

New Ordinance on Procedure and Ways of Application of the Methods for Defining Market Prices

Ordinance No H-9 of 14 August 2006 of the Minister of Finance on Procedure and Ways of Application of the Methods for Defining Market Prices (the Ordinance) was published in the State Gazette, issue 70 of 29 August 2006. It abrogates Ordinance No 5 of 26 February 1999 of the Minister of Finance on Procedure and Ways of Application of the Methods for Defining Market Prices.

The purpose of the Ordinance as secondary legislation is to give more detailed regulation to the procedure and ways of applying the methods for defining market prices, the rules and norms regarding tax regulation in defining market prices. In the new Ordinance “methods for defining market prices” are the methods for defining market prices within the meaning of § 1, i. 10 of the Additional Provisions of the Tax and Social Security Proceedings Code (TSSPC), namely: comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method. Major principle in the tax legislation is that for tax purposes the prices in related party transactions shall be determined under the terms negotiated between unrelated parties, i.e. at market terms and prices. The material tax laws (the Corporate Income Taxation Act, the VAT Act and the Individuals’ Income Taxation Act) do not contain separate definition of the term “market price” and of the methods of its determination, but refer in this respect to the provision of TSSPC cited above.

In comparison to Ordinance No 5 of 26 February 1999 the present Ordinance contains more detailed and specific provisions regulating and differentiating the essence of the particular methods and the ways and procedure for their application. The most important points where attention shall be paid to can be summarized as follows:

1. The Ordinance contains strict and explicit regulation regarding the cases in which each method can be applied to, as well as the possible exceptions. For example:
 - a. Comparable uncontrolled price method is applicable when there is a similarity in the characteristics of the product or service, i.e. there is an identical or similar product.
 - b. Resale price method is applicable when there is similarity in the functions and in the cases of purchase followed by sale of products where the person carrying out the resale does not add significant value to the value of the products as a result of altering their physical characteristics or as a result of using intangible assets.
 - c. Cost plus method is applicable when there is similarity in the functions and in the cases of purchase followed by sale of products or provision of services where the person carrying out the resale does not add significant value to the value of the products as a result of altering their physical characteristics or as a result of using intangible assets.

These three methods shall be used in defining the market prices, but in the cases where they cannot give reliable and rational result, the transactional net margin method or the profit split method are applicable.

2. A principle has been introduced that when individual application of a particular method does not lead to a result representing the usual commercial and financial relations between unrelated parties on comparable terms, the simultaneous use of two and more methods is acceptable. For achieving this goal a rule has been implemented that there shall be sufficient comparability between the controlled transaction and the comparable uncontrolled one. For reaching this comparability Art. 11 of the Ordinance envisages that in the case of established substantial differences between the two transactions, when applying the respective method, adjustments of the results of the uncontrolled transaction shall be made on the basis of those factors affecting the price. The factors having influence on the price are thoroughly and explicitly listed with respect to each one of the methods. This means that if a dispute arises during a tax audit concerning the amounts of the prices applied under transactions between related parties, the revenue authorities as well as the person being audited shall prove the comparability of the transactions and the effect/influence of the respective factors.

3. According to the new Ordinance, special rules have been introduced in defining market prices of services within a group of related parties (intra-group services). There shall be used the comparable uncontrolled price method and the cost plus method separately or in a combination. For the purpose of defining market price of a subscription intra-group service, research on the information for a period of several years is required and the price is determined directly and indirectly. Special attention has been paid to the way of allocation of expenses or profits between the entities within the group in the case of indirect determination of the price and the choice of appropriate allocation basis.

4. The complexity and the specific requirements with respect to application of the methods raise the issue of **documentary support** in defining market prices and preparation of special documentation by the taxable persons in this respect. Pursuant to Art. 63 of the Ordinance, in case of presence of such documentation representing the nature and the scope of the respective transaction with related parties, the choice of the method applied and the compliance achieved with the relations between related parties, the revenue authorities during tax audits and check-ups are obliged to start their analysis of the defined prices with the method chosen by the taxable person. Revenue authorities shall clarify all facts and circumstances regarding the lawful and objective determination of market prices – to collect and analyze additional information, such as statistical, exchange, customs and any other. Therefore, precise definition of the market prices and consideration paid on the transactions realized between related parties are required.

5. Special rules are implemented in defining market prices of intangible assets.

6. We would like to draw attention to the fact that the enforcement of the Ordinance cancels the rate of allowable deviation from market prices – 25%, which has been implemented in Art. 13 of the revoked Ordinance No 5 of 26 February 1999. According to Art. 62, para 2 of the new Ordinance, when the revenue authorities establish differences in the result achieved with the method chosen by the taxable person, they apply method which would lead to a result attributable to usual commercial or financial relations between unrelated parties on comparable terms.

The Ordinance entered into force on 2 September 2006.

The information provided in this material presents only a general view of the implemented principles and provisions of the Ordinance and it is not complete. Should any questions arise about the application of the new provisions, please, do not hesitate to contact us on tel. 943 37 00, fax 943 37 07, e-mail address: office@afa.bg, or postal address: 38, Oborishte Str., Sofia 1504.

