of “low-tax” jurisdictions);
- regulation of the Cabinet of Ministers of Ukraine No. 381 dated 4 June 2015, On the adoption of a procedure for the calculation of a range of prices (profitability) and the median of this range for transfer pricing purposes;
- regulation of the Cabinet of Ministers of Ukraine No. 616 dated 8 September 2016, On the adoption of the list of goods,which have stock exchange quotations, and international stock exchange markets for verification of whether the conditions of controlled transaction comply with arm’s length principle;
- regulation of the Cabinet of Ministers of Ukraine No. 504 dated 17 July 2015, On the adoption of a procedure for advance pricing arrangements in controlled transactions, based on which unilateral, bilateral and multilateral agreements are concluded for transfer pricing purposes;
- order No. 706 of the Ministry of Finance, On approval of the procedure of monitoring of controlled transactions and the procedure for interviewing authorized persons, officials and/or employees of a taxpayer on transfer pricing issues.

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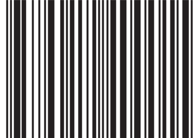
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