

## Rulebook on Transfer Pricing and Methods Applied for Determining Prices in Related Party Transactions in Accordance with the Arm's Length Principle has been enacted



The Rulebook on Transfer Pricing and Methods Applied for Determining Prices in Related Party Transactions in Accordance with the Arm's Length Principle, was enacted on 5 July 2013 by the Minister of Finance and Economy of the Republic of Serbia ("The Rulebook").

The Rulebook was published in the Official Gazette of the Republic of Serbia no. 61 on 12 July 2013, and is expected to come into force on 20 July 2013.

Please find below an overview of the most important provisions.

### Motives for enacting the Rulebook

The Rulebook was enacted with the main aim to clarify numerous dilemmas that have existed in the area of applying transfer pricing rules in Serbia, especially bearing in mind that in the past few years transfer pricing has gradually become one of the most significant tax issues in Serbia.

After an extended period during which limited rules hindered a more significant development of practice in this area, enacting this Rulebook represents an important step forward in amending regulations and in introducing a clear link to OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines").

The Rulebook prescribes norms that specify the form and content of transfer pricing documentation, selection and methods applied for determining prices in accordance with the arm's length principle, as well as the approach to

determining potential transfer pricing adjustments to the Corporate Income Tax ("CIT") base.

Thus, adding more clarity in defining the rights and obligations of taxpayers, particularly regarding transfer pricing documentation requirements, will contribute to easier implementation of existing rules, as well as to the greater certainty in determining overall CIT liability.

### Transfer pricing documentation

In accordance with the Rulebook, a taxpayer is obliged to submit its transfer pricing documentation along with its tax balance sheet in the form of a report, which should contain the following:

1. Analysis of the group of related parties to which the taxpayer belongs
2. Analysis of activities
3. Functional analyses
4. Selection of methods for assessing the arm's length nature of related party transactions
5. Appendices.

In preparing transfer pricing documentation, the taxpayer is obliged to list all related parties, and to describe the nature of their relation. This provision is especially important because it may potentially result in greater tax burden for taxpayers which operate within large multinational groups.

### Methods for analyzing transfer pricing

The Rulebook prescribes that, unlike the former practice where a comparable uncontrolled price method was the

primary one, taxpayers are now required to choose the most suitable method for determining arm's length prices for the purpose of transfer pricing analyses, based on the circumstances of each particular case.

The method should be chosen at the level of each type of transaction. In certain cases, combining various methods is allowed. The selected method should be practically applicable and its implementation should yield a reasonable assessment of the results, in accordance with the arm's length principle.

The Rulebook also describes all the methods that could be used for transfer pricing analyses according to the OECD Guidelines. Moreover, general guidelines for application of various methods, as well as examples of situations in which methods could be applied are prescribed. The Rulebook prescribes the following methods:

1. Comparable Uncontrolled Price Method
2. Resale Price Method
3. Cost Plus Method
4. Transactional Net Margin Method
5. Profit Split Method

In accordance with the provisions of the CIT Law, besides the methods stated in the Rulebook, any other method can also be used, under the condition that the methods stated in the Rulebook are not applicable, or when the alternative method is more appropriate, bearing in mind the circumstances of each specific case.

The conclusion, which is an integral part of the Rulebook, should contain the taxpayer's assessment of compliance of their transfer prices with the arm's length principle which has been performed by applying the appropriate method discussed above.

In case transactions with related parties were not under market conditions, the taxpayer determines the amount of potential transfer pricing adjustment for each individual transaction with every single related party using the above mentioned methods. The total amount of adjustments to be included in the CIT base is determined by adding up adjustments arising from transactions with each individual related party.

An important new provision introduced by the Rulebook is the possibility that a taxpayer could decrease the transfer pricing adjustment toward each single related party, for the amount of the "negative adjustment" realized in other transactions with the same related party. "Negative correction" is allowed if the taxpayer generates transfer pricing income that is higher than market income, or generates expenses on related party transactions which are lower than market ones.

## Conclusion

Enactment of the Rulebook is expected to mark a new era in transfer pricing in Serbia, in which the transfer pricing documentation will become an integral part of accompanying documentation that is required when submitting the CIT return.

Although answers to certain questions will become clearer through practice, it is apparent that the intention of the legislator is to introduce a link with international best practice and to catch up with the practice in the region.

Following the pattern repeated in most neighboring countries, it is also reasonable to expect that the introduction of new, more detailed regulations regarding the content of transfer pricing documentation would, among other things, bring this area of taxation into the focus of control by the Tax Authorities.

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