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RA Tax Law Regulations: Transfer Pricing Practice in Armenia

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1. Introduction

Background of the Problem

Transfer pricing is a method of tax avoidance commonly utilized by big corporations, to put it simply. Transfer price is the price an organization pays to transfer goods from one subsidiary or internal branch to another segment of the same organization.[1] Peter Harris and David Oliver in their book named "International Commercial Tax" discuss, in general terms, the practice of the transfer pricing, regulations stated by OECD and also some kind of issues that business entities or tax authorities might face when applying transfer pricing method. Further to this, Sol Picciotto in his book "International Business Taxation" discusses the practice of some states in the sphere of transfer pricing. Having in regard the mentioned books and other sources by other scholars I have tried to juxtapose the international regulations with the newly enacted Armenian regulations and to come up with a reasonable judgement about Armenian transfer pricing regulations (practice).

Statement of the Problem

As transfer pricing regulations are newly incorporated into the Tax Code of Armenia and we do not have enough practice to make clear conclusions about the productivity of those rules, in this paper I will mainly concentrate on the possible challenges that Armenian tax authorities or business entities may be faced with. Besides the raised issues I will suggest some possible solutions using international regulations or practice of developed states.

Methodology

I try to bring about the current regulations and delve into the existing situation and challenges regarding transfer pricing in four chapters.

The first chapter of this paper is an introduction to transfer pricing. In this chapter I discuss the transfer pricing as a method of tax avoidance. The chapter covers also the practice

[1] Nicole Barnhouse, Alton Booth, Kevin Wester, Transfer Pricing

of other states and international regulations regarding transfer pricing. Additionally, it contains some discussion on the impact of absence of transfer pricing rules on the economy of a state.

The second chapter is discussion regarding methods of transfer pricing and challenges for the Republic of Armenia. Chapter includes discussion on traditional methods of transfer pricing stated by the OECD and in the Tax Code of the Republic of Armenia as well. The list of challenges also includes the competence of the controlling body and sources of uncontrolled transaction.

Third chapter relates to resolutions of challenges raised in the third chapter. Suggestions of solutions might be done through enactment of Government Decree and amendments in the Tax Code.

The last chapter is a separate topic, which relates to the double taxation that might rise in case of transfer pricing. The chapter mainly provides discussion of OECD regulations on double taxation and also regulations related to taxation of related companies.

Significance

In the light of the recent amendments in RA Tax Code regulations and considering the lack of local practice it is important to discuss in detail the topic of transfer pricing and to get acquainted with the international practice and regulations.

Scope and Limitations

In this paper my aim has been to explore the existing tax regulations, compare them with the experience of other states which have more developed practice, and, possibly, suggest some solutions to current problems or difficulties that come about when we shift from theoretical discussions to practical experience.

For it would not be practical to do a full research and analysis of all aspects of the recently incorporated 'phenomenon' - a new challenge for Armenian tax authorities and, possibly, a new chance for further improving tax regulations - the focus of this research will be limited to the core discussion of methods of transfer pricing, competence of controlling

body, reliable sources of uncontrolled transactions and double taxation issues that companies might encounter in case of transfer pricing.

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2. Introduction to Transfer Pricing

International tax law presents international aspects of national regulations.[2] The most known international regulations in this field is the OECD Model Tax Convention and OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The OECD Model Tax Convention regulates relations regarding taxation between states. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations contains transfer pricing regulations.

Transfer pricing is one of the valuable and important aspects of modern international taxation. Transfer pricing continues to hold center stage as the most important international tax issues multinational corporations face as we move into the new millenium.[3] To have a full image about the transfer pricing I would like to have a little discussion on what is transfer pricing.

One of the foremost purposes of operating a business is to gain and maximise profit. Few if any companies engage in business relations not having as a primary aim the course of business of making bigger income. But the larger the income gets, the larger the taxable portion of the income will become. Tax authorities are trying to keep companies within their control by imposing tax regulations and companies, on the other hand, are trying to avoid taxes.

There are two ways to minimize the tax burden in the context of international tax law: tax avoidance and tax evasion. International tax evasion is an activity with an illegal nature as it entails trying to minimize taxes in a way of non-disclosure of earned income. The companies having taken this course of actions make transactions that are taxable but are

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[2] Brian J.Arnold, International Tax Primer, Chapter 4
[3] William F. Hahn and Tobin E. Hopkins, Transfer pricing in 2000 and Beyond

intentionally concealed from tax authorities. The consequences of tax evasion could result even in criminal penalties and charges.

International tax avoidance, in its turn, is usually a lawful way for minimizing taxes. It could be implemented by careful tax planning.[4] Companies can plan their business activities and transactions in a way that accumulated taxes could be lower as otherwise would be considering the scopes of the applicable tax legislation of the jurisdiction where the company is residing. The tax planning may even include companies residing in more than one country. In order to implement a good tax planning the tax legislation of the countries where companies are residing and also double taxation treaties between those countries, if applicable, should be taken into consideration.

International tax law is known for its anti-tax avoidance methods. One of those methods is transfer pricing rules. Recently Armenia has adopted rules regulating prices of transactions between controlled entities, which, to my mind, is a big challenge for Armenian tax authorities.

As stated in the Tax Code of the Republic of Armenia transfer pricing is a procedure for determining financial indicators in controlled transactions[5]. Here we firstly need to identify what are financial indicators and controlled transactions.

Financial indicator is much easier to comprehend: in particular, it is the price of the transaction, the price that controlled entities use to sell products or services between each other. The controlled transactions are transactions which occur between affiliated companies. RA Tax Code explains the affiliated companies by a whole article, but for sake of simplicity I will suggest to put it as follows: companies are being considered as affiliated when the same taxpayer directly or indirectly participates in the management, control, or participation of two or more taxpayers in their charter or share capital[6].

This is the description offered by RA Tax Code and it will be used to determine the transaction price between affiliated entities, which by virtue of its ultimate beneficial owner (hereinafter referred to as UBO) could be set higher or lower than the fair market price having in regard the tax regime of each country where affiliated companies are residing.

[4] Brian J. Arnold, International Tax Primer, Chapter 7
[5] Tax Code of Republic of Armenia, article 361.1.3
[6] Tax Code of Republic of Armenia, article 362.1

Accordingly, the transfer pricing rules are enacted to regulate the price of transactions between affiliates to appropriate it with fair market price.

Thus, affiliated companies have the power to decide where to shift or, rather, to *transfer* the price. In other words the UBO of the affiliated companies can choose which company should pay the main portion of the taxes raised from the main activity of 2 companies by transferring the price of the good from one company to another. For example: company A residing in country A produces and sells products to affiliated company B residing in a low tax jurisdiction B with a lower price.

There we might have no risk if the affiliated companies, residing in the Republic of Armenia, are transferring the price between each other in the territory of the Republic of Armenia, because companies should be taxed by the same tax rates and there is almost no difference which one of the companies shall pay the raised taxes. In the same country transfer pricing could be used for other purposes, such as growth of activity of a company.

When we move the transaction to the international level, the problems arise. This is the case discussed in an example provided above. According to that example the company residing in a low tax jurisdiction country buys a product with lower price than that normally available in the market, and sells it with a higher price. As a result, the company residing in the low tax jurisdiction will pay taxes for its income from the sale of goods at a much lower rate of taxes than would have been paid by a producing company. This leads to less taxable amounts for both companies together.

The business owners benefit from these transactions, but it is unacceptable from the perspective of tax authorities and for the whole economy of the state in general terms. The absence of proper transfer pricing regulations may in extreme cases cause decline in economic growth of the country. But how is the economic growth of the country connected with transfer pricing? The first notion is merely connected with the science of Economics and the other one is merely a tool of law. Despite the fact that we deal with notions of different spheres of sciences, they are strictly connected and interrelated with each other.

Let's discuss it in yet another example. Company A residing in country A produces and sells items to an affiliated company B residing in country B. The price of a specific transaction is shifted to company B for the purpose of avoiding paying taxes at a higher rate in country A. As a result the country A gets less tax inflow to the state budget than it should have received. So the country encounters difficulties, which lead to decreases in economic

growth. In order not to get into detailed economic discussions, I will just say that economic growth is an important precondition for a developed state, without which states could not record progress in life quality of society. In order to visualise this scenario it is enough just to think about what the taxes paid by the legal entities or individuals are directed to. For example the paid taxes might serve to grow governance, defense, health care, education, etc. Without taxes the state will not be able to implement proper defense, education, etc. So in absence of the mentioned factor, the state could not record progress in economic growth. As we can see, the non-payment of taxes may lead to a delayed development of a state or in extreme cases even to a crisis. So assumably, regulated price of transactions between affiliated entities could be an incentive for developing the state economy and making life better as the regulations are created for making companies to show their real income and accordingly pay taxes from that income.

By returning to our main discussion I would like to talk about the principles of transfer pricing. The main principle of transfer pricing in RA Tax Code and also in international regulations is the *Arm's length principle*. It is a tool for valuation of transaction, according to which the financial indicators of controlled transactions are not different from the financial indicators of uncontrolled transactions[7]. The transactions are classified as compatible with the scope of Arm's length principle by the methods of transfer pricing stated in RA Tax Code. To put it simple I can say that there exists a space filled with thousands of transactions between uncontrolled entities. Based on that transaction the tax authorities calculate and set financial indicators of some kind of transactions: they decide the fair market price of the products. If the controlled transaction occurs the tax authorities will choose one of the already chosen transactions and compare the fair market price with the transaction price made between controlled entities. In this way tax authorities will decide whether the controlled transaction is within the scope of Arm's length principle or not.

In accordance with RA Tax Code if a taxpayer implements a controlled transaction, the taxes will be calculated based on the financial indicators decided within Arm's length principle[8]. So we come to the conclusion that affiliated companies making transactions between each other should be taxed according to the Arm's length principle, which means that the price of the goods subject to transaction should be within the scope of Arm's length

[7] Tax Code, article 361
[8] Tac Code, article 364

principle, otherwise tax base of the transaction will be decided by the tax authority based on the similar transactions made between uncontrolled entities. However, it should also be mentioned that considering the market size of Armenia, somewhat monopolistic nature of certain business activities and the scarce practice of the tax authorities it might be difficult to find transaction prices for making the necessary comparisons based on Arm's length principle.

Practice in the United States of America: The public discussions regarding transfer pricing reemerged in the 1960s. Despite the fact that states gave broad power to tax bodies in the 1920s and 1930s, international businesses did make use of transfer price manipulations for tax avoidance purposes. The United States of America has adopted 482 regulations in 1968. These 482 regulations regarded the arm's length principle: taxpayers should show that arm's length transfer price for tangible property was based on comparable market transactions.

The adopted regulations specify that for each category of transaction the primary test should be Comparable Uncontrolled Price: the price that was charged in independent transactions between unrelated parties. The regulations stated three methods as well and the hierarchy is the following: first, CUP, then Resale Price Minus, third Cost of Production Plus, and the forth - some appropriate method of pricing other than those described.[9]

OECD: The OECD Transfer Pricing Guidelines authorise various methods for establishing an arm's length price. These are usually divided into three "traditional transaction methods" and two acceptable "other methods". In the case of each method the key issue is comparability. The Guidelines outline five comparability factors: characteristics of the property or services, functional analyses, contractual terms, economic circumstances and business strategies.

Generally the preferred approach is the 'comparable uncontrolled price' method. An Arm's length price is being determined by reference to sales of similar products made between unrelated parties. If the CUP method is not acceptable, other traditional methods will be used: 'resale price' method and 'cost plus' method. When none of the traditional methods might be used the two other methods will be used: 'transactional net margin' method and 'profit split' method.[10]

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[9] Sol Picciotto - International business taxation

[10] "International Commercial Tax" - Peter Harris and David Oliver, pg. 236-239

As we can see the US model and the OECD model are more or less the same as the Armenian regulations. The three models recognise Arm's length price as the main principle and all controlled transactions should be in scope of that principle. The Arm's length price should be decided by the same methods. So the approach to the transfer pricing rules and to estoppel to manipulations is the same.

On 11 of March 2020[11] The World Health Organization announced about the COVID-19 being increased by 13-fold over China and the number of affected countries increased triple. The Republic of Armenia is also not an exception. On 16th of March 2020 the Government of the Republic of Armenia announced a State of Emergency in the whole country. As a result, many businesses just stopped working. The income that could have been earned by entities in that period of time will be zero and many companies risk going bankrupt. Here we cannot escape problems related to transfer pricing. The seller company, which has earned lower income by selling the items to its affiliates at a lower price, will have no income in an emergency situation and it would be difficult to operate the company. As a result it may even lead to bankruptcy of the company.

As stated in the article published by Duff & Phelps on 12th of March on 2020[12] the companies not operating in this period will be obliged to provide evidence to tax authorities that income becomes lower not because of violation of transfer pricing rules, otherwise they will be risky objects for making check-ups by tax authorities.

Previously, Armenian companies were free to enter into transactions between its affiliates without any restriction set by the tax legislation of the Republic of Armenia. Companies easily have made transactions at a really lower price and in that way they have paid less taxes and made more profit. The sphere of transfer pricing was absolutely not regulated, which may have even led to cuts of the budget of the State and less money for public purposes. However, what might cause transfer pricing regulations and what risks might bear companies starting from the moment of coming into force the transfer pricing regulations?

The answer is much simpler - chaos. Regulations regarding transfer pricing stated in the Tax Code of the Republic of Armenia came into force from the beginning of 2020 and

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[11] World Health Organization, WHO Director-General's opening remarks at the media briefing on COVID-19 - 11 March 2020 link

[12] Jill Weise, Steven Carey, Ted Keen, Fabien Alfonso and Douglas Fone, COVID-19 – The Expected Transfer Pricing Impact, Mar 12, 2020 link

until 15th of April of 2020 there has not yet been issued any decree from Government related to the application or practice of transfer pricing regulations. Many companies encounter barriers on how they should act to be in the space of arm’s length principle or which body is going to control the application of the transfer pricing rules. These and many other questions are still unanswered.

As the transfer pricing regulations are stated in RA Tax Code, the control over the application of the regulations should be done by tax authorities. The function of tax authority in the Republic of Armenia is mainly reserved to the State Revenue Committee (hereinafter: Committee), which is acting under the supervision of the Government. The question that arises is whether the Committee is the most appropriate body for control over regulations and, the other important question, in which ways the Committee will use its force.

As already has been mentioned the only legal document containing regulations regarding transfer pricing is RA Tax Code, which, in its turn, contains only general rules regarding the newly incorporated phenomenon.

To sum up this chapter, a discussion has been provided on definition and general rules of transfer pricing. The challenges and difficulties that might be raised in Armenian reality in connection with the application of transfer pricing rules will be discussed in the next chapters.

3. Transfer Pricing Methods and Challenges for Armenia

As discussed in the previous chapter transfer pricing rules are aimed to regulate price of transfers between related entities. The price of that transaction should be in space of Arm's length principle, which has been discussed as well. For identifying if the price of that kind of transaction is in the scope of Arm’s length principle, we need to use methods of transfer pricing to compare prices with fair market price.

The core principle lying in the foundations of transfer pricing regulations is the equal treatment of the parties: the controlled transactions should be subject to taxation in the same way as non-connected ones, and tax authorities should have the tools to detect any diversion having an aim of tax avoidance. In this case the tools of law that will bring the desirable result are methods of transfer pricing.

RA Tax Code provides 5 methods of transfer pricing:

- Comparable uncontrolled price
- Resale price method
- Cost plus method
- Transactional net margin method
- Profit split method[13]

In accordance with the OECD Transfer Pricing methods[14], the first 3 methods are known as traditional methods. Comparable uncontrolled Price (hereinafter: CUP) is the main method of transfer pricing. The next methods may be used if this one is not applicable for the specific case. The CUP method is, is to put it simply, comparison between the prices of goods of a controlled transaction with the price of goods of an uncontrolled transaction[15]. This notion, however, gives rise to many questions starting from the definitions of controlled and uncontrolled transactions and ending with the ways how methods should be used in practice. The starting point is controlled and uncontrolled transactions from which starts the application of the method. Transactions are deemed to be *controlled* if they occured between related entities[16]. Accordingly, *uncontrolled* transactions are occurring between unrelated parties. Hence, the price of goods transferred between related entities should be the same as the price of goods transferred between unrelated entities based on the CUP method. As we have identified what are controlled and uncontrolled transactions, we need to clarify how they can be comparable with each other.

As stated in RA Tax Code the uncontrolled transaction is comparable with controlled transaction if there is no such difference that can affect the financial indicators for the application of that particular method[17]. Hence, the nature of comparable transactions should be almost the same in order to be able to find the real price of the transaction. If the 2 transactions are more or less the same they might be considered as comparable.

I would like to draw your attention to yet another question related to the objects of comparison: *what* should be compared - the businesses or the transactions? As RA Tax Code uses the wording "transaction", we infer that the comparable objects are the transactions not

[13] Tax Code of Republic of Armenia, article 368
[14] OECD, Transfer Pricing methods, July 2010 link
[15] Tax Code of Republic of Armenia, article 368.1
[16] Tax Code of Republic of Armenia, article 363.1
[17] Tax Code of Republic of Armenia, article 365

the businesses. But for finding the appropriate transaction we need to go to the 'appropriateness' of the businesses. Which means we need regulation regarding the comparability of the businesses, because without finding the appropriate business it will be impossible to find the comparable transaction.

At this point we need to discuss what similar businesses mean. Can a company doing business by merely reselling clothes be compared with a company which produces then sells clothes? My opinion on this is that they are different types of businesses and cannot be comparable with each other. By the wording of the Tax Code the controlled transaction should be compared with uncontrolled transaction to find out if the price between controlled entities is within the scope of the Arm's length principle. Let's assume that there is no essential difference in these transactions and the physical characteristics of the products are the same. Thus, we may conclude that the transactions are comparable. But there is another essential component - the businesses are different. One company merely sells the clothes and the other one firstly produces the clothes then sells. Despite the fact that the law states that in case of finding appropriate comparable transactions the functions of the contracting parties should be taken into consideration, including production factor, the law does not describe the meaning or impact of production factor. What does it mean the production should be taken into consideration? Does it mean the producing company's transaction is not comparable with a non-producing company? These questions do not have answers in the Tax Code. Thus, as a result the transactions made by different businesses could be considered as comparable transactions and a transaction will be compared with an incomparable transaction. This is a big challenge for Armenian tax law regulations and authorities, which I think needs to be addressed by way of further amending the rules and regulations regarding comparability of businesses.

By examining the transaction price by the CUP method we can encounter another problem. What can occur if the subject of the transaction is unique, or is produced partly, or is a well known brand? Here we cannot find comparable transactions as they are unique products and there might not be any other similar transaction made by uncontrolled entities that might be considered as comparable. For example, a company produces ordinary clothes and sells to its subsidiary residing abroad, but the other company produces similar ordinary clothes putting on its brand name and sells them to a non-connected company residing abroad. The brand name makes the product ten times expensive. In this case we have the

same type of business and production of the same type of products. Could they be comparable transactions?

In the first case we have a controlled transaction and in the second case an uncontrolled transaction. The uncontrolled transaction will serve as a base for deciding fair market price for that kind of clothing. After that if a controlled transaction will happen it will be considered as a transaction not compelling to the scope of Arm's length principle. As mentioned by Peter Harris and David Oliver in the "International Commercial Tax" book, the transactions are not comparable where the goods and services are so special that there is no external market for them and they are not offered for sale to third parties. Taking into account the mentioned viewpoint, transactions explained above cannot be comparable as the subject of the transaction are unique goods, which are not offered to third parties. Besides that we will not be able to find any transaction which could serve as a base for comparison. As a result, the main method of transfer pricing will not be applicable and the next method should be considered.

Another field where we will encounter the above-mentioned problem is IP. Technologies are developing very fast and the transaction on transfer of intellectual properties is becoming broader. IP by itself is unique and it is almost impossible to find any transaction for making comparison. So problems arise here which might be a challenge for Armenian tax authorities in deciding the fair market price for transactions regarding transfer of intellectual property. Afterall what methods should be used for identifying the real price of IP transferred between related entities? It is evident that the CUP method is not applicable because of absence of comparable transactions. So we need to try to apply the other methods of transfer pricing.

Resale Price method: The next method of transfer pricing is the Resale Price method (hereinafter: RPM). The RPM is the second method and is merely being used for the cases connected to resale of products purchased from related entities.

The resale price method sets the arm's length price for the sale of goods between related parties by subcontracting an appropriate markup from the price at which the goods are ultimately sold to unrelated parties.[18]

[18] Brian J.Arnold - "International tax premier", pg.62

We can conclude from the above definition of resale price method that it is also based on the comparison with the same kind of transactions occurring between unrelated parties. Here the subject of comparison is not the price of the product, but the percentage that resellers add to the price of purchased product.

A difficulty that may arise when using this method is ascertaining an appropriate markup, especially where the related reseller adds value to the product. The markup price should be that of a typical distributor engaging in similar activities. It is also difficult to use this method if significant time passes between when the reseller purchases the goods from the related party and when it resells them to an independent party. With the resale price method the comparison of the product is not as critical as comparing the markup of an independent sales agent if the reseller's functions, terms and risks are comparable.[19]

The essence of this method is to push companies to pay real taxes to the state budget and not to reduce the taxable amount by implementing tricky methods. RPM forces affiliated companies to pay taxes as others do, despite the price by which it purchased the product to its related company or companies. Tax authorities compare the percentage that independent companies add to a comparable type of products and set the percentage that related companies should be governed by. In other words, tax authorities set the percentage from the resale price as a tax base in resale transactions and oblige related companies to calculate taxes based on that percentage.

Thus, in RPM, the resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions.[20]

As the method is based on comparison, tax authorities should find comparable transactions and find out how much the independent parties add to the purchased price. But what is the difference between RPM and CUP? The CUP is also based on comparison with similar transactions and if there is no comparable transaction the CUP method becomes not applicable anymore. Does the RPM work if there is no similar transaction to compare? The main characteristic of this method is scope of comparable transactions. Let us instantiate it with an example.

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[19] Peter Harris and David Oliver - "International commercial tax", pg. 237
[20] OECD - Transfer Pricing methods, July 2010, link

Company A residing in country A produces jackets with 100 USD each and sells them to its subsidiary company B residing in country B for 150 USD. Company B resells the purchased jackets by 400 USD. As the jackets have been purchased from related parties the resale price should be under control of transfer pricing regulations. In this case country B will apply RPM after identifying non-compliance of CUP method. This means that the resale price used by company B for reselling the product will be compared with the markup percentages of independent companies for similar services. Let’s assume that the markup price for RPM in country B is 50%. In result the taxable amount for company B in country B will be 50% of 400 USD (resale price) - 200 USD. Hence, company B will pay tax from 200 USD according to the tax rate of the country.

This method may prove more practical in many cases than the CUP method. Resale price method gives opportunity to compare the markups of independent sales agents. Thus, in the above example, it does not matter that the comparable independent sales agent resells jackets, it may resell other types of clothes, but the markup might be the same as it could be in case of jacket resales. What is essential is that we do not encounter a problem such as the uniqueness of the products, because we are not obliged to find an appropriate similar product for comparison. The essential is to find a business that makes activities in a more or less similar sphere and to find out how much they add to the price that they had purchased that product.

In comparison with the general method of CUP, the scope of resale price method application is much narrower. It could be used only in cases when we deal with the resale of products purchased from a related entity. Besides, there is another side of the coin - what concerns the comparability of the transactions the scope of the RPM is broader than that of CUP method. The comparable transactions should not be strictly the same. This makes RPM to be more practical, to be used in many more cases and secure a certain amount of taxes to the state budget as the independent parties do, regardless of the price by which related companies made transactions between each other.

Before examination of the other methods let’s discuss the Armenian regulations on resale price method. In the list of transfer pricing method resale price method is the second and it is explained as a method, in which the markup received from the resale of the subject of the controlled transaction is compared with the markup received from the resale of the

subject of the comparable uncontrolled transaction.[21]The resale price method may be applied, in particular, when the reseller has not added any significant additional value to the resold product during the resale of the goods acquired in the controlled transaction.[22]

This is the whole regulations that exist in the legislation of the Republic of Armenia. As of 15th April 2020 there are no additional regulations or guidelines regarding RPM or other methods of transfer pricing.

After examination of the existing regulation it is not clear what should be compared markup prices or markup percentages. This ambiguity in legislation might be bases for future problems and difficulties in application of the resale price method in its whole meaning and purpose. Without mentioning the comparable objects the legitimate aim of this method is being put under doubt. If the comparable object is not specified it could be the price of products as well. So after that the method will be inapplicable together with the CUP method. If the comparison object is prices, then we should find similar products, which have already been done in case of CUP method. In case of not finding the appropriate product the RPM becomes inapplicable as well, and having such a method becomes meaningless.

The international practice as stated in the work of Peter Harris and Sol Picciotto, recognizes markup percentages as comparable objects. For RA a regulating decree is needed to further clarify the situation and will set markup percentages as comparable objects in case of application RPM.

Cost Plus Method: The last traditional method is the Cost Plus Method (hereinafter: CPM). CPM establishes an arm's length price using the manufacturing and other costs of the related seller as the starting point. An appropriate percentage of profit is added to these costs. This method is often appropriate when determining the arm's length price of semi-finished products sold between related parties or for the provision of services.[23]

As we can assume from the above mentioned definition the CPM is being used only in cases if one of the related companies is engaged in production. So if a company sells its own product to a related party the price of the transaction will be regulated by the CPM, after non appliance of CUP method.

[21] Tax Code of the Republic of Armenia, article 368.1
[22] Tax Code of the Republic of Armenia, article 368.2
[23] Peter Harris and David Oliver - "International Commercial Tax" pg. 237

The Cost plus method is similar to the Resale Price method by its appliance and practice. The scope of CPM appliances is narrower as it includes companies which are engaged in production. The appliance of this method is based on comparison as the other methods. The comparison identifies how much the producers add value to the cost of the product. As in case of the RPM here the markup will be the percentage that the companies in the same sphere of business usually add to their products. As a result, the scope of comparable transactions is broader and it may be easy to find appropriate transactions and to set the markup percentage to the products sold by the producer to the affiliated company.

Assumingly we have found the comparable transaction and have found the appropriate margin of resale price, remains one question - what should be the tax base for such kind of transaction.

In the aspect of tax law, the profit of a company after deducting all expenses that are considered deductible based on tax legislation of the residing country is the entrepreneurial income. For example, the RA Tax Code states that net income is the result of overall income and deduction of deductible expenses stated by the same Code.[24]

Examining the definition of the RPM we may conclude that the markup percentage is being added to the cost of the product that has been produced by that company. The cost of the product is being accepted as the price that company had used during the production.

Thus, the income for the company is the amount that has been added to the cost of the product and tax base in case of applying RPM is the markup price.

For example, A resident in country A produces jackets with 100 USD each and sells them to its subsidiary B residing in country B for 150 USD. As the transaction was made between related companies it shall be governed by the regulations of transfer pricing. Country A will use CPM after non-compliance of CUP method. The markup percentage for cloth production in country A is 100%. As a result, tax authorities will state that the jacket should have been sold for 200 USD. Company A should pay taxes from the markup price - 100 USD in country A, according to its tax law regulations. So this is a practical example on application of CPM.

The CPM regulations in the Republic of Armenia are somewhat different from the international regulations and practice. The RA Tax Code defines the CPM as follows: "*the markup applied to the direct and indirect costs incurred during the supply of the subject of*

[24] Tax Code of the Republic of Armenia, article 150.1.1

*the controlled transaction is compared with the markup applied to the direct and indirect costs incurred during the supply of the subject of uncontrollable transactio*n".[25] So, the Tax Code mentions markup price as well, but does not ascertain the markup percentage. This problem is also actual in the case of RPM, which is discussed above.

The next important factor that I want to mention is the "cost of product". The cost has been discussed above, it is the price that company has used to produce that product. But how is that price being identified and by whom?

As stated in "International Commercial Tax"[26] a difficulty with this method is determining an appropriate margin and cost base on which to add a markup. I agree with the mentioned opinion and I want to discuss issues related to the cost of manufactured products.

After the deep examination of the Tax Code of the Republic of Armenia I will undoubtedly say that the cost of the product is being "decided" by the manufacturer. It is being done in the following way: manufacturer shows sources of expenses and then shows the total expenses, which is being considered as "cost" - base for adding markup price. So it is possible that manufacturers may show less expenses and in that way minimize the product cost. In that price the tax authorities will add their respective percentage and charge taxes from that markup. In result companies will pay less taxes.

The purpose of the transfer pricing rules is to force companies to pay the real taxes from the real income and do not find ways to make manipulations with the result of tax avoidance. So, besides the enactment of transfer pricing rules the Tax Code should include norms ensuring the reliability of sources that are being used in transfer pricing methods.

Controlling body: Besides praiseworthy regulations regarding transfer pricing implemented by the legislative body of the Republic of Armenia there is another side of the coin - the controlling body. The regulations regarding transfer pricing are stated in RA Tax Code and the only tax authority in the Republic of Armenia is the State Revenue Committee (hereinafter: Committee), which means that the control over mentioned regulations is being carried by the Committee. The fact that the Committee is an adjacent body to the Government does not make it a reliable and competent body for regulating relations in the field of transfer pricing.

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[25] Tax Code of the Republic of Armenia, article 368.1.3

[26] Authors - Peter Harris and David Oliver

In my personal experience as a practicing lawyer I have dealt with the Committee in many cases, even in cases related to transfer pricing. Before 2020 related multinational companies had made thousands of transactions without any restriction to product price. These transactions led to payment of less taxes, even non-payment of taxes, showing 0 income, but the Committee didn't have any possibility to take measures to stop the companies making that kind of transactions. The reason for this inability was the absence of tools of law, similar to transfer pricing rules.

Starting from 2020 the transfer pricing rules have come into force, but what is significant, is the fact that the rules may prove of no help to the Committee to overcome the issues in this field. We have regulations concerning transfer pricing methods, their implementation and application, but there is no regulation about the measures that Committee should or can take to control this field. The main issue is sources from where the Committee might have known about controlled transactions and then find out their compliance with the law.

The only source of information about implemented controlled transactions is the notification by taxpayers about the controlled transactions, the price of which is above 200 million AMD (without VAT and excise tax) in the same tax year.[27]

It is evident that controlled transactions below 200 million AMD do not fall under regulations of transfer pricing. The point regarding the 200 million AMD cup needs attention, as for a little country such as Armenia, it should not concentrate only on the large transactions. However, let us not delve into the issues concerning this threshold, and concentrate on the sources of information regarding controlled transactions.

As we can see from the Article 375 of the Tax Code, the Committee is being notified about controlled transactions from taxpayers who implement them. But is it fair for a State body to rely on taxpayers and do not seek any additional measures to receive information from other objective sources?

My judgement is that the state body is obliged to have its own sources for getting information regarding controlled transactions. Taxpayers might not act fairly everytime and might not make notification about controlled transactions. In result, the Committee might not be aware and will not take appropriate methods to make affiliated companies pay taxes as independent entities do.

[27] Tax Code of the Republic of Armenia, article 375.1

Together with leaving the responsibility on the taxpayers, the Committee does not even enact obligating norms for non-submission of information about controlled transactions. So, if taxpayers do not notify the Committee about implemented controlled transactions, they will not be penalized by state authorities for non-disclosure of the information which they should have done.

Afterall, the Committee acting on behalf of the Republic of Armenia and representing the State in relations with taxpayers, does not have enough tools to force taxpayers to notify about controlled transactions or implement administrative penalties over dishonest taxpayers.

My stance on the issue is that the Committee is not in power to regulate controlled transactions and apply a transfer pricing method to identify its compliance with fair market prices. Accordingly, here arises a question regarding the competence of the controlling body. After a full investigation of transfer pricing regulations and authorities of Committee I may surely mention that Committee is not the competent body that could regulate relations in this sphere in the light of the current regulations.

The same problem may occur in case of finding non-controlled comparable transactions, which is being discussed below.

Sources of uncontrolled information: The next challenge that needs a solution is the issues concerning the sources of the information regarding not controlled transactions. From the discussion of transfer pricing regulations and especially methods we may conclude that it is built on comparison. All methods are using comparison with independent (uncontrolled) transactions to find out the fair market price of products subject to controlled transactions. In order to have more accurate results the sources of uncontrolled transactions should be reliable. From where should the information be taken in order to be considered as reliable?

The sources of uncontrolled transactions may be external and internal uncontrolled transactions.[28] Internal uncontrolled transactions are transactions where one of the parties in an uncontrolled transaction is also a party in a controlled transaction. External transactions are transactions where both parties are not affiliated.[29] Besides external and internal uncontrolled transactions, the Tax Code also recognized other sources.

[28] Tax Code of the Republic of Armenia, article 367
[29] Tax Code of the Republic of Armenia, article 361

The Tax Code states the sources for uncontrolled transactions, but does not mention from where the information regarding uncontrolled transactions should be taken. This is not a guarantee for having reliable sources. It is useful that the Tax Code recognizes some sources for uncontrolled transactions, but the absence of regulations on from where should be taken that information to fall under the sources of the uncontrolled transactions, makes the sources less reliable.

Not going deep into the details of the mentioned issue, I would like to discuss another closely related issue. Let's just assume that we have information from the sources mentioned in the Tax Code and we need to analyze them. But should we take into consideration when that information was received? To find the answer we need to discuss another article of the Tax Code.

The Tax Code states:

> *"the information used in assessing the comparability of an uncontrolled transaction with a controlled transaction must relate to the tax year in which the controlled transaction took place, except in the cases of:*
>
> *1) when the information on the tax year for the implementation of the controlled transaction is not known when the comparability of the uncontrolled transaction with the controlled transaction is assessed. In this case, the information of the previous tax year may be used in case of meeting the requirements of comparability defined by Article 365 of the Code.*
>
> *2) when the data relating to not more than 3 tax years prior to the execution of the controlled transaction reveal facts that may affect the determination of the comparability of the comparable transactions."* [30]

So we have three types of information that might be used - information received in the same tax year, received in previous tax year and even received 3 tax years priorly. This regulation does not make sense, because we are dealing with a market in which there are special fluctuations. Every product or service loses or gains price even in months or weeks and what would be the reasoning behind using information gained 1 to 3 tax years priorly?

[30] Tax Code of the Republic of Armenia, article 370

Problems can occur even if we use information received in the same tax year as well. A vivid example is present nowadays, when many types of businesses are closed because of the COVID-19 and as a result many many products could lose their value or record an increase in the value. So, if the controlled transactions happened in the beginning of April of 2020, the information that was received in February of 2020 might not be correct and reliable.

Taking into account that the regulations on using information received even within the same tax year could not be considered as reliable, it is meaningless to talk about the information that was received 2-3 tax years priorly. From the perspectives of Tax authorities it is one more chance to find a comparable transaction. It seems easier for tax authorities to overcome the difficulties, which can occur in finding comparable transactions, but it may put business entities in a difficult situation. Companies might be required to pay much more taxes than they should have, but there could be cases when companies might pay less taxes. So, it depends on the case at hand, but in order to have fair regulations for both sides (tax authorities and taxpayers) we need to take into consideration situations from both perspectives.

In this chapter I have tried to provide a discussion regarding the Armenian transfer pricing regulation and bring about the reasonable assumptions concerning the challenges that may arise for Armenian tax authorities. The shortcomings and issues mentioned above do not affect negatively the transfer pricing regulations rendering them completely unuseful. Moreover, all the discussed challenges have their solutions and that possible solutions will be suggested in the chapters to follow.

4. Double Taxation

In this chapter I would like to talk about a separate aspect of international tax law. As the topic of this paper is a discussion regarding transfer pricing, which is being implemented between different states, there is a high possibility of double taxation cases to arise for the concerned parties. I feel the need to incorporate a little discussion on international double taxation regulations and possible issues that legal entities might face.

The main instrument of states for avoiding double taxation is the treaties signed between them. But in fact not all countries have double taxation treaties between each other. The absence of treaties puts international business companies in a difficult situation. Their income will be taxed twice: first time abroad as source income and second time in place of incorporation as residence income.

The 3 most common methods of double taxation known in international tax law are:

1. Deduction method,
2. Exemption method,
3. Credit method.[31]

Deduction method allows the taxpayers of the country of residence to claim deduction in computing income for taxes, including income tax, paid to a foreign government in respect for foreign source income.

In case of Exemption method the country of residence exempts foreign source income derived by its residence country tax.

Credit method provides the taxpayers of the country of residence with a credit for income taxes paid to a foreign country against residence country taxes otherwise payable. Under the credit method foreign taxes are deductible in computing the tax payable to the residence country but not in computing the taxpayer's income.

International regulations in double taxation are stated in OECD convention with respect to taxes on income and on capital (hereinafter: Convention). The article 23 of the mentioned Convention is dedicated to international aspects of double taxation and its methods. The Convention accepts only two elimination methods of double taxation - exemption method and credit method.

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[31] Brian J.Arnold - "International tax premier"

For elimination of double taxation we need to examine three factors. There should be the same company, same income and the same tax year. After this test we may conclude that we deal with double taxation.

As we see for double taxation we need to have the same income, same company and same taxable year, but in case of transfer pricing the companies may be different. As we are going to discuss double taxation in context of transfer pricing, we need to have a look at the regulations regarding double taxation which are stated by article 23 of the Convention.

The OECD convention differentiates 2 types of double taxation: juridical and economic.[32] Juridical double taxation - the same income or capital is taxable in the hands of the same person by more than one State. Economic double taxation - two different persons are taxable in respect of the same income or capital. If two states wish to solve problems of economic double taxation, they must do so in bilateral negotiations.

First we need to find out which regulations are applicable for transfer pricing. As I have discussed in previous chapters the transfer pricing is being implemented by different but somehow connected (affiliated) entities, such as parent and subsidiary. Despite the entities being different, the beneficiary is the one, who is going to get income from the business activities of affiliated entities. Accordingly, if the entities are connected the income gained by them will be considered as the same income. Usually the transfer pricing is being implemented between different entities which are somehow connected. Despite the fact that they are connected and may have the same shareholders, the companies in the eyes of states are being considered as different entities and should be taxed separately by the states where they reside.

So, we cannot surely say which type of double taxation is applicable for transfer pricing cases. The business purpose of the connected companies is the same and the income gained by the seemingly different companies is the same. From the other side, the companies are separate entities which are registered and residing in different states. Hence, the tax authorities of each state will consider the earned income by each of the entities as source income and tax accordingly.

The most appropriate type of double taxation for transfer pricing cases is the economic double taxation. Reasoning behind this conclusion is the following: the aim of the

[32] OECD, Model Tax Convention on Income and on Capital, Commentary on articles 23A and 23B (link)

beneficiary is to gain profit by two or many companies and as a result the same income will be gained by different companies.

It is evident from the commentary on article 23, that the economic double taxation regulations are reserved to contracting states, which is another difficulty for states and for companies as well. To describe the double taxation in the light of transfer pricing I would like to represent an example:

Company C owns two companies - company A residing in country A and company B residing in country B. A produces doors 1000 USD each. Company A sells the doors to B by 1100 USD. B resells the purchased doors by 2000 USD.

According to the CUP method company A sold doors to B by lower price, the market value is 1500 USD and accordingly taxes will be calculated based on market value. Tax authorities of country B acknowledge that company B resell the doors also by lower price, the market value of that product is 2500 USD.

The tax for A will be calculated on 500 USD (net profit) and tax for B 1400 USD (net profit), but as a result the whole profit of companies together was 1000 USD. After the implementation of transfer pricing method CUP by both countries the taxable amount for the whole income is 1900 USD. As we can see the whole income of companies together is 1000 USD, but they together paid taxes based on 1900 USD. So the difference (900 USD) was taxed twice.

Here we deal with economic double taxation, which resolutions are reserved to contracting states. How should companies resolve this kind of issues?

The resolution is up to states. Contracting states should discuss and find possible solutions, but I guess none of the contracting states will concede its right to source taxation from the companies. From the perspective of tax authorities it is fair that each income was taxed in the residing state as source income. But from the side of the beneficiaries it is not fair, because they have paid much more taxes than they should have paid.

But fortunately the regulation of double taxation exists in the article 9 of the Convention as well. Article 9 regulates taxation between related entities:

> *Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the*

enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.[33]

The commentary on article 9 ascertains further that in case of associated companies there might arise economic double taxation (taxation of the same income in the hands of different persons). Examining article 9 we can conclude that it provides some kind of regulation regarding double taxation in case of transfer pricing.

According to the mentioned article we should have certain conditions for making adjustments in order to avoid double taxation. The first condition is the existence of bilateral agreement between states, as the commentary on the same article mentions that economic double taxation is being regulated by agreements between states.

The second important condition is the compliance to the transfer pricing rules. Transaction between affiliated companies should be made as it might be in case of independent parties. In other words the transaction between affiliated companies should be in the space of arm's length principle.

The last condition is the taxed income of one of the affiliated companies. One of the affiliated companies should be taxed by the tax authorities of the residing state for the income gained in that state.

So after compliance of these three conditions the rules regarding exception of double taxation might come into force. I would like to examine each of the three conditions.

Bilateral agreement between states: if the states where two affiliated companies are residing separately do not have agreement regarding economic double taxation the transaction implemented in the sphere of transfer pricing might be put under the risk of being taxed twice. The international regulation (Convention) does not have any imperative norm to regulate the issue that arises in the discussed topic. The absence of the agreement between states might cause economic issues for that state. Large companies which are going to invest money in a certain state will avoid doing so in states which do not have agreement with the

[33] OECD,Model Tax Convention on Income and on Capital 2017, Commentary on article 9

state where it is residing, because in result of the investment, the earned income for the investor might be taxed twice and provide lower income.

The legal aspects of not having such kind of agreement is not as important as the economic aspects. Companies might do research and find out the existence of the agreement between states and will decide where they should make investments and where they should not do so.

I will suggest to include an international regulation for states to have economic double taxation treaties with each other. This will minimize the risk of being taxed twice by two states and will attract companies to make investments and in that way help less developed states to develop further.

Next condition relates to compliance of transfer pricing rules. It is not clear from the article 9, what it means by saying *"if the conditions made between the two enterprises had been those which would have been made between independent enterprises".* We can just conclude that it states about the compliance of the rules of arm's length principle. But if the conditions of independent transactions were not kept and it was corrected by tax authorities, based on which taxes have been paid, could it be considered as compliance of the considitions?

Commentary on article 9 states: *"...the paragraph may not be invoked and should not be applied where the profits of one associated enterprise are increased to a level which exceeds what they would have been if they had been correctly computed on an arm's length basis".* So if the transaction was not made in the space of arm's length principle the article 9 will not be applied.

After the explanation of the commentary the question remains the same. I would like to discuss the issue based on the example stated above. The affiliated companies A and B made transactions which were not within the space of arm's length principle, but they have paid taxes according to the arm's length principle which was decided by the tax authorities of both states. As a result the companies have paid taxes as the independent companies might do. Is Article 9 applicable in this example?

I think that the article 9 is applicable in this case-example, because the essence of transfer pricing rules is to force affiliated companies to pay taxes as independent parties do. It is not important whether the companies have paid taxes according to arm's length principle by themselves or by the power of tax authorities. After payment of taxes according to the

arm’s length principle, companies should have the possibility to apply article 9 to their transactions and avoid double taxation.

The last condition is more or less clear. It refers to cases when one of the affiliated companies residing abroad makes transactions and pays taxes accordingly. If the beneficiary resides in a country other than the source income, the source state should make appropriate adjustments. In the example country B should make appropriate adjustments for the income gained in country B by company B. But what is an appropriate adjustment?

Neither the article 9, nor the commentary regarding article 9 do not give explanation what could be considered as appropriate adjustment. After examination of article 9, it is presumably reserved to the contracting states. So the amount of money or method of double taxation elimination is being decided by the contracting states.

To conclude, this regulation to my judgement is very arbitrary, because each state could dictate its rules and it might put business companies in a difficult situation. This issue together with the issue of not having economic double taxation treaties between states, should be regulated by an imperative international norm, which will force states to conclude economic double taxation treaties and set the amount of appropriate adjustment.

4.

5. Resolution of challenges

In this paper I have offered discussion regarding the challenges of Armenian reality in transfer pricing and in this chapter I will speak about the possible solutions of the previously mentioned challenges. As the transfer pricing rules are newly imported into Armenian legal system, we cannot rely on the existing cases regarding it. Accordingly, we should discuss the law without having practice and assume how it can work in practice and what possible challenges there could be.

The challenges are serious for the Republic of Armenia, but we do not need to change the whole regulations. We can find an easier solution to all priorly mentioned challenges. Most challenges might be resolved by the enactment of a Government decree. Decree should involve practical regulations and also additional mechanisms for implementation of the transfer pricing norms.

Firstly, I will talk about the challenge regarding the **CUP method**. As already discussed, the main issue is finding appropriate transactions that could be used as a base for comparison. In case of finding the comparable uncontrolled transaction first of all the factor of business spheres the companies operate in should be taken into consideration. It means that before coming to the transaction comparison we should have regulations regarding comparability of businesses with independent companies. The criterias for business comparability will give a chance for having a proper source of information and reliable bases for comparison of similar transactions.

Business comparison criterias are keys for reliable and proper source of information. The criterias for business comparison are needed as much as criterias for transaction comparison. The only solution for having reliable bases for transaction comparison is enactment of criterias for businesses that might be compared. So the suggestion is to include criteria for business comparison also, which will explain what kind of businesses could be considered as comparable with each other. If the businesses are the same the transactions could be much more similar and the chances for finding more similar transactions will be higher.

The mentioned regulations will help to find transactions more easily and the CUP method becomes more reliable. The comparable uncontrolled price method, being considered

as the main and first method of transfer pricing, will stay in the main position and there will not be necessity to apply other methods of transfer pricing.

It is also important to discuss the possible barriers from the side of business entities. Under the shade of the absence of practical regulations from the Government on application of transfer pricing rules, the entities may appear in a difficult situation. Companies before the enactment of the regulations freely made transactions between their related entities and no state body restricted them. After the regulation came into force the companies should make transactions with the related entities which have to be in the space of the arm's length principle. In other words the transfer price should be the same as the fair market price of that kind of transaction. But do companies have the possibility to be informed whether their price is the same as the fair market price? For example two affiliates have made transactions with the same price for an extensive amount of years and now they should be governed by the transfer pricing rules and put the transaction price the same with the fair market value.

The price of the same product might fluctuate, especially nowadays, where most of the businesses are not working because of the COVID-19. So if the price of the products is inclined to fluctuations, the companies making transactions every time will have to pay different amounts of tax. The amount of tax that should have been paid to the state budget is one of the main points that should have been taken into consideration before entering into a transaction, because the more tax is paid the more damages the company could bear. It is clear that companies will not be obliged to pay penalties for selling products at a price other than fair market value, but they will have to pay taxes based on the fair market price, which could lead to payment of additional taxes than they have considered or calculated. But how could companies escape problems and make proper calculations?

At this moment there are no regulations that can help companies to overcome the difficulties arising around the price of the products being sold to related entities. The Tax Code gives the opportunity to use information received even 3 years ago. This approach is unacceptable, because as already discussed the price of products are inclined to fluctuation. Fluctuation can occur every month and it is meaningless to use information received three years ago and accept it as reliable and correct.

The price could have a serious role in case of proper planning of business income and expenses, it is important for companies to make transactions in the space of arm's length

principle. For instance, this problem is more important for companies which make transactions regarding the same product not every day, but once in 3 months.

In this case companies should have the possibility to know the fair market price of the product which they are going to sell to their affiliated company. Companies should not identify the fair market price of the products by their means, such as evaluation of the products by specialized companies, which most probably will not cost less money. Why should companies pay additional money every time for entering into transactions between affiliated companies in the space of arm's length principle. This might be considered as a non-business friendly approach, which may cause an outflow of main business capital from the country.

Having in regard to the interest of business companies I will suggest creating a platform where the legal entities could have the possibility to be introduced with the market prices of products which they need. The platform might be created by the Statistics Committee of the Republic of Armenia with the information received from the local companies and making it accessible for companies under the unanimous names. The information that should have been received from other states could be done within the framework of bilateral treaties and cooperation against international tax avoidance.

This solution will give opportunity to business companies to be aware about the market prices of the products that they are going to sell or purchase from the affiliate company. In result the companies might properly plan how much taxes they should pay and what expenses are needed for striving for the maximum income.

Suggested solution is going to work for tax authorities as well. After creation of the platform they will have a huge number of transactions and can easily find uncontrolled transactions for comparison. Besides that the result of comparison will be more accurate and reliable.

The next challenge for Armenian tax authorities and business companies is the issues regarding methods of **RPM and CPM**. The methods have been discussed in the 3rd chapter. According to that discussion both methods are based on comparison with the prices of transactions made between independent parties.

The major issue is the comparing price. Comparison should be made not between prices of transactions, but between the markup percentages that similar businesses add to their product at the time of selling them to an independent party. Decree should also set the

frame of possible comparison. The frame should be broader than that of CUP. In the case of RPM and CPM the frame of comparability should include transactions made in more or less similar spheres. As a result, there will be no need to find absolutely similar transactions to compare, tax authorities should only find what percentages business entities add to the price of products in some specific field, such as in the market of clothes.

The absence of wording “markup percentages” and frame of comparison may lead to non appliance of both methods together with CUP method. Without that wording tax authorities will search for maximum similar transactions to compare them with the transactions made between connected companies. After not finding the appropriate transactions that are considered as comparable by the notion of the Tax Code, the tax authorities will come to the conclusion that the methods are not applicable because of absence of comparable transactions.

The changes in the law will have its positive impact on the practice. The possibility for finding an appropriate transaction will be much higher, because the comparaison will not be made between the prices of the same kind of product, but between the percentages that are being added by the reseller or manufacturer on the price of the product, which could be more or less similar.

These solutions are easy to include in a Government decree and give a practice to the appliance of transfer pricing rules. But the next issue might not have a solution by enactment of Government decree.

A major issue is the liability of taxpayers for notification of controlled transactions. The RA Tax Code does not have a single norm stating responsibility in the form of fines for non-notification about controlled transactions.

We may encounter a serious problem because of this. The only source that tax authorities might know about implemented controlled transactions are the taxpayers themselves. But can we rely on the objectivity of taxpayers each time?

By notifying about controlled transactions related entities making difficulties for themselves. After notification they need to be sure that their transaction in the space of arm’s length principle, otherwise tax authorities will find out the real price of the controlled transaction by own means. As a result, entities will result in paying much more taxes than they could have paid by non-notifying. Moreover, they can easily state lower prices in their

controlled transactions and accordingly pay less taxes. Afterall, tax authorities may not even know about the implemented transactions

As we see the notification about controlled transactions is not in the interests of the business entities. Hence, the regulations regarding transfer pricing might seem meaningless, because the only hope of the state body is the responsibility of the taxpayer.

To avoid future issues, I will suggest making an amendment in the Tax Code. The first amendment should be in the shape of substantial liability for taxpayers for non-notification about controlled transactions. If companies acknowledge that they should pay considerable fines, they will notify tax authorities about controlled transactions each and every time.

To conclude, these are possible solutions to challenges that might encounter Armenian business entities and tax authorities. As has been mentioned the issues might be resolved by Government Decree and some amendments in the Tax Code.

I would like to sum up the discussion regarding resolution of challenges in the field of transfer pricing regulations. There might arise many other challenges, such as the cup of 200 million AMD and etc, but I have chosen the most important ones for discussion. The resolutions are not as much harder as they seem. We need to do further research and find more appropriate solutions to include them in the decrees or law amendments.

6. Conclusion

In this paper I have tried to demonstrate what is transfer pricing, its regulations in the Republic of Armenia and, of course, the international practice. I made a discussion about the most vulnerable points of transfer pricing regulations. Besides the mentioned issues and challenges the regulations seem to be valuable. It is remarkable that the Tax Code includes regulations on transfer pricing relations, but as it is the first time that the Republic of Armenia is trying to regulate such a sphere, the challenges are inevitable. The only thing is consistency and recent amendments during operation.

Accepting transfer pricing rules as one of the main directions for the prevention of tax avoidance, legislation should give more power to the Committee and ensure its stable action by implementation of counteract measures against dishonest taxpayers.

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