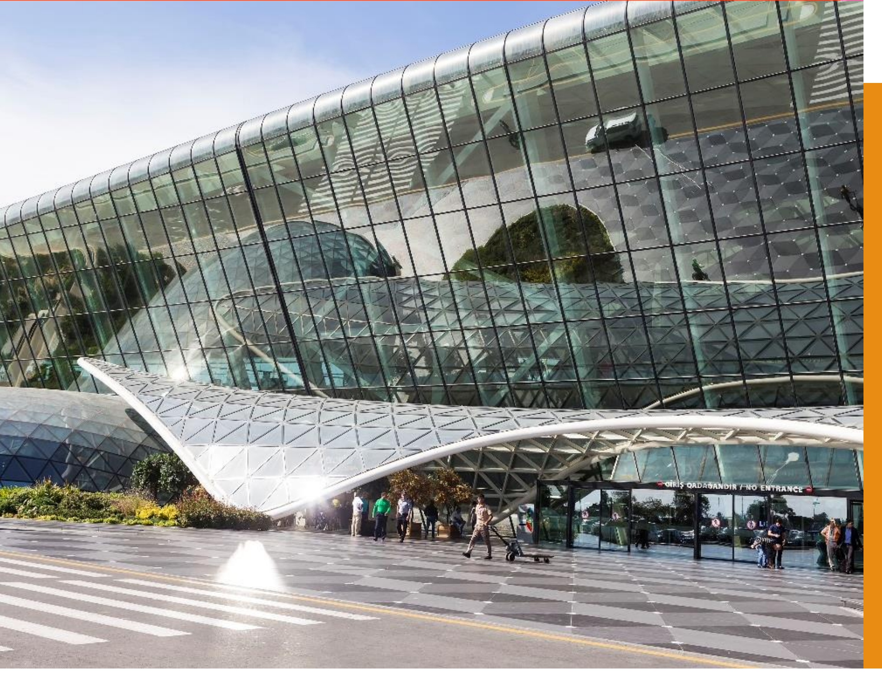
March 2017

PwC Azerbaijan Times

Issue №10, Breaking news

Overview of this Issue:

- **Transfer Pricing Regulations have been approved**



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Transfer Pricing Regulations have been approved

The Ministry of Taxes approved Transfer Pricing Regulations, effective as of 08 February 2017.

Transfer pricing is only applied for the purposes of corporate/personal income tax and to so-called controlled transactions exceeding AZN 500,000 per controlled party.

The following transactions are controlled:

- a resident and non-resident in related party relationship;
- a permanent establishment of a non-resident or any representative office, branch office or other unit of such non-resident in other countries;
- a resident and (or) a permanent establishment of a non-resident and persons established (registered) in a country with a favorable tax regime.

For the purposes of comparability analysis, both internal comparables (internal data of the party to the controlled transaction) and external comparables (external data of the independent parties) may be used.

In doing the comparability analysis (a process of selection of the uncontrolled transaction comparable to the controlled transaction) the following criteria must be taken into account:

- Type, origin, quality and other indicators of the goods (works, services);
- Contractual terms, including quantity of the goods (work, services), delivery and payment terms;
- Functions performed by the parties to the transaction;
- Tangible and intangible goods and rights in the possession of the taxpayer;
- Economic conditions- geographical location of the markets, existence of similar goods (work, services) in the market;
- Marketing strategy, etc.

Where the transaction involves transfer of intangibles, additional comparability factors must be considered.

The Regulations provide 3 transactional transfer pricing methods and 2 profit methods:

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• Comparable uncontrolled price method ("CUP");

• Resale price method ("RSM");

• Cost plus method ("CoPM")

• Comparable profit method ("CPM");

• Profit split method ("PSM");

The Regulations prescribe, to the extent it is possible, strict priority of application of CUP method. Other methods may only be applied if the transfer price cannot be determined by direct application of CUP or no comparable uncontrolled price is found.

If no comparable transaction is found during application of CPM, this method may be applied based on a "20% deemed profit method".

If the audited controlled transaction involves supply of goods (work, services) and if the actual price charged:

• is below the transfer price or lower limit of the arm's length range, taxes shall be computed based on the transfer price; or

• exceeds the transfer price or lower limit of the arm's length range, taxes shall be computed based on actual price.

If the audited controlled transaction involves purchase of goods (work, services) the value of which was claimed as tax deductible, and if the actual price charged

• is below the transfer price or upper limit of the arm's length range, taxes shall be computed based on actual price; or

• exceeds the transfer price or upper limit of the arm's length range, taxes shall be computed based on the transfer price.

The actual price charged in a controlled transaction is respected if such price equals the transfer price or falls within the arm's length range.

The transfer price is the average price, being the sum of all prices charged in selected comparable uncontrolled transactions divided by the number of such uncontrolled transactions.

A TP documentation filing requirement is introduced for transactions per controlled party exceeding AZN 500,000 per annum. The TP documentation must be filed by the end of March 31 following the tax/reporting year. Failure to do so is subject to a financial sanction of AZN 500.

Where the value of the transactions per controlled party does not exceed AZN 500,000 and no filing requirement is applicable therefore, the taxpayer is still required to follow the Regulations in computing his/her tax liability.

In determining transfer prices, the following databases may be used:

• International or local exchange quotations;

• Foreign trade statistics of the customs authorities;

• Reports placed in reliable sources;

• Databases of specialized agencies to which the tax office is subscribed, etc.

An advance pricing agreement mechanism is also introduced. At the taxpayer's request, the tax office may inform the taxpayer on the recommended transfer pricing method to apply for a particular transaction. The taxpayer is required to submit his/her request at least 3 months prior to carrying out the transaction.

The Regulations also set out provisions on TP dispute resolution, and avoidance of double taxation, as well as provide relevant examples of each of the transfer pricing methods.

PwC Azerbaijan will organise an awareness session dedicated to Transfer Pricing, scheduled for 7 April, 2017. The event will be held in JW Marriott Absheron Baku Hotel from 09.00 till 13.00.