



COMPARATIVE ANALYSIS OF LEGISLATION ON TRANSFER PRICING IN NEIGHBORING COUNTRIES

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Abstract:

This paper analyzes the problem of the influence of legal requirements related to the calculation of transfer prices on the amount of taxable profit and the amount of income tax. It also deals with the compliance of the legislation in the Republic of Serbia with the relevant requirements of the European Union, as well as with the regulations of neighboring countries. Given that a large number of companies do business with related parties both in the country and in neighboring countries, the emphasis was placed on analyzing the justification of harmonizing transfer prices with prices at "arm's length" and on comparing the requirements imposed on taxpayers by the legal regulations of the Republic of Serbia, the Republic of Croatia, the Republic of Montenegro, and Bosnia and Herzegovina.

Keywords:

transfer prices, profit tax, "arm's length" principle, documentation on transfer prices, neighboring countries.

1. INTRODUCTION

In the Republic of Serbia, there are many legal entities that do business with related parties at the national and international level. In order to prevent the spillover of profits from one country to another, or from one legal entity to another, the goal of each country is to show the real tax liability for income tax of each legal entity in the group of related parties by using legislation to bring down the prices of transactions between related parties to market-acceptable prices. This paper points out the justification of harmonizing transfer prices with "arm's length" prices and harmonizing the regulations in the Republic of Serbia with the regulations of neighboring countries (the Republic of Serbia, the Republic of Croatia, the Republic of Montenegro, and Bosnia and Herzegovina). The subject of the research is the impact of the legislation regarding transfer prices on the amount of taxable profit and the amount of calculated income tax and the prevention of tax evasion based on transactions between related parties, as well as the compliance of the legislation of the Republic of Serbia with the regulations of neighboring countries. Transfer pricing as a problem is known in the world literature. It gains its greatest importance with the publication of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, which are relied upon by both legal regulations of our country, as well as the regulations of neighboring countries.

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2. TRANSFER PRICES AND THE JUSTIFICATION OF THEIR ADJUSTMENT WITH "ARM'S LENGTH" PRICES

A transfer price is considered a price arising in connection with transactions with funds or created by making obligations between related parties. In the literature, this price can also be found under the names of prices "at arm's length" or prices in controlled transactions. According to IAS 24 Disclosure of relationships with related parties (Decision on determining the translation of International financial reporting standards (IFRS) number 401-00-4351/2020-16 of September 10, 2020 ("Official Gazette of RS", no. 123/2020 and 125/2020)), transactions between related parties are business changes in the transfer of resources (assets - property), services or obligations between related parties, regardless of whether or not compensation is charged, i.e. whether "free" resource transfer is carried out (Petrović, 2021).

The essence of dealing with transfer prices and reporting them is that income and expenses incurred in transactions with related parties are recognized at the level of income and expenses that would arise in transactions between unrelated parties. Transfer pricing reporting is based on the "arm's length" principle. What the transfer price is compared to is the market price or the price at "arm's length" or the price in uncontrolled transactions, and that is the price arising in connection with the transactions of funds or created by making obligations between unrelated parties. Namely, the prices of transactions between related parties are compared to the prices of the same transactions that would be realized between unrelated parties on the market. If there appears a difference according to which the taxable profit shown in the tax balance sheet is lower than the one that would have been realized if the transactions were carried out at market prices, the taxable profit must be increased.

Transactions that affect the amount of taxable profit are transactions that are recorded in the taxpayer's accounting books within income and expense accounts. In the event that a taxpayer has shown a lower amount of income at transfer prices than they would have shown if "arm's length" prices had been used, a taxpayer is obliged to increase the taxable profit for the difference up to the amount of income at "arm's length" prices. In the same way, if they presented the expenses at transfer prices in a larger amount than it would be the case with at "arm's length" prices, the taxpayer is obliged to reduce them to "arm's length" prices and thus increase the tax base for determining the income tax of legal persons.

The justification for the special presentation of transactions between related parties and the reduction of transfer prices to "arm's length" prices lies in the fact that transactions between related parties are potentially risky areas for tax evasion. In doing business between related parties at the international level, multinational companies can strive to reduce the tax liability of the group by directing part of the taxable income to those countries where the tax rate is lower. In business between related parties within the country, taxpayers may strive to reduce the tax liability of the group by directing part of the taxable income to members of the group who have current or carried forward tax losses from previous years or the possibility of using tax incentives.

3. COMPATIBILITY OF LEGAL REGULATIONS REGARDING TRANSFER PRICING IN THE REPUBLIC OF SERBIA WITH REGULATIONS OF NEARBY COUNTRIES

In the case of multinational companies, the need to meet legal obligations that may differ from country to country creates additional problems. Different requirements can lead to a greater burden on multinational companies and can, as a consequence, have higher costs in fulfilling obligations than would be the case with a similar company that operates exclusively within the framework of one legal regulation. In applying the principles for taxation, the question of establishing appropriate transfer prices for taxation purposes arose. These are the prices at which the company transfers tangible goods and intangible assets or provides services to related parties. For the purposes of the OECD Guidelines, the concept "related person" refers to a person who meets the conditions set forth in Article 9 (paragraphs 1 a and 1 b) of the OECD Model 1 Convention. Under these conditions, two companies are connected if one of them participates directly and indirectly in the management, control and capital of the other and if "the same persons participate indirectly and directly in the management, control and capital" of both companies, i.e. if both companies are under single control (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2011). When it comes to the compatibility of our legal regulations with the legal regulations of neighboring countries, it can be said that there is a great compatibility of our regulations with the regulations of neighboring countries. However, there are some exceptions.

In this part of the paper, we will briefly point out the similarities and differences in the reporting of transfer prices in the Republic of Serbia, the Republic of Croatia, the Republic of Montenegro and Bosnia and Herzegovina. The research sample consists of one EU member state and



three candidate states in order to compare the legislation of these countries, their similarities and differences, and how similar the legislation of the candidate states are to the legislation of the EU member states in this area. Also, these are the states from the closest environment.

Given that the legislation of all countries relies on OECD Guidelines, they can be compared. The content analysis of selected legislation is the research method used. Since the legislation is changing, below is a list of reviewed regulations.

Table 1. Overview of legislation by country

Republic of Serbia	Law on profit tax of legal entities ("Official Gazette of RS", no. 25/2001, 80/2002, 80/2002 (other law), 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014 (other law), 142/2014, 91/2015 (authentic interpretation), 112/2015, 113/2017, 95/2018, 86/2019, 153/2020 and 118/2021); Rulebook on transfer prices and methods that are applied according to the "arm's length" principle when determining the price of transactions between related parties ("Official Gazette of the RS", no. 61/2013, 8/2014, 94/2019 and 95/2021)
Republic of Croatia	Law on profit tax ("National newspapers", no. 177/2004, 90/2005, 57/2006, 146/2008, 80/2010, 22/2012, 148/2013, 143/2014, 50/2016, 115/2016, 106/2018, 121/2019, 32/2020, 138/2020); Rulebook on profit tax ("National newspapers", no. 95/2005, 133/2007, 156/2008, 146/2009, 123/2010, 137/2011, 61/2012, 146/2012, 160/2013, 12/2014, 157/2014, 137/2015, 1/2017, 2/2018, 1/2019, 1/2020, 59/2020, 1/2021); Rulebook on the procedure for concluding a preliminary agreement on transfer pricing ("National newspapers", no. 42/2017)
Republic of Montenegro	Law on profit tax of legal entities ("Official newspaper of the Republic of Montenegro", no. 065/2001, 012/2002, 080/2004, "Official newspaper of Montenegro", no. 040/2008, 086/2009, 040/2011, 014/2012, 061/2013, 055/2016, 146/2021)
Bosnia and Herzegovina	Law on profit tax of legal entities ("Official newspaper of the Federation of Bosnia and Herzegovina", no. 15/2016 and 15/2020); Rulebook on the application of the Law on profit tax ("Official newspaper of the Federation of Bosnia and Herzegovina", no. 88/2016, 11/2017, 96/2017, 94/2019, 87/2020 and 33/2022); Rulebook on transfer pricing ("Official newspaper of the Federation of Bosnia and Herzegovina", no. 67/2016)

Source: Websites of the ministries of finance of the sampled countries

3.1. TRANSFER PRICING REPORTING OBLIGEES

When it comes to determining related parties, in addition to the direct and indirect influence of legal and natural persons who exert this influence through their ownership or management function, related persons are also considered those who are natural persons' related persons, which have ownership or management function in the taxpayer. In the Republic of Serbia, any non-resident legal entity from a jurisdiction with a preferential tax system is considered a person related to the taxpayer. To a certain extent, the regulations of neighboring countries also consider natural persons' related persons, who have an ownership or management function in the taxpayer, as related parties. Likewise, the regulations of individual countries check transfer prices only at the international level, while at the level of the same country, the prices of transactions between related parties in that country are not checked. In the Republic of Serbia, transfer prices are checked both at the international and national levels. In the Republic of Croatia, related persons are considered to be persons where one person has direct or indirect participation in the management, supervision or capital of

another person, or the same persons have a direct or indirect participation in the management, supervision or capital of the company. Also, in the Republic of Croatia, if a legal entity has transactions with related parties abroad, it is obliged to report those transactions through documentation on transfer prices. If it does not do so, the tax administration has the right to deny those transactions. Apart from multinational companies, those liable to report on transfer prices are related companies that are residents in the Republic of Croatia if one of the related persons has the status of a privileged taxpayer and/or has the right to carry forward tax losses from previous tax periods.

In accordance with the above, the obligees responsible for the preparation of documentation on transfer prices are:

1. companies that do business with related parties abroad;
2. companies that do business with related parties in the Republic of Croatia if one of the related parties has a privileged tax position, i.e. pays income tax at rates that are lower than the prescribed rate or is exempt from paying income tax or has the right to carry forward tax loss from previous tax periods in the tax period.



In Bosnia and Herzegovina (unlike other countries where this is not intended to be done), a person who is found to be knowingly entering into a business relationship with a taxpayer with the aim of transferring profits is considered a related person. In such cases, the individual transaction is executed under the circumstances as if it were a related party.

3.2. APPLICATION OF METHODS FOR CHECKING TRANSFER PRICES

In the Republic of Croatia, it is prescribed that when it is possible to apply both the classic transaction method and the transaction profit method with equal reliability, preference is given to the classic transaction method, i.e. when it is possible to apply the method of comparable uncontrolled prices and some other method for determining transfer prices with equal reliability, preference is given to the method of comparable uncontrolled prices, with the emphasis that it is necessary to find the method that is most suitable for a specific case. When it comes to determining the price of a transaction in accordance with the "arm's length" principle, in Bosnia and Herzegovina the preference is given to the method of comparable uncontrolled prices, the cost price method increased by normal earnings and the resale price method, and only in the event that the mentioned methods cannot be applied one of the other methods can be used. The method of comparable uncontrolled prices has an advantage in application in relation to all other transfer pricing methods. In other countries, the legislation does not give priority to any method, so all methods can be used equally. Namely, when determining the transaction price according to the "arm's length" principle, the method that best suits the circumstances of the case is used, and it is possible to use a combination of methods.

3.3. TRANSFER PRICING DOCUMENTATION

The topic of transfer pricing in the Republic of Serbia has become relevant in the last few years, although the obligation to display transactions between related parties was introduced into our tax legislation through the Law on Corporate Profit Tax back in 1991. However, only since 2013 has there been an obligation to submit documentation on transfer prices with the tax balance sheet. The documentation is submitted in the form of a transfer pricing report (full and abbreviated transfer pricing report). From that moment, the calculation of transfer prices and their impact on the taxable profit gained great importance both in the tax legislation of the Republic of Serbia and in the tax practice of taxpayers.

According to the Law on Corporate Income Tax ("Official Gazette of the RS", No. 25/2001, ..., 118/2021), the taxpayer is obliged to separately show transactions with related parties in his tax balance sheet and together with it submit a report on transfer prices, in which it shows the value of transactions at transfer prices between related parties and at prices that would have been realized on the market for such or similar transactions if there were no related parties ("arm's length" principle). In the Republic of Croatia, the taxpayer is required to have a transfer pricing report and to submit it at the request of the tax administration. Also, the taxpayer can enter into a preliminary agreement on transfer prices and contractual relations, which is a preliminary agreement between the taxpayer and the Ministry of Finance of the Tax Administration, as well as the tax authorities of other countries where related parties are residents or operate through a business unit, which for transactions between related parties, before they began, establishes an appropriate set of criteria, to determine the transfer prices for those transactions over a period of time. In other countries, this possibility is not prescribed.

When it comes to the application of regulations on transfer prices in the Republic of Montenegro, from 2022, detailed regulations for reporting on transfer prices are being introduced. Large taxpayers are required to submit transfer pricing documentation to the Tax Administration, while other taxpayers should have documentation on transfer prices, but submit it at the request of the tax authority. Also, as in the Republic of Serbia, there are two types of transfer pricing reports, a full and abbreviated transfer pricing report. The method of determining transfer prices and the content of the documentation is carried out in accordance with the OECD Transfer Pricing Guidelines and other international organizations. In Bosnia and Herzegovina, a taxpayer who participates in transactions with related parties, at the time of submitting his tax return, is required to have documentation on transfer pricing that contains sufficient information and analysis in order to confirm that the terms of his transactions with related parties are in accordance with the principle of "arm's length". There are two types of transfer pricing reports in Bosnia and Herzegovina, a full and abbreviated transfer pricing report. The criteria for compiling a full or abbreviated transfer pricing report differ from country to country.



3.4. DEADLINES FOR DELIVERY OF TRANSFER PRICING DOCUMENTATION

In the Republic of Serbia, documentation on transfer prices is submitted to the tax authority along with the tax return which determines corporate income tax and the tax balance within 180 days from the end date of the tax period for which the tax is determined. If a tax return and a tax balance sheet are submitted in the event of a status change, opening and closing of liquidation or bankruptcy proceedings, a transfer pricing report is submitted with the tax return within 60 days. In the event that the taxpayer fails to attach transfer pricing documentation to the tax balance, i.e. attaches it in an incomplete form, the competent tax authority will issue a warning and order him to do so or to complete it within a period that cannot be shorter than 30 or longer of 90 days from the day of delivery of the reminder.

In the Republic of Croatia, the taxpayer submits documentation on transfer prices at the request of the tax administration, but together with the income tax return, they submit a report on business events with related parties on a specially prescribed form, if during the tax period business events with related parties in the business books were recorded. The profit tax application is submitted to the Tax Administration no later than four months after the end of the period for which the profit tax is determined.

In the Republic of Montenegro, from 2022, the obligation to submit documentation to the Tax Administration is for large taxpayers, while other taxpayers should own pricing documentation, but submit it at the request of the tax authority within 45 days of the request. The deadline for submitting documentation for large taxpayers is June 30, 2027. As of this date, the documentation will be submitted together with the tax return, no later than three months after the end of the period for which the tax is calculated.

In Bosnia and Herzegovina, the taxpayer is only required to submit documentation on transfer pricing within 45 days of receiving the request from the Tax Administration. If the total amount of the taxpayer's transactions exceeds the amount of 500,000.00 KM in the tax period, the taxpayer is obliged to submit to the Tax Administration, together with the tax return, a separate review of those transactions. The tax return is submitted to the Tax Administration within 30 days after the deadline prescribed for submitting annual financial reports.

3.5. OVERVIEW OF SIMILARITIES AND DIFFERENCES IN TRANSFER PRICING REPORTING IN NEIGHBORING COUNTRIES

For the sake of better transparency and systematicity, an overview of the basic similarities and differences in transfer pricing reporting in the Republic of Serbia, the Republic of Croatia, the Republic of Montenegro, and Bosnia and Herzegovina.

Table 2. Summarized similarities and differences

Country	Republic of Serbia	Republic of Croatia	Republic of Montenegro	Bosnia and Herzegovina
Similarities and differences				
Application of OECD Guidelines	Yes	Yes	Yes	Yes
Related persons	Persons who have direct and indirect influence through ownership or management functions; Related persons are also considered those who are natural persons' related persons, which have ownership or management function in the taxpayer; Any non-resident legal entity from a jurisdiction with a preferential tax system	Persons who have direct and indirect influence through ownership or management functions	Persons who have direct and indirect influence through ownership or management functions; Related persons are also considered those who are natural persons' related persons, which have ownership or management function in the taxpayer	Persons who have direct and indirect influence through ownership or management functions; Related persons are also considered those who are natural persons' related persons, which have ownership or management function in the taxpayer; A person who is found to be knowingly entering into a business relationship with a taxpayer with the aim of transferring profits is considered a related person



Level of transfer pricing reporting	International and national level	International level, and national level only if one of the related persons has the status of a privileged taxpayer and/or has the right to carry forward tax losses from previous tax periods	International and national level	International and national level
Methods for checking transfer prices	All methods can be used equally	When it is possible to apply both the classic transaction method and the transaction profit method with equal reliability, preference is given to the classic transaction method, i.e. when it is possible to apply the method of comparable uncontrolled prices and some other method for determining transfer prices with equal reliability, preference is given to the method of comparable uncontrolled prices, with the emphasis that it is necessary to find the method that is most suitable for a specific case	All methods can be used equally	The preference is given to the method of comparable uncontrolled prices, the cost price method increased by normal earnings and the resale price method, and only in the event that the mentioned methods cannot be applied one of the other methods can be used; The method of comparable uncontrolled prices has an advantage in application in relation to all other transfer pricing methods
Delivery of transfer pricing documentation	Documentation on transfer prices is submitted to the tax authority along with the tax return which determines corporate income tax and the tax balance within 180 days from the end date of the tax period for which the tax is determined	The taxpayer submits documentation on transfer prices at the request of the tax administration, but together with the income tax return, he submits a report on business events with related parties on a specially prescribed form no later than four months after the end of the period for which the profit tax is determined	From 2022, the obligation to submit documentation to the Tax Administration is for large taxpayers, while other taxpayers should own pricing documentation, but submit it at the request of the tax authority within 45 days of the request; The deadline for submitting documentation for large taxpayers is June 30, until 2027, after which the documentation will be submitted together with the tax return, no later than three months after the end of the period for which the tax is calculated	The taxpayer is only required to submit documentation on transfer pricing within 45 days of receiving the request from the Tax Administration ; If the total amount of the taxpayer's transactions exceeds the amount of 500,000.00 KM in the tax period, the taxpayer is obliged to submit to the Tax Administration, together with the tax return, a separate review of those transactions, within 30 days after the deadline prescribed for submitting annual financial reports



4. CONCLUSION

The legislation of the Republic of Serbia in the area of determining transfer prices is largely harmonized with the relevant legislation of neighboring countries because, as in other countries, it relies on the OECD Guidelines, which are based on the "arm's length" principle. Of course, as in the regulations of each country, there are additional specificities that the legislation requires from its taxpayers. When it comes to the issue of transfer pricing, one gets the impression that transfer pricing is still a relatively new and complicated topic for taxpayers. For this reason, knowledge and achievements in this area should be further spread through additional education and professional and scientific articles in order to bring transfer prices as close as possible to taxpayers. Transfer prices are significant for both tax administrations and taxpayers because they affect the amount of taxable profit of related parties in different tax jurisdictions, but also within one tax jurisdiction. The OECD Member States are encouraged to follow the Guidelines in their domestic practices related to transfer pricing, and taxpayers are encouraged to use the Guidelines in determining whether their transfer prices are within the „arm's length“ principle for tax purposes.

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