

Legislative alert

The President of the Republic of Kazakhstan signed a new Law on Transfer Pricing (the "Law") on 9 July 2008 which will take effect from 1 January 2009. One of the new requirements contained in the Law is maintenance of transfer pricing documentation.

New transfer pricing requirements: maintenance of documentation

In this issue we would like to draw your attention to the new documentation requirements established by the Transfer Pricing Law, which shall be effective from 1 January 2009.

Transfer pricing documentation requirements are described in Article 5 of the Law "Rights and obligations of the transaction participants". This article obliges transaction participants to maintain reports and documentation justifying the transaction price. It also prescribes submission of transaction monitoring information and reports to the authorized body. Therefore the Law provides for two forms of transfer pricing documentation:

- ▶ Reports on transaction monitoring
- ▶ Documentation justifying the transaction price

The exact type of documents that should be maintained in each particular case depends on the type of transaction. In particular, reports on transaction monitoring shall be provided by the participants of international business transactions involving goods (work, services) the list of which is approved by the Government of the Republic of Kazakhstan (Article 6 of the Law). With respect to other transactions involving goods and falling within the scope of the Law, transaction participants shall maintain documentation justifying the transaction price. The authorized body has the right to request such documentation from the transaction participant.

So, what do reports on transaction monitoring and documentation

justifying the transaction price represent? Requirements for these documents are specified in Article 7 of the Law.

Reports on transaction monitoring

In accordance with Article 7 of the Law, transaction monitoring reports shall comprise the following information:

1. Documentation justifying the applied prices, including:
 - ▶ information on relationships of the parties;
 - ▶ description of entrepreneurial activity of the transaction participant, industries where the transaction participant operates, and market conditions;
 - ▶ forecasts, business strategy, transfer pricing methodology, including information on factors that impact the price formation;
 - ▶ functional analysis, analysis of risks, tangible and intangible assets;
 - ▶ opinion on the application of the arm's length principle in international business transactions;
 - ▶ reports according to international standards, including financial statements;

2. Method used for determination of market price;
3. Source of information used for determination of market price;
4. Information on international business transactions, including supporting documents on transactions falling within the scope of the Law, as well as information required for determination of the price differential;
5. Description of goods (work, services), including physical characteristics, quality and reputation on the market, country of origin and manufacturer, availability of the trademark and other information related to the qualitative characteristics of the goods (work, services);
6. Contractual terms;
7. Strategy of business transactions;
8. Commission fee (margin) of a trade broker (compensation for intermediate trade functions);
9. Other information that justifies the correctness of the transaction price and influences deviation of the transaction price from market price.

Information indicated in points 1, 5, 6, 7, 8 and 9 above should be provided to the tax authorities in case these conditions and information influence the deviation of the transaction price from market price.

In accordance with point 9 of Article 2 of the Law, reports on transaction monitoring should be presented annually to the tax authorities in accordance with the procedure and forms approved by the authorized body. Apparently, the procedures and forms of reports will be established in a transfer pricing instruction, which is currently being developed by the Tax Committee of the Ministry of Finance.

Documentation justifying the transaction price

Participants of transactions involving goods that are not subject to transaction monitoring requirements are obliged to maintain documentation justifying the transaction price and submit it to the authorized bodies upon request. In accordance with point 1 of Article 7, such documentation includes:

- ▶ information on relationships of the parties;
- ▶ description of entrepreneurial activity of the transaction participant, industries where the transaction participant operates, and market conditions;
- ▶ forecasts, business strategy, transfer pricing methodology, including information on factors that impact the price formation;
- ▶ functional analysis, analysis of risks, tangible and intangible assets;
- ▶ opinion on the application of the arm's length principle in international business transactions;
- ▶ reports according to international standards, including financial statements.

The list of documents and information provided in Article 7 of the Law is quite extensive and contains documentation which is specific and conceptually new for Kazakhstan's transfer pricing legislation, such as functional analysis and analysis of risks. Evidently, the Law's authors adopted the experience of foreign countries and principles of the OECD Transfer Pricing Guidelines in this regard.

In fact, the new Law puts the burden of proof on transaction participants and formalizes the obligations of transaction participants to maintain and submit transfer pricing documentation regularly (in cases where transactions are subject to

monitoring) or upon request (in cases where transactions are not subject to monitoring) to the authorized bodies. Obviously this requirement increases the administrative burden of transaction participants who will require additional resources for the preparation of such documentation.

Responsibility of the transaction participants

What penalties are envisaged in the Law for incompliance with the transfer pricing documentation requirements? Bare non-compliance with the transfer pricing documentation requirements should not lead to adjustments of objects of taxation because such adjustments may only be made based on the results of a tax audit. However, the Law provides for other penalties for incompliance with the transfer pricing documentation requirements. Firstly, Article 19 of the Law stipulates that violation of the transfer pricing legislation shall entail liability established by the laws of the Republic of Kazakhstan. Secondly, based on the results of transaction monitoring, a transfer pricing audit can be initiated by the authorized bodies (for example,

in cases of complete or partial absence of monitoring reports). Thirdly, in accordance with Article 13 of the Law, in determining the market price a differential is taken into account for in cases of timely and reasonable presentation of transaction monitoring information. For goods that are not subject to transaction monitoring, a differential is taken into account for provided that the transaction participant complies with the requirements established with regard to documentation justifying the applied price. Thus, in cases of untimely or unreasonable submission of documentation, the tax authorities have the right not to take into account a differential, which can result in adjustments of objects of taxation.

Since the Law will take effect from 2009, taxpayers are still to see how these transfer pricing documentation requirements will be applied in practice. However, it is clear now that the participants of transactions subject to transfer pricing control should pay special attention to the maintenance of transfer pricing documentation and start active preparatory work in this regard.

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