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**APPLICATION OF NEW REQUIREMENTS FOR STANDARDIZED TRANSFER PRICING DOCUMENTATION IN THE REPUBLIC OF BULGARIA – ADVANTAGES AND BENEFITS FOR TAX AUTHORITIES AND TAXPAYERS**

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**Abstract:** Transfer pricing raises a number of issues and challenges for companies operating transfer operations and for the tax administrations of the countries in which they operate. Along with the increasing role of international transfer pricing on a global scale, increasing attention is paid to possible improvements in the control in this area and improving the regulatory measures in the individual countries aimed at limiting and countering the attempts at manipulation by companies in order to reduce paid profit taxes, customs duties, etc. through the transfer pricing. In modern conditions of continuously increasing globalization, more and more perceivable is the need for application of uniform, internationally recognized requirements and rules to documentation and control of transfer prices.

The main purpose of this scientific paper is to examine the major rules and requirements related to the preparation of standardized transfer pricing documentation in the Republic of Bulgaria in the contemporary conditions. It discusses the increasing role and significance of international transfer pricing in the context of globalization and the necessity for application of uniform international guidelines on transfer pricing. A special attention is paid to the systematization of significant advantages and benefits of the application of standardized, globally recognized requirements in the field of transfer pricing in the Republic of Bulgaria both for companies -taxpayers and for tax administrations.

The methodology of research of the issues in the paper involves the application of the historical-logical and systematic approaches and the methods of observation, comparison, analogy, analysis and synthesis, induction and deduction, etc. In accordance with the systematic approach, the information for transfer pricing of the different constituent entities of the multinational groups is considered as an integral part of the information for transfer pricing of the group as a whole.

As a result of the research made, it is concluded that the implementation of the standardized rules for documentation that multinational groups must prepare in order to justify the methodology for determining transfer prices used in their international intra-group transactions provides valuable advantages and benefits both for the tax administrations of the relevant countries and for the taxpayers.

From the perspective of tax authorities, the adoption of standardized requirements achieves improvement of the methodology of transfer pricing and tax audit in this area, higher degree of reliability, comparability and transparency of information provided by taxpayers for control over transactions between related parties. Through these requirements are achieved also better results in the tax discipline, the prevention of tax evasion and effective tools for avoidance and resolution of transfer pricing disputes.

From the position of the taxpayers it is of utmost importance that through the uniform, internationally recognized requirements for documentation and tax audit of transfer prices the burden and costs in preparing the documentation on pricing in international transactions between related parties are significantly reduced. The introduction of these rules creates clarity and predictability with regard to information required to prove that their transactions with related parties satisfy the arm's length principle. The standardized documentation enables taxpayers to defend their tax position, provides guarantees for the tax treatment of the transactions between related parties, possibilities for advance compliance with the requirements and hence for avoidance of penalties and transfer pricing disputes with tax administrations.

**Keywords:** international transfer pricing, documentation of transfer prices, globalization.

## **1. INTRODUCTION**

International transfer pricing is a process of fixing prices, under which international intra-group sales of various assets or services between related parties within a group are carried out. The main goal pursued by the mechanism of this pricing is to optimize performance and maximize overall profits for the group as a whole on a global basis. Achieving this goal requires minimizing the amount of taxes paid on profits worldwide and avoiding restrictions imposed by the countries, in which the different foreign subsidiaries of the company operate, for regulation and control of their activities (restrictions on repatriation of profits, control over the amount of intra-group exchange, etc.). Differences in taxation around the world and tax issues have a significant influence on decisions regarding the selection of:

“(1) where to locate a foreign operation,

- (2) what legal form the operation should take, and  
(3) how the operation will be financed” (Doupnik, Perera, 2015, p.541).

Transfer pricing raises a number of issues and challenges for companies operating transfer operations and for the tax administrations of the countries in which they operate. Along with the increasing role of international transfer pricing on a global scale, increasing attention is paid to possible improvements in the control in this area and improving the regulatory measures in the individual countries aimed at limiting and countering the attempts at manipulation by companies in order to reduce paid profit taxes, customs duties, etc. through the transfer pricing. In modern conditions of continuously increasing globalization, more and more perceivable is the need for application of uniform, internationally recognized requirements and rules to documentation and control of transfer prices.

The main purpose of this scientific paper is to examine the major rules and requirements related to the preparation of standardized transfer pricing documentation in the Republic of Bulgaria in the contemporary conditions. It discusses the increasing role and significance of international transfer pricing in the context of globalization and the necessity for application of uniform international guidelines on transfer pricing. A special attention is paid to the systematization of significant advantages and benefits of the application of standardized, globally recognized requirements in the field of transfer pricing in the Republic of Bulgaria both for companies -taxpayers and for tax administrations.

## 2. MATERIALS AND METHODS

The methodology of research of the issues in the paper involves the application of the historical-logical and systematic approaches and the methods of observation, comparison, analogy, analysis and synthesis, induction and deduction, etc. In accordance with the systematic approach, the information for transfer pricing of the different constituent entities of the multinational enterprise (MNE) group is considered as an integral part of the information for transfer pricing of the group as a whole.

Various international organizations have long been involved in issues related to the approaches to determine transfer prices for tax purposes, methodology for control over the same, creation and adoption of uniform international guidelines on transfer pricing. Among them a very important role plays the Organization for Economic Cooperation and Development (OECD), which, along with its other activities, is also engaged in the development of coherent rules for determining transfer prices in terms of taxation and problems of international regulation of transfer pricing of multinational companies. It has developed its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, whose basic edition is from 1995 (OECD,1995), which are periodically updated and supplemented. They are applied by many countries in the implementation of tax control over transfer pricing in transactions between related parties.

Bulgaria observes the uniform requirements in the field of transfer pricing within the European Union and follows the global trends related to the creation and adoption of uniform international guidelines on transfer pricing. The rules for documentation and tax audit of transfer prices, which are applicable in the country, are based on the recommendations of OECD and on the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union.

The basic principle enshrined in the OECD Guidelines is the arm's length principle, which has been adopted by most countries around the world, including Bulgaria, as the basis of their tax legislation on transfer pricing. This principle requires that related parties are regarded as separate tax subjects and the transactions between them are compared with those made between independent parties.

The main causes for the widespread application of the arm's length principle in tax legislation around the world are:

- this principle ensures equality in tax treatment of related and independent parties and thus prevents the creation of tax advantages or adverse effects that would otherwise distort the relative competitive positions of the two groups of tax subjects;
- by eliminating the tax factor from the process of making economic decisions, the arm's length principle promotes international trade and investments (Transfer pricing manual, slip 5, 2010, National Revenue Agency of the Republic of Bulgaria, p.1).

Increasingly important are the efforts being made in recent years to introduce uniform requirements in the field of transfer pricing within the European Union. In October 2002 the European Commission established the Joint Forum on Transfer Pricing. Later, with European Commission Decision of 22.12.2006 the operation of the Forum was continued by officially establishing the Expert Group on Transfer Pricing and determining its structure and tasks. It is called the EU Joint Transfer Pricing Forum and is composed of experts from the public and the private sector in the field of transfer pricing. The tasks of this Forum are as follows:

- to create of a platform where experts from the business and the national tax administrations can discuss transfer pricing problems which hinder cross-border business activities within the Community;

- to advise the European Commission on the tax issues related to transfer pricing;
- to assist the European Commission in finding practical solutions compatible with the OECD Guidelines in order to achieve a more uniform application of the transfer pricing rules within the Community (Commission Decision of 22 December 2006 setting up an expert group on transfer pricing (2007/75/EC), Official Journal of the European Union (OJ) L/2007/32 of 06.02.2007, p.1).

Among the most important results of the work of the EU Joint Transfer Pricing Forum, which is aimed at establishing uniform requirements and procedures for transfer pricing, are the preparation and application of the following documents:

- Code of Conduct for the effective implementation of the Convention on elimination of double taxation in connection with the adjustment of profits of associated enterprises /the so-called “Arbitration Convention”/ (Official Journal of the European Union (OJ) C/2006/176 of 28.07.2006, p.8);
- Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (Official Journal of the European Union (OJ) C/2006/176 of 28.07.2006, p.1);
- Procedures for prevention and resolution of disputes relating to transfer pricing and Guidelines for advance pricing agreements within the European Union (SEC (2007) 246; COM (2007) 71/ 26.02.2007, Communication from the Commission of the European Communities on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU, p.1).

“An ongoing task of the EU Joint Transfer Pricing Forum is to monitor and manage the effective implementation of its achievements. This is done both by producing annual statistical reports and by preparing specific reports” (Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period July 2012 to January 2014; COM (2014), p. 5).

In October 2018 the EU Joint Transfer Pricing Forum agreed the Report on a Coordinated approach to transfer pricing controls within the European Union (EU Joint Transfer Pricing Forum, 2018). This report establishes best practices by issuing various recommendations for both taxpayers and tax administrations and encourages closer cooperation in the field of transfer pricing controls. In March 2019 the EU Joint Transfer Pricing Forum agreed a Report on the application of the profit split method within the European Union. The report clarifies key concepts, under which conditions to use the method and how to split the profit (EU Joint Transfer Pricing Forum, 2019).

The Code of Conduct on transfer pricing documentation requirements for associated enterprises in the European Union defines the requirements for the amount and type of documentation that member states shall accept for the purposes of their internal rules on transfer pricing. It standardizes the documentation that companies must provide to tax authorities on pricing in international transactions between related parties.

The introduction of uniform rules on the amount and type of documentation related to the application of transfer pricing in the European Union aims at:

- reducing the tax complications that companies face when conducting transactions with related parties in other EU member states;
- allowing related parties to comply with the requirements in advance before tax audits are commenced and thus avoid possible penalties and lengthy and costly disputes with the tax authorities;
- facilitating the work of the tax authorities exercising control over the prices applied between related parties.

Transfer pricing documentation shall provide an opportunity to analyze the process of pricing in controlled transactions (transactions between related parties) and to substantiate the correlation between the prices accepted by related parties and the market prices. In order to achieve this it is necessary that the preparation of the transfer pricing documentation are based on several basic principles:

- transparency;
- credibility, relevance and accessibility of the information used;
- clarity to an extent that allows the tax authorities to determine whether the process of pricing has applied the arm’s length principle;
- reproducibility of the results in transactions between independent third parties (Transfer pricing manual, slip 2, 2010, National Revenue Agency of the Republic of Bulgaria, p.1).

The Guidelines for advance pricing agreements developed by the EU Joint Transfer Pricing Forum primarily aim at preventing transfer pricing disputes and the associated double taxation. Advance pricing agreements are agreements between the tax administrations of the relevant EU member states that determine how future transactions between related tax subjects domiciled in two or more member states will be taxed. The guidelines for conclusion of such agreements are an effective tool for dispute avoidance, which has valuable advantages for tax administrations and

tax subjects. Through them guarantees for the methodology of transfer pricing and tax treatment of transactions between related parties are provided in advance. This simplifies or prevents costly and time-consuming tax audits of the transactions included in the advance pricing agreements. This allows all parties under advance pricing agreements to make the respective savings. The uniform Community guidelines establish procedures for effective conclusion of advance pricing agreements, detail their usual stages and describe how the procedure shall be carried out at each stage.

Very important at the conclusion of advance pricing agreements are the critical assumptions underlying the determination of transfer prices and the evidence that the methodology proposed by them will lead to results corresponding to the arm's length principle. Depending on the methodology and manner of its application such evidence may include e.g.:

- examination of the criteria for comparability of the transactions and any amendments made in order to achieve this comparability;
- reasons why a certain method has been selected for transfer pricing;
- presentation of the manner in which the proposed methodology will be used, supported by specific financial data.

### 3. RESULTS AND DISCUSSIONS

The national regulatory requirements for transfer pricing in the Republic of Bulgaria in the contemporary conditions are based on the approaches of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD, 2017) and measures of the OECD/G20 Base Erosion and Profit Shifting /BEPS/ Project (Report on BEPS Action 13 “Transfer Pricing Documentation and Country-by-Country Reporting”, 2015). The introduction of these requirements is also consequence of Bulgaria's accession in 2016 to the OECD Inclusive Framework on BEPS membership, which involves more than 100 countries and jurisdictions. With changes in the Tax and Social Insurance Procedure Code in 2019, the new rules for the preparation of documentation for transfer pricing were introduced in the Bulgarian legislation. These rules are included in a new chapter /eight “a”/ - “Documentation for Transfer Price Formation”, in force from 01.01.2020 (Tax and Social Insurance Procedure Code, 2020). The transfer pricing documentation follows the approaches adopted by the OECD and the European Union for standardized, unified content.

In order to achieve the main objectives of transfer pricing documentation requirements the country adopts a standardized three-tiered approach to transfer pricing documentation for multinational groups. The three-tiered structure of documentation consists of:

- a master file containing standardized information relevant for all MNE group members;
- a local file referring specifically to material transactions of the local taxpayer;
- a country-by-country report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the group (OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017, p.233).

The master file should provide an overview of the business of the multinational group, including the nature of its global business operations, its overall transfer pricing policies and its global allocation of income and economic activity in order to assist tax administrations in evaluating the presence of significant transfer pricing risk. The information required in the master file can be grouped in five categories:

- 1) the MNE group's organizational structure;
- 2) a description of the group's businesses;
- 3) the MNE group's intangibles;
- 4) the intercompany financial activities and
- 5) the MNE group's financial and tax positions.

The information in the local file supplements the master file and helps to meet the objective of assuring that the taxpayer has complied with the arm's length principle in its material transfer pricing positions affecting a specific jurisdiction. This file focuses on information relevant to the transfer pricing analysis of transactions between a local country affiliate and associated enterprises in different countries.

The rules regarding the content of the information in the local file in the Bulgarian legislation are regulated by Art.71c of the Tax and Social Insurance Procedure Code. This information includes:

- information about the local taxpayer:
  - description (scheme) of the management and organizational structure;
  - the identity data of the owner or owners of the person's shares or units;
  - the names and the position of the natural persons, to whom the management authorities report their activities;
  - a detailed description of the activity and business strategy;

- major competitors;
- controlled transaction information - subject of the local file:
  - description of the transactions and circumstances, in which they are carried out, including their value;
  - the identity data of the related parties and the quality, in which they engage in the controlled transactions;
  - the amount of received and paid amounts for the transactions, broken down by type and jurisdiction of the payers and recipients;
  - copies of contracts, governing controlled transactions;
  - detailed comparability and functional analysis;
  - description of the method, chosen to determine the market prices of the transactions and the reasons for that choice;
  - indication of the related person, selected for tested parted (the party to the controlled transaction, to which the relevant market pricing method applies);
  - summary of the important assumptions, made in applying the market pricing method; summary of the price data and/or financial indicators used in applying the chosen market pricing method;
  - a list and description of selected comparable transactions between independent parties; description of each adjustment, made for the sake of better comparability;
  - description of the allocation base (keys) in the case of intra-group services and the reasons for choosing the relevant base (key);
  - description of the factors, used to distribute the combined operating profit/loss under the distributed profit method;
  - a copy of existing pre-pricing agreements and other tax statements, issued by a competent authority of another state or jurisdiction and which are related to the controlled transactions – subject of the documentation;
- financial information:
  - annual financial statement for the relevant year;
  - information and calculations, showing how the financial data, used in applying the market pricing method are related to or derive from the annual financial statements;
  - a summary of the price data or financial indicators of the selected independent comparable transactions or persons, used in the analysis and the source of the relevant data.

In accordance with the requirements of the Council Directive (EU) 2016/881 of 25.05.2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, in the Republic of Bulgaria the rules for automatic exchange of country-by-country reports were introduced in the Tax and Social Insurance Procedure Code. The reports contain information on the distribution of revenues, profits, assets and taxes of entities, belonging to a MNE groups. In the country-by-country report MNE groups should provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued. They should also report the number of their employees, stated capital, accumulated earnings and tangible assets in each tax jurisdiction. MNE groups should identify each entity within the group doing business in a particular tax jurisdiction and provide an indication of the business activities in which each entity engages. In a situation where a constituent entity of MNE group cannot obtain or acquire all the information required in order to fulfill the reporting requirement under the Directive 2016/881, “Member States could consider this as an indication of the need to assess high-level transfer-pricing risks and other base-erosion and profit-shifting risks related to that MNE group” (Directive 2016/881, 2016, p.3).

The implementation of the standardized rules for documentation that multinational groups must prepare in order to justify the methodology for determining transfer prices used in their international intra-group transactions provides valuable advantages and benefits both for the tax administrations of the relevant countries and for the taxpayers. From the perspective of tax authorities:

- 1) the adoption of standardized requirements achieves improvement of the methodology of transfer pricing and tax audit in this area, higher degree of reliability, comparability and transparency of information provided by taxpayers for control over transactions between related parties;
- 2) the standardized three-tiered approach to transfer pricing documentation provides tax administrations with useful, adequate and relevant information to perform efficient transfer pricing risk assessment analysis and to increase efficiency of tax audit activities;
- 3) through the rules for preparation of transfer pricing documentation are achieved also:
  - better results in the tax discipline;
  - the prevention of tax evasion;
  - effective tools for avoidance and resolution of transfer pricing disputes.

From the position of the taxpayers:

- 1) it is of utmost importance that through the uniform, internationally recognized requirements for documentation and tax audit of transfer prices the burden and costs in preparing the documentation on pricing in international transactions between related parties are significantly reduced;
- 2) the introduction of standardized rules creates clarity and predictability with regard to information required to prove that their transactions with related parties satisfy the arm's length principle.
- 3) the standardized documentation:
  - enables taxpayers to defend their tax position;
  - provides guarantees for the tax treatment of the transactions between related parties;
  - provides possibilities for advance compliance with the requirements and hence for avoidance of penalties and transfer pricing disputes with tax administrations.

#### 4. CONCLUSIONS

International transfer pricing is one of the most important and topical issues that is faced by the multinational groups in the contemporary conditions of globalization. The limiting factors on the application of these pricing are the regulatory measures introduced by the individual countries. The current national legislation of the different countries around the world usually contains special provisions relating to the settlement of transfer pricing issues. International transfer pricing is one of the most problematic aspects of the relationship between multinational groups that carry out global business and regulatory authorities of the countries in which they operate.

The introduction of standardized requirements for preparation of transfer pricing documentation in the Bulgarian legislation shows that the Republic of Bulgaria attaches increasing importance to the efforts at the global level to strengthen the fight against tax fraud, tax evasion and aggressive tax planning. These rules provide comprehensive and relevant information for MNE groups regarding their structure, transfer pricing policy and transactions with related parties, as well as greater transparency and fairer taxation of these companies. This information enables the tax authorities to react to harmful tax practices by undertaking adequate risk assessments and tax audits. Enhancing transparency for MNE groups is an essential part of tackling base erosion and profit shifting in the contemporary global economy.

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