



Russian Federal Tax service comments on the arm's-length level of loss-making transactions

The Russian Federal Tax Service has, for the first time, acknowledged that a loss-making transaction may still be considered arm's-length for transfer pricing purposes in Russia in its [letter No. ShYu-4-13/2724@*](#) dated 5 March 2022 (the "Letter").

According to the Letter, in the current economic environment, where the applicable sanctions introduced at the US and EU level may influence the economic conditions of commercial transactions, Russian taxpayers may be forced to sell their goods produced for exportation abroad with a discount, which may in certain cases lead to a loss resulting from such transactions.

This being said, the Federal Tax Service should consider that these

circumstances may influence the pricing applied in, and the results of such transactions, when conducting the transfer-pricing control over such transactions and when considering applications for advance price agreements filed by taxpayers.

Comments

Although Russian tax authorities have historically pronounced their intention to consider the economic circumstances of the transactions performed when conducting transfer-pricing audits, they have never before in practice confirmed the possibility of recognising loss-making transactions as performed in compliance with transfer-pricing requirements.

This was not even the case during the COVID-19 pandemic, when tax authorities suggested that taxpayers apply the adjustments aimed at ensuring the comparability of the commercial terms of tested transactions, which was formulated rather vaguely in Russian tax legislation.

However, this new initiative, although representing a positive shift in the perception of Russian tax authorities, still leaves a vast number of open questions to be clarified.

For example, it is not clear what economic circumstances Russian tax authorities will actually consider when assessing the compliance of the transaction with the arm's-length principles. In practice, accompanying economic consequences of the sanctions, such as exchange-rate volatility or temporary suspension of certain businesses in Russia, may have even stronger influence on the results of the commercial transactions than the immediate restrictions introduced as part of the sanctions packages.

Moreover, the Letter explicitly addresses the taxpayers engaged in exportation of the goods produced, while current economic conditions will likely influence the prices charged in and the results of various types of transactions performed in Russia, including importation of goods to Russia, provision of works and services, transactions with intellectual property, etc. It is unclear whether similar approaches would ultimately be applicable to a wider range of cross-border transactions. falling under transfer-pricing control.

Finally, the Letter does not address the possibility of performing cross-border adjustments aimed at reduction of tax payable to the Russian budget, currently prohibited under the legislation in force. However, such adjustments may in fact be required in the current conditions, especially in cases when the Russian parties to the controlled transactions hold entrepreneurial status, and are thus generally bound by the obligation to ensure arm's-length profitability to their routine counterparties.

Our tax team will be closely monitoring further anti-crisis developments in the transfer pricing domain and will report on any such changes.

** In Russian*



Maria Kabanova

Expertise

TAX

TRANSFER PRICING

ACCOUNTING AND REPORTING