Guidance on Controlled Transactions Aggregation

Since April 2013, the Ministry of Finance has issued several Letters that clarify certain transfer pricing provisions of the Russian Tax Code and the taxpayer’s right to aggregate controlled transactions into groups for purposes of preparing the notification on controllable transactions and transfer pricing documentation.

1. Introduction

In recent months, the Ministry of Finance has issued several Letters that provide guidance and clarify conditions for the aggregation of a taxpayer’s controlled transactions into a group of transactions for purposes of preparing the notification on controllable transactions (the notification) and transfer pricing documentation (documentation). Although the explanations provided in the Letters are non-binding, the guidance that the Letters supply to taxpayers is useful and the authors believe it is likely to be supported and applied by the tax authorities during their reviews of taxpayer notifications and documentation.

2. Background

The Russian Tax Code (TC or Tax Code) does not provide a clear explanation for the term “group of uniform transactions.” The only thing that is mentioned under article 105.7 is that “uniform transactions” are transactions in identical or, in the absence thereof, homogeneous goods (work, services), which were concluded under comparable economic and/or financial conditions. However, it is still unclear which types of transactions can be treated as uniform (homogeneous) in practice and how to aggregate them for purposes of preparing the notification and documentation.

A few months ago, Russian authorities published several clarifying Letters regarding the aggregation of controlled transactions into a group of transactions. Although the clarifications provided are non-binding, the guidance in the Letters is quite useful for taxpayers and the authors believe the tax authorities probably will support and apply these clarifications during taxpayer notifications and documentation audits.

The Letters clearly state that a taxpayer has a right (not an obligation) to aggregate controlled transactions in a group. However, in order to do so, the taxpayer must be sure that these transactions meet certain requirements.

3. Requirements for Aggregation of Controlled Transactions

The Ministry of Finance points out that for transfer pricing purposes, the main factor that influences the price is not the subject matter of the transaction but rather the type of activity carried out and, more importantly, the functions performed by the company.

In Letter N 03-01-18/33520 of 16 August 2013, the Ministry of Finance provides the following list of criteria that must be the same for transactions in order to aggregate them:

- functions performed by the party to the transactions;
- pricing methodology applied in the transactions;
- profit level indicator chosen to support the arm’s length nature of the price for the performed activity; and
- actual profitability indicators of comparable independent companies, defined based on accounting (financial) statements in accordance with the TC (based on the transactional net margin method (TNMM)), or calculated in respect of taxpayer transactions with independent parties (for other methods).

The Letter specifically emphasizes that the aggregation of controlled transactions is a right and not an obligation of the taxpayer. Therefore, the taxpayer is authorized to determine whether and which of its transactions to aggregate. However, in this regard the taxpayer must be able to prove that the aggregated transactions meet the required criteria.

4. Group of Transactions as Shown in the Notification

According to the Letter, a taxpayer is not required to reflect all detailed information regarding the specific parameters of each transaction, such as the price per unit, quantity, place of transaction, or place of shipment of the goods, related to the specific subject matter of the transaction. At the same time, a taxpayer will have to disclose the name of the group of controlled transactions, the amount of income received (expense incurred) and the pricing methodology applied for the aggregated transactions.

5. Examples of Aggregation

In the Letter of 16 August 2013, the Ministry of Finance has included two practical examples of how to aggregate controlled transactions for transfer pricing purposes.

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1. PricewaterhouseCoopers Russia B.V., Moscow.
2. The definition of “identical” and “homogeneous” goods (work, services) is provided in paragraphs 6 and 7 of article 38 of the Tax Code.

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Example 1

A company is engaged in the distribution of a wide range of food products, alcoholic beverages, household chemicals and dinnerware. Goods are supplied from related parties, each of which is engaged in the delivery of a particular type of good. The company has chosen to apply the TNMM with return on sales as the profit level indicator for the calculation of expenses incurred in these controlled transactions. For these purposes, the company relies on publicly available sources of information and types of activity supported by the OKVED Code (Russian National Classifier of Economic Activities), as well as international and other classifiers. The company can receive information about the profitability ratios of food product distributors (i.e. wholesalers of fruits, vegetables, meat and meat products, alcoholic beverages and confectionary), as well as of those that distribute ceramics, glass and cleaning products.

How can the company aggregate transactions for transfer pricing purposes? The company can apply a single measure of profitability and reflect the subject matter of the transaction as a generalized type of food product sold (e.g. fruit and vegetables), not specifying all the types of fruits and vegetables (such as apples, pears, grapes, tomatoes, cucumbers, potatoes, etc.) as separate items of transactions. Consequently the entire set of transactions carried out by the company could potentially be divided into the following groups of homogeneous transactions (depending on the subject matter of the transaction):

- supply of fruits and vegetables;
- supply of meat and meat products;
- supply of confectionary;
- supply of chemicals, etc.

However, for these purposes, the functions performed by the company, as well as the terms of the contracts, must be similar for each aggregated group. Otherwise, no aggregation will be possible.

Example 2

The company supplies to related parties construction materials (timber, linoleum, wallpaper, glue, spikes, plinth, etc.), purchases fuel and lubricants (different brands of petrol, diesel), buys spare parts for different types of automotive products and rents the premises. The company decides to apply the TNMM with return on sales as the profit level indicator to determine that the profit is at arm’s length. The company has access to information regarding the profitability of companies, engaged in (i) the sale of wood, construction materials and sanitary equipment, (ii) the sale of fuel, (iii) the sale of auto spare parts and accessories and (iv) rental of real estate.

Consequently, the company can aggregate transactions in several groups with the following subjects:

- construction materials;
- fuel;
- spare parts; and
- rentals.

As seen from the above, in Example 2, the Ministry of Finance pays special attention to different functions and economic conditions (different types of activities) as crucial parameters of transactions for the purpose of aggregation.


Despite the fact that the Federal Tax Service (FTS) did comment on the approach to aggregation of controlled transactions suggested by the Ministry of Finance, the FTS issued several letters which provide particular guidance on possible variants of aggregation specified for the construction industry and financial transactions.

Special provisions for construction industry. According to the FTS guidance, construction work that includes a number of separate transactions, as recognized by article 38 of the TC, may be aggregated if they are all mentioned in a contract for performing construction work as one subject matter of a transaction. For example, in line 030 of section 1B of the notification a taxpayer may write "Performance of construction and installation work on construction of two-section monolith dwelling house with variable number of floors (18-20-22) and underground parking for 100 vehicles and individual heating units". In this case, only one sheet of section 1B in the notification will be required.

Special provisions for financial transactions. In order to aggregate financial transactions, e.g. loan and guarantee transactions, the following criteria as provided by the FTS must be considered by the taxpayer:

- the debtor’s credit history and ability to pay;
- the nature and the market value of obligations;
- the period for which the loan or bank loan is granted;
- the currency which is the subject matter of a loan/guarantee contract;
- the formula to determine the interest rate (fixed or floating interest rate); and
- other conditions that may impact the interest rate.

Therefore, loans granted under different interest rates and in different currencies do not respect the criterion of homogeneity and, as a result, it will not be possible to aggregate them. This position was supported by the Ministry of Finance in Letter N ОA-4-13/26775 of 10 July 2013.

7. Conclusion

In the Letters, the Ministry of Finance provides high-level guidelines on how to aggregate controlled transactions into a group of transactions. Under these guidelines, the controlled transactions must meet certain criteria (such as functions performed, methodology applied and profit level indicator used to support the arm's length price level) in order to be aggregated.

In addition, it is also clearly stated that a taxpayer has a right (not an obligation) to aggregate controlled transactions in a group and it is the taxpayer’s choice as to which transactions to aggregate, based on the criteria mentioned in the Letter. In the meantime, it is necessary to bear in mind the importance of the functional analysis and economic facts and circumstances of the transaction over the subject itself when aggregating controlled transactions.

4. Letter of the FTS N ОA-4-13/11860 of 2 July 2013
5. Letter of the FTS N ОA-4-13/12513@ of 11 July 2013