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COMPARATIVE ANALYSIS OF TRANSFER PRICING TAXATION IN FORMER YUGOSLAVIAN COUNTRIES

Komparativna analiza poreske regulacije transfernih cena u zemljama bivše SFR Jugoslavije

Abtract

Transfer pricing, as a potential instrument for avoiding real tax liability, is one of the growing tax issues of the 21st century. In an effort to shed light on the negative effects of transfer pricing application on local tax budgets and identify certain mechanisms for efficient tax control, the paper discusses basic implications of transfer pricing misuse in terms of taxation, as well as some instruments of taxation thereof. Also, in order to determine the awareness of the seriousness of this issue in former Yugoslavian countries, the presentation and analysis of the representation of certain instruments of transfer pricing taxation in these countries were carried out in the context of supranational regulations. The analysis showed that there are large oscillations in the tax approach to the control of implementation of transfer pricing when conducting transactions between related legal entities, and that these differences are conditioned on the level of development and structure of legal regulations.

Keywords: *transfer pricing, taxation of transfer prices, former Yugoslavian countries.*

Sažetak

Transferne cene, kao potencijalni instrument za izbegavanje prave poreske obaveze, predstavljaju jedno od rastućih poreskih problema 21. veka. U nastojanju da se rasvetle negativni efekti primene transfernih cena na lokalne poreske budžete i identifikuju određeni mehanizmi efikasne poreske kontrole, u radu su sagledane osnovne poreske implikacije zloupotrebe transfernih cena, kao i pojedini instrumenti njihove poreske regulacije. Takođe, s ciljem utvrđivanja osveštenosti zemalja bivše SFR Jugoslavije u pogledu ozbiljnosti odnosne tematike, dat je prikaz i analiza zastupljenosti instrumenata poreske regulacije transfernih cena u tim zemljama u kontekstu nadnacionalnih regulativa. Analiza je pokazala da između razmatranih zemalja postoje velike oscilacije u uobličavanju poreskog pristupa nadzoru primene transfernih cena pri obavljanju transakcija između povezanih pravnih lica, te da su te razlike uslovljene stepenom razvijenosti i izgrađenosti samih zakonskih propisa.

Ključne reči: *transferne cene, poresko regulisanje transfernih cena, zemlje bivše SFR Jugoslavije.*

Introduction

In conventional accounting literature, transfer pricing is defined as a technique for optimal allocation of costs and revenues between related legal entities. At first glance, this definition does not indicate the possibility of misuse, but the fact is that transfer pricing applied through the creation of an adequate cost and revenue structure, in accordance with the interests of a group of related legal entities, is a potential means of increasing wealth of that group. Namely, the application of transfer pricing allows the "migration" of capital between related legal entities in order to reduce tax liability in accordance with the advantages of certain tax environments, which, in parallel, leads to an increase in the group's final profit. That kind of business is called aggressive tax planning. Acceptable tax planning is related to business transactions and the way in which these transactions are made, which means that they must have an economic goal. On the other hand, aggressive tax planning aims to reduce tax liability according to applicable legal acts, but the taxpayer's intention is contrary to the legislator's goal.

As a part of aggressive tax planning, transfer prices have assumed their true form through the intensification of business at an international level, brought forth by globalization. Exempt from the restrictions of territorial jurisdiction, companies have been granted the freedom to expand their business abroad, with the possibility of using low tax rates and various forms of tax subsidies in different tax jurisdictions. The scope, power and complexity of globalization pose a challenge to the conventional way of thinking about transfer pricing and the possibilities of monitoring thereof in these complex production and exchange networks. In this way, domestic companies were allowed to become multinational, and, by establishing new companies through joint ventures with local companies or through other business arrangements, foreign companies became part of the domestic business scene.

With the increase in the number of multinational companies, the volume of commercial transactions at an international level within one company has also increased, and it is estimated that somewhere around two-thirds of all business transactions in the world are being performed precisely within multinational companies or groups of related legal entities. By using the benefits of the globalization process, multinational companies have been able to maximize their profits by reducing their tax liability through their own international channels for the transfer of funds (relying on transfer prices) and, in essence, they have become a law unto themselves because the legislative framework could not monitor the rate of growth of their international power, leaving their activities largely outside of legal control.

In the past few years, in order to clarify and detect the use of transfer pricing as a means of misusing different national tax regulations in a timely manner, tax authorities in developed countries have resorted to aggressive audits and legal actions. Engaging an additional number of employees in tax control bodies ensured more detailed studies of the related legal entities' corporate policies. In this way, tax authorities in developed countries seek to reveal inadequate application of transfer pricing in a timely manner (before significant consequences for the business sector, local budget and society arise) and, in accordance with existing legal procedures, take the necessary safeguard measures.

On the other hand, developing countries, such as the former Yugoslavian countries, are much more vulnerable to abuse of transfer pricing for the purpose of reducing tax liability. Their handicap is reflected primarily in the absence of adequate and comprehensive tax regulations in this area, absence of an appropriate control mechanism and insufficiently trained professional staff for a more detailed study of the related legal entities corporate policy on the application of transfer pricing. For this reason, transfer prices pose a unique challenge for these countries and present an unidentified potential source of domestic capital outflow.

Tax implications of transfer pricing

The possibility of "moving" profit from one country to another, in order to obtain tax benefits, arises from each country's freedom to determine transfer pricing (based on subjectivity in determining costs and their allocation), as well as differences in profit tax rates (because each country independently decides on the level of tax rates).

Since the goal of every business is to create long-term value for equity holders, one way to do this is to minimize tax liability by using the following mechanisms:

- international allocation of accounting profits through the arrangement of a financial structure by members within a group or by branch offices within a multinational company (financing through loans at higher interest rates in members operating in high income tax jurisdictions leads to minimizing total tax liability at the group level),
- reallocation of common costs (research and development costs, marketing costs and the like) to countries with high income tax rates reduces taxable profits in members of the group or branches operating in those countries,
- the use of transfer pricing for transferring profits from countries with high profit tax rates to countries with low or zero tax burden (maximizing costs in the first and income in the second), which leads to minimization of tax liability and maximization of profit after taxation at the level of the group as a whole.

The process of globalization opened the way for the growth of multinational business entities and particularly contributed to the ways of avoiding genuine tax obligations. Transfer pricing soon transformed from an accounting technique into a method of resource allocation, which had significant consequences on the distribution of income, domestic well-being and domestic prosperity and the quality of life in individual countries.

Addressing the question of transfer pricing in avoiding tax liability, many countries have adopted legal solutions that allow tax authorities to subsequently correct taxpayer's financial statements in the event of incorrect implementation of transfer pricing and, therefore, to collect additional tax.

However, developing countries generally avoid the introduction of any control over the use of transfer pricing, fearing the negative impact on the inflow of direct foreign investment. Also, as a rule, those countries do not have experience in implementing control mechanisms and procedures that would prevent arbitrary use of transfer pricing and very often they do not have adequate and comprehensive laws on corporate income tax.

By consciously or unconsciously creating the conditions for the legal avoidance or reduction of tax liability of taxpayers operating within a group of related entities or as a part of multinational companies, developing countries are becoming fully exposed to the risk of erosion of the taxable base through the transfer of profits to other tax jurisdictions.

Although the problem of transfer pricing basically relates to the transactional relationships between related entities located in different tax jurisdictions, the issue of the transfer pricing effects is a significant tax issue even in cases of operations of related entities within the same tax jurisdiction. Namely, when related entities are located in the same jurisdiction where one set of tax rules applies to all taxpayers, the issue of transfer pricing is reduced to the level of tax incentives and tax exemptions which lead to the reduction of calculated tax or reduction of the tax base. By applying transfer pricing, a related entity may transfer part of the tax base to another related entity within the same jurisdiction, which, based on certain grounds, is entitled to different benefits (e.g. entity exempt from tax in the first couple of years has the right to reduce the tax base due to employment, investment, export activities, etc.), thus reducing the overall tax liability in a legal way.

Accordingly, the negative effects of taxation on transactions between domestic taxpayers can particularly be seen in the domain of jurisdictions that seek to stimulate the development of certain activities and certain areas and reduce the unemployment rate through appropriate privileged tax treatment. In this case, competent tax authorities should pay considerable attention to the balancing of economic interests on the one hand and, on the other, to consequently created losses of tax revenues. Also, it is necessary to strengthen the tax control mechanism for applying transfer pricing among domestic taxpayers, which requires adequate and comprehensive legal regulations, multifunctional tax teams and good databases.

Basic instruments of transfer pricing taxation

With the process of globalization, transfer pricing, as an instrument of multinational business entities used for the controlled flow of taxable profit, jeopardized objectivity and fairness in taxation, thus becoming one of the main subjects of interest among national tax institutions and various international organizations.

In an effort to ensure a balanced and satisfactory taxation framework for the proper use of transfer pricing in the process of conducting controlled transactions, appropriate documents were adopted at an international level, thus establishing key solutions for overcoming the challenges of applying transfer pricing between different national tax jurisdictions.

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, issued by the Organization for Economic Co-operation and Development (OECD), became an internationally recognized document in the field of regulating transactional relations of multinational companies and groups of related legal entities. The first version of this document was issued in 1995, after which it went through several modifications and was amended by additional instructions related to international services, intangible assets, advance pricing agreements, comparability analysis, necessary documentation, etc.

The aforementioned document defines the arm's length principle as a basis for determining transfer prices. The essence of this principle is based on the use of a price that can be achieved between completely independent business entities for certain goods or services in the conditions of free competition. Traditional transaction methods (comparable uncontrolled price method, resale price method, cost plus method) and transactional profit methods (transactional net margin method, transactional profit split method) are listed as approved methods. Also, instructions are given for the implementation of reliable comparability analysis, as well as the rules and recommendations for the collection of transfer pricing documentation and recommendations and instructions related to other segments in relation to the application of transfer pricing (transfer of intangible assets, special fees for services within the group, resolution of disputes on transfer pricing and business restructuring issues).

The OECD Guidelines are closely linked to Article 9 of the Model Tax Convention on Income and on Capital, which sets out authoritative principles of the arm's length principle, as the basis for bilateral tax treaties between OECD member countries and non-member countries.

Article 9 of the OECD Model Tax Convention constitutes the basis for conducting a comparability analysis by introducing the need:

- to compare conditions (including, but not limited to prices) agreed upon or imposed between related parties and those that would be established between unrelated parties, in order to determine the allowed balance adjustments for the purpose of calculating tax liability of related parties;
- for determination of profit that would be realized under market conditions, in order to determine the amount of correction.

The next significant publication entitled Aligning Transfer Pricing Outcomes with Value Creation represents the final report for actions 8-10 of the Action Plan on Base Erosion and Profit Shifting Project1. This publication was created as the result of reviding the existing OECD Transfer Pricing Guidelines in order to align transfer pricing outcomes with value creation for the following categories of transactions: intangible assets, contractual arrangements and other high-risk transactions.

Another publication within the BEPS Project related to the issue of transfer pricing is Transfer Pricing Documentation and Country-by-Country Reporting, issued as the final report of the Action 13 of the BEPS Action Plan. This publication includes a revision of the existing rules on the development of transfer pricing documentation in order to improve its transparency for tax administrations, as well as simplification of the rules and procedures for compiling the documentation for multinational business entities.

In accordance with this publication, transfer pricing documentation should consist of three key parts:

1 The Base Erosion and Profit Shifting Project was launched by OECD and G-20 in 2013. It represents the concretization of basic steps to prevent erosion of the national tax base and the transfer of profits between individual tax jurisdictions. The action plan of this project consists of 15 actions whose task is to equip tax authorities with national and international instruments to solve the problem of tax avoidance, ensuring that profits are taxed in jurisdictions where economic activities generate profit and create value. All actions provide national tax authorities with the guidelines for preventing harmful tax practices of multinational business entities. Out of the 15 actions, four are related to transfer prices, specifically 8, 9, 10 and 13. For more information, see [10].

- master file – includes standardized information relevant to all members of a multinational group,
- local file – related to significant material transactions of the local taxpayer and
- Country-by-Country Report – containing specific information on the global allocation of the total profit of the multinational group and the amount of tax paid by individual countries, as well as certain indicators of the location of performing economic activity within a multinational group.

In this way, tax administrations are provided with a reliable information base for estimating the transfer pricing risk for the purpose of making decisions on implementation of a more detailed audit. It is recommended that Country-by-Country Report should be automatically distributed, according to the adopted cooperation mechanism between countries. The relevant publication also provides guidance on its implementation, in order to ensure that reports are delivered in a timely manner, to ensure their secrecy and that received information is used properly.

Taking into account the abovementioned documents, it is evident that the first step (when it comes to the basic solutions for curbing the uncontrolled implementation of transfer pricing) is to ensure the provision of comprehensive legislation on transfer pricing, with three main segments:2

- core provisions,
- administrative and procedural provisions and
- practical provisions.

Core provisions set the framework for the legislation on transfer pricing in the country. They define the scope of legislation (e.g. to which parts of tax legislation the relevant regulations are applied, which categories of taxpayers and what types of transactions will be regulated and covered), stipulate a valid reference standard (e.g. the arm's length principle) and provide the competent tax administration with the necessary legal authority to execute certain types of adjustments of transfer pricing (e.g. primary, secondary, compensation, etc.).

Administrative and procedural provisions address administrative and procedural issues, such as compliance requirements (e.g. reporting and documentation), penalties, advance pricing agreements and the authority to issue secondary legislation.

Practical provisions direct the practical application of the arm's length principle (the mere existence of standards is usually not enough to provide the necessary level of security) and include provisions related to comparability, transfer pricing methods, the choice of the appropriate method and such.

After providing the appropriate legal basis, attention should be focused on activities that represent the basic preconditions for successful mastering of the challenges that transfer pricing puts before national tax systems:3

- staff training and development,
- improving access to information and
- settling transfer pricing disputes.

Staff training and development involves improving the knowledge and skills of national tax administration inspectors. Namely, specialized training creates an appropriate basis for the formation of independent transfer pricing teams within the competent tax authorities, structured in such a way as to represent the right mix of skills and knowledge of tax administration regulations in order to maximize the efficiency of available funds for transfer pricing.

In terms of access to information, a reliable estimation of transfer pricing risk factors requires financial data which would allow the determination of transfer pricing compliant with the arm's length principle. The simplest and most effective means to ensure public availability of relevant data (after setting up a legal framework that would obligate companies, including those in the private sector, to submit their reports and ensure that those reports are publicly available) is the Internet, or, more precisely, receiving and processing of data electronically. Over the past few years (since 2006), cloud computing has brought about a real revolution in the field of computers. Namely, cloud computing is the most convenient way to establish an adequate electronic service for receiving and publishing financial information, because it represents a low or zero-cost solution for tax administration and includes low or complete absence of engagement of governments: since there is no need for purchasing expensive applications, it

2 For more information, see [1, pp. 58-112].

3 For more information, see [5, pp. 69-76].

eliminates the need for acquiring powerful computers (to support applications), minimizing the costs of maintaining hardware and software and hosting. Through this system of data access, tax administrations can monitor a wide range of reported results in the corporate sector, primarily in their own country, but in other countries as well.

Settling transfer pricing disputes implies, first and foremost, the existence of a clear and sufficiently detailed instruction regarding the compliance with and application of the arm's length principle to ensure consistency, reduce unreliability and ensure prompt and effective resolution of the arising disputes. Furthermore, the publication of guidelines on how to settle specific transfer pricing issues contributes to increasing transparency and helps participants in the business sector to proactively address potential problems related to specific intra-group transactions. In addition to this, transfer pricing disputes can be avoided by applying the concept of "shelter" or "safe harbour" or through advance pricing agreements. Such agreements usually last several years, thereby reducing the need for an audit in that period, uncertainty, risk for investors and the costs of alignment. However, given the fact that disputes will arise even when certain strategies for their avoidance are implemented, the task of the competent tax administration is to consider the ways of dealing with potential disputes about transfer pricing:4

- domestic dispute resolution – applied when there is no tax agreement with the country in which double taxation occurred or when the taxpayer does not want information to be shared with the other tax administration;
- international dispute resolution – when two countries have signed a tax treaty (in accordance with Article 9 of the OECD Model Tax Convention), but the taxpayer considers that certain adjustment arises from the misinterpretation of the arm's length principle by the tax administration, they have the right to submit a request for the mutual agreement procedure;
- mutual agreement procedure (MAP) – competent authorities, i.e. local governments negotiate the disputed case, while taxpayers can participate or attend these negotiations or consultations only as observers or by providing individual clarifications (the entire procedure lasts for 24 months on average);
- arbitration – involvement of an independent party for the purpose of assessment of each contracting party and facilitation of tax relief in cases of double taxation of the taxpayer, i.e. multinational company;
- alternative dispute resolution – mediation, i.e. engagement of an expert who needs to determine the necessary factual guidelines for the dispute itself.

In an effort to show the extent to which the former Yugoslavian countries devoted themselves to the issue of taxation of transfer pricing implemented by legal entities and how indicated solutions for overcoming the challenges of transfer pricing are integrated into local tax laws and regulations, a comparative overview of tax treatment of transfer pricing in these countries is presented and analyzed in the next section of the paper.

Tax treatment of transfer pricing in former Yugoslavian countries – comparative overview

Tables 1, 2 and 3 summarize the presentation of the transfer pricing tax regime in former Yugoslavian countries. Starting from the fact that the European Union (EU) represents the largest and the most integrated group of countries in the world and that countries that fall under the same category, as a rule, have legal regulations developed almost to the same degree, the classification of those countries according to their EU member status is performed in order to provide an adequate comparative basis.

In this regard, the paper compares tax regulations of Slovenia and Croatia (the member countries of the EU), followed by tax regulations of Serbia, Montenegro and FYR Macedonia (candidate countries for EU membership) and, finally, it contains an analysis of tax regulations of Bosnia and Herzegovina (potential candidate for EU membership), classified by tax jurisdictions: Republic of Srpska, Federation of Bosnia and Herzegovina and Brčko District.

By observing Slovenia and Croatia, as the only former Yugoslavian countries that now have the status of EU members, it becomes evident that considerable attention has been devoted to regulating transfer pricing issues in Slovenian tax regulations.

4 For more information, see [1, pp. 326-337].

Table 1: Tax regime of transfer pricing in the former Yugoslavian countries with the EU membership status

	Slovenia	Croatia
Profit tax rates	**19%**	**18%**
Type of regulation	OECD Guidelines	OECD Guidelines
Status of related legal entities	Direct or indirect possession of at least 25% of the capital or stocks or control rights or voting rights in managing another legal entity.	Direct or indirect participation in the capital, control or management of another legal entity, without specific thresholds defined.
Transfer pricing methods	All methods listed in the OECD Guidelines; the application of other methods is not allowed.	All methods listed in the OECD Guidelines; the application of other methods is not allowed.
Transfer pricing documentation	Yes.	Yes.
Requirements for annual preparation of documentation	With the annual tax return.	With the annual tax return (but this is not explicitly stated in legal regulations).
Submission deadline upon request by tax authorities	30-90 days.	Not regulated.
Tax penalties for untimely delivery of transfer pricing documentation	For legal entities from 1,200.00 € to 30,000.00 €. For the person responsible from 600.00 € to 4,000.00 €.	Not regulated.
Tax penalties for underestimation of tax base based on the use of transfer pricing	For legal entities 30-45% of underestimated tax liability. For the person responsible from 700.00 € to 5,000.00 €.	From 2,000.00 HRK to 200,000.00 HRK, along with the payment of tax on profits on the established taxable difference at the standard tax rate (including a default interest rate of 12% per annum).
Legal limitation for assessing tax based on the adjustment of transfer pricing	5 years (from the date when the tax obligation should have been calculated).	3 years (from the year following the year in which the tax return should have been filed).
Tax dispute resolution	Internal options: appeal to the Ministry of Finance and appeal to the Administrative Court. International options: mutual agreement under the EU Arbitration Convention and bilateral tax treaties.	Internal options: appeal to an independent second-instance body within the Ministry of Finance and appeal to the Administrative Court. International options: not regulated.
International agreements for the avoidance of double taxation	54 contracts.	61 contracts.
Transfer Pricing Unit	Yes.	No.
Databases for comparing controlled and uncontrolled transactions	''Amadeus'', ''Orbis'' and ''ktMINE''.	''Amadeus'' and ''Orbis''.
Advance pricing arrangements	Yes (unilateral, bilateral and multilateral).	No (but legal requirements for their conclusion are provided).
Action Plan on BEPS	Embedded in legal regulations.	Not embedded in legal regulations.

Source: Author's overview based on applicable legal regulations.

Slovenia has a higher profit tax rate than Croatia. The main transfer pricing regulation is OECD Guidelines, although Croatia is not the member of OECD, while Slovenia has been its member since 2010. Unlike in Croatia, in Slovenia there is a specific participation percentage threshold in determining the status of a related legal entity. Also, the deadline for periodic submission of documentation on transfer pricing is clearly legally defined, as well as the deadline for submission of documents at the request of competent tax authorities, along with appropriate tax penalties for failure to comply with the deadline. In Croatia, there is no legal obligation of disclosing information about transactions to related parties on an annual basis, that is, there is no obligation to deliver that information to the tax administration along with the tax return. Also, the deadline for submitting documentation at the request of competent tax authorities has not been defined. However, in practice, in case of large taxpayers, the tax administration requires the transfer pricing documentation to be delivered when submitting the annual tax return. For this reason, there are no clearly defined penalties for untimely delivery of documentation. Regarding the legal limitation for tax assessment based on the adjustment of transfer pricing, in Slovenia this period is longer than in Croatia, and also international options for resolving tax disputes are defined in this country, while Croatia defined only internal options. Slovenia showed great progress in the field of regulating transfer pricing issues by establishing a separate unit within the tax administration with 15-20 internationally trained auditors in the field of controlling transfer pricing application. Also, the Tax Administration of Slovenia uses specialized software for accessing several databases to check the justifiability of the conditions under which transactions between related legal entities are carried out. In Croatia, there is no requirement regarding the use of a particular database for the comparison of the controlled transactions and the conditions of uncontrolled transactions, but Croatian Tax Administration uses specialized software to access almost all databases that Slovenia can access. Tax regulations and tax practices in Slovenia support the application of advance pricing arrangements and the Action Plan on BEPS, while in Croatia the legislation envisages the conclusion of advance pricing arrangements, but it is not used in practice, while the BEPS Action Plan is not incorporated into its legislation.

As regards transparency, as one of the basic conditions for efficient taxation of related legal entities profits, the official website of the Financial Administration of the Republic of Slovenia within the Ministry of Finance lists all laws, regulations, instructions and forms for calculation and reporting of corporate income tax and provides an overview of all the necessary data for the application of transfer prices and the regulation of business and tax relations of related legal entities. Accordingly, the Guide for Transfer Pricing Control announces that in the period from 2010 to 2016, based on 452 audits of transfer prices, Slovenia additionally collected EUR 77.1 million of budget revenue [2, p. 4], which emphasizes the importance and usefulness of more precise legal regulation of the issue concerned.

Also, from the transparency point of view, the Tax Administration of the Republic of Croatia, within the Ministry of Finance, published on its official website all the legal regulations, rules and forms related to the preparation and submission of annual tax return in the field of application of transfer pricing and regulation of loans between related legal entities.

The following table presents an overview of transfer pricing tax regime in the former Yugoslavian countries that have met the conditions for obtaining the status of candidate for EU membership.

By observing the level of profit tax rate in the former Yugoslavian countries with the status of candidate for EU membership, it can be concluded that Serbia has the highest tax rate, while Montenegro has the lowest. Although the transfer pricing rules have been present for more than a decade in the corporate tax legislation of Serbia, the Ministry of Finance did not publish concrete and detailed regulations on the application of these rules until 2013. In doing so, efforts were made to harmonize local rules and practices with established international guidelines. Regarding Montenegro, the rules on transfer pricing have been incorporated into legal regulations for more than a decade (with exceptionally low reliance on international guidelines), but the Ministry of Finance did not publish specific and detailed regulations on the application of these rules. However, when determining transfer prices, it is recommended that taxpayers generally respect the rules on transfer pricing (at least to the extent they are specified by legal regulations), since tax authorities have a legal option to retroactively change their current practice. On the other hand, Macedonian tax legislation does not contain explicit provisions on transfer pricing. The existing provisions on transfer pricing are general and mostly refer to the situation when a taxpayer, at the request of competent tax authority, needs to provide information and evidence that will confirm that the transfer prices were formed in accordance with the arm's length principle. Characteristic legal rules and regulations that are (minimally) related to transfer pricing are based exclusively on national regulations, not relying on the OECD Guidelines whatsoever.

In Serbia, it is permissible to apply all five methods specified in the OECD Guidelines. The most appropriate method for the circumstances of the specific case has priority and, if necessary, it is possible to use a combination of several methods. It is also possible to apply other methods apart from the prescribed ones if they seem more appropriate or if the application of the prescribed methods is not possible. In Montenegro, traditional transaction methods are the

Table 2: Tax regime of transfer prices in the former Yugoslavian countries with the status of candidate for EU membership

	Serbia	Montenegro	Macedonia
Profit tax rates	**15%**	**9%**	**10%**
Type of regulation	National regulations (based on the OECD Guidelines).	National regulations (poorly supported by the OECD Guidelines).	National regulations.
Status of related legal entities	Direct or indirect possession of at least 25% of stocks, stake or votes in the taxpayer's management bodies, which entails the possibility of control over or significant influence on business decisions. In case of tax consolidation, there is direct or indirect control over more than 75% of stocks or stake.	Special relationships that may have a direct or indirect impact on the conditions or economic results of transactions between those legal entities. In case of tax consolidation, there is direct or indirect control over more than 75% of stocks or stake.	Direct or indirect control over or influence on the business decisions of the taxpayer based on the possession of at least 20% of stocks, stake or voting rights or on the basis of certain agreements and contracts.
Transfer pricing methods	All methods listed in the OECD Guidelines, with the possibility of applying other methods if the application of the first five is not possible.	Traditional transaction methods (preference is given to comparable uncontrolled price method).	Comparable uncontrolled price method and cost plus method.
Transfer pricing documentation	Yes.	Yes.	Yes.
Requirements for annual preparation of documentation	With the annual tax return.	With the annual tax return.	Not regulated.
Submission deadline upon request by tax authorities	30-90 days.	Not regulated.	Not regulated (according to the assessment of competent tax authorities).
Tax penalties for untimely delivery of transfer pricing documentation	100,000.00 RSD – 2,000,000.00 RSD.	Not regulated.	2,500.00 € – 3,000.00 € or suspension of business activities for 3 to 30 days.
Tax penalties for underestimated tax base based on the use of transfer pricing	30% of the value of additional tax liability (but not less than 200,000.00 RSD).	Not regulated.	3,000.00 € with default interest of 0.03% on the amount of additional tax liability for each day of delay.
Legal limitation for assessing tax based on the adjustment of transfer pricing	5 years from the end of the year in which the tax obligation should have been calculated (but this is not explicitly stated in legal regulations).	5 years from the end of the year in which the tax obligation should have been calculated (but this is not explicitly stated in legal regulations).	Not regulated.
Tax dispute resolution	Internal options: process of complaint to the competent tax authority and appeal to the Administrative Court. International options: not regulated.	Internal options: process of complaint to the competent tax authority and appeal to the Administrative Court. International options: not regulated.	Internal options: not regulated. International options: not regulated.
International agreements for the avoidance of double taxation	58 contracts.	41 contracts.	44 contracts.
Transfer Pricing Unit	No.	No.	No.
Databases for comparing controlled and uncontrolled transactions	None are applied.	None are applied.	None are applied.
Advance pricing arrangements	No.	No.	No.
Action Plan on BEPS	Not embedded in legal regulations.	Not embedded in legal regulations.	Not embedded in legal regulations.

Source: Author's overview based on applicable legal regulations.

only legally permitted, where preference is given to the comparable uncontrolled price method, while Macedonian tax legislation supports the application of only two methods. Annual submission of documentation on transfer prices, with the annual submission of the tax return, is mandatory both in Serbia and Montenegro. However, the deadline for submitting the relevant documentation at the request of competent authorities is defined only in Serbia. Accordingly, Serbian tax legislation has also stipulated tax penalties for untimely delivery of documentation and underestimation of tax base based on the use of transfer pricing, while there are no penalties in Montenegrin tax legislation. In Macedonian tax legislation, there is no defined deadline for submitting documentation on transfer pricing, but there are specified tax penalties for absence of necessary documentation or underestimation of the tax base. In all three countries, there is no specified legal limitation for assessing tax based on the adjustment of transfer pricing, but, generally, in Serbia and Montenegro, this period is limited to five years, starting from the end of the year in which tax obligation should have been determined, while the absolute limit is ten years.

These countries do not have a separate tax unit for transfer pricing control, do not apply any database for the comparison of controlled and uncontrolled transactions (it is not mandatory by law), their tax legislation does not foresee and apply advance pricing agreements and there is no integrated Action Plan on BEPS. However, although Macedonian tax legislation does not stipulate the possibility of concluding advance pricing agreements, the taxpayer has the right to submit a request to the competent tax authority with an analysis of transfer pricing, in order to obtain an opinion on the compatibility of the methodology chosen when determining transfer prices in accordance with the requirements of domestic legislation. The main disadvantage in this procedure is the limited knowledge of the staff with regard to resolving such and similar issues related to transfer pricing, due to which the competent tax authority often provides ambiguous, i.e. insufficiently precise and clear answers or does not provide them at all, which increases the uncertainty of the taxpayer and indicates the necessity for significant legal improvement in that area.

The official website of the Tax Administration of Serbia provides all necessary information regarding the relevant laws and by-laws, forms, instructions and the most frequently asked questions of taxpayers (including the answers of competent authorities), as well as actualities regarding taxation, including the issue of transfer pricing. It also contains the rulebook regarding the contents of the tax return for the calculation of corporate income tax, as well as the rulebook regarding the list of jurisdictions with a preferential tax system, where 51 countries from the lists of offshore financial centers are identified as well. The number of countries indicated is lower than the total number of countries on those lists, and for this reason, the website of the Tax Administration of Serbia also contains links for the complete lists of offshore financial centers.

The Law on Income Tax, as well as the rulebook on and the form of the consolidated tax return, can be downloaded from the official webiite of the Tax Administration of Montenegro. Legal regulations related to corporate income tax, implementation of the tax procedure and regulation of customs issues and procedures can be found on the official website of the Tax Administration of Macedonia and the Customs Administration of Macedonia.

Table 3 presents the tax treatment of transfer pricing in the three tax jurisdictions in Bosnia and Herzegovina, in order to emphasize their mutual incompatibility and diversity.

Bosnia and Herzegovina consists of two territorial and administrative entities and Brčko District, which is why legal regulations are adopted separately for each jurisdiction. There are significant differences in some segments. This constitutes an aggravating circumstance for all companies operating in the entire territory of Bosnia and Herzegovina; thus, the status of Bosnia and Herzegovina, as a legally unified state, becomes violated.

Profit tax rates are harmonized in all competent jurisdictions of Bosnia and Herzegovina. The national tax regulations of the Republic of Srpska are in accordance with the OECD Guidelines. In the Federation of Bosnia and Herzegovina, they are partially relying on the existing Guidelines, while the tax regulations of the District have adopted only the methods of transfer pricing. Also, the definition of the status of a related legal entity is not mutually harmonized, which leaves considerable space for tax dilemmas if the entire territory of Bosnia and Herzegovina is viewed as a single business space. The deadline for periodic submission of transfer pricing documentation is not legally defined in the Brčko District, nor is the deadline for its submission at the request of competent tax authorities. Accordingly, penalties for untimely delivery of documentation and the reduction of the tax base based on the use of transfer pricing have not been defined. In the Republic of Srpska and the Federation of BIH, those penalties are incorporated in legal regulations, but they differ from one another. Internal options for resolving tax disputes have been established in all three tax jurisdictions, while international options are not regulated in any of them. Also, none of the three tax jurisdictions has a separate

Table 3: Tax regime of transfer pricing in the former Yugoslavian country with the status of potential candidate for EU membership

	Republic of Srpska	Federation of Bosnia and Hercegovina	Brčko District
Profit tax rates	10%	10%	10%
Type of regulation	National regulations (based on the OECD Guidelines).	National regulations (partially based on the OECD Guidelines).	National regulations (based on the OECD Guidelines only in the field of transfer pricing methods).
Status of related legal entities	Direct or indirect participation in the management, control or capital of another legal entity, owning at least 25% of stocks or stake in another legal entity with voting rights or when the entity has the factual ability to control decisions of another legal entity.	Direct or indirect possession of at least 25% of the capital, stocks or voting rights. In case of tax consolidation, there is direct or indirect control over more than 50% of stocks or stake.	Direct or indirect possession of at least 10% of stocks in a joint-stock company, or equity shares. In case of tax consolidation, a parent company owns at least 80% of the stake in a legal entity included in a group of legal entities.
Transfer pricing methods	All methods listed in the OECD Guidelines, with the possibility of applying other methods in accordance with the arm's length principle, if the first five methods cannot be applied.	All methods listed in the OECD Guidelines (priority is given to the traditional transaction methods) with the possibility of applying other methods in accordance with the arm's length principle, if the first five methods cannot be applied.	All methods listed in the OECD Guidelines.
Transfer pricing documentation	Yes.	Yes.	Yes.
Requirements for annual preparation of documentation	With the annual tax return.	With the annual tax return.	Not regulated.
Submission deadline upon request by tax authorities	30 days.	45 days.	Not regulated.
Tax penalties for untimely delivery of transfer pricing documentation	For a legal entity from 20,000.00 BAM to 60,000.00 BAM. For the person responsible from 5,000.00 BAM to 15,000.00 BAM.	For legal entities from 3.000,00 BAM to 100,000.00 BAM. For the person responsible from 2,500.00 to 10,000.00 BAM.	Not regulated.
Tax penalties for underestimating tax base based on the use of transfer pricing	Determined additional taxable profit is subject to the standard corporate income tax rate, increased by 0.03% for each day of delay in settling that obligation.	3,000.00 BAM -100,000.00 BAM. Also, the established additional taxable profit is subject to the standard corporate income tax rate, increased by 0.04% for each day of delay in settling that obligation.	Not regulated.
Legal limitation for assessing tax based on the adjustment of transfer pricing	5 years (from the date the tax return was filed or from the date of tax obligation becoming due, counting from the later date).	5 years (from the end of the year in which the tax return should have been filed).	Not regulated.
Tax dispute resolution	Internal options: complaint to the Ministry of Finance of the Republic of Srpska, as well as initiation of an administrative dispute before the relevant District Court and filing an appeal before the Supreme Court of the Republic of Srpska. International options: not regulated.	Internal options: appeal to an independent second-instance body within the Ministry of Finance of the Federation of BIH, as well as initiation of an administrative dispute before the Cantonal Court and filing an appeal before the Supreme Court of the Federation of BIH. International options: not regulated.	Internal options: appeal to the Appellate Commission, as well as initiation of an administrative dispute before the Basic Court of the Brčko District. International options: not regulated.
International agreements for the avoidance of double taxation	International agreements signed by BIH (37 contracts).	International agreements signed by BIH (37 contracts).	International agreements signed by BIH (37 contracts).
Transfer Pricing Unit	No.	No.	No.
Databases for comparing controlled and uncontrolled transactions	None are applied.	None are applied.	None are applied.
Advance pricing arrangements	No.	No.	No.
Action Plan on BEPS	Not embedded in legal regulations.	Not embedded in legal regulations.	Not embedded in legal regulations.

Source: [22, pp. 58-59].

tax unit for the supervision of transfer pricing, their tax administrations do not use any databases for comparing controlled and uncontrolled transactions, there are no advance pricing agreements and the BEPS Action Plan is not embedded in their legal regulations.

In terms of transparency, the official website of the Tax Administration of the Republic of Srpska provides complete and detailed information related to the legal regulations on corporate income tax and other relevant regulations. Detailed information on the laws, regulations, instructions, forms, etc. are published on the website of the Tax Administration of the Federation of BIH according to appropriate categories, which allows all interested users to easily find the necessary regulations.

However, the Tax Administration of the Brčko District does not have its own website. It is an integral part of the Brčko District Government website. The existing laws and regulations related to the work of the Tax Administration itself are not presented transparently and systematically.

Conclusion

The former Yugoslavian countries with the status of EU member states have a better regulated tax regime of transfer pricing, especially Slovenia which has been a member since 2004. This is completely expected, given the fact that more comprehensive legislation is one of the prerequisites for joining the EU. Also, in the last 10 years, the Tax Administration of Slovenia has seen a significant increase in transfer pricing audits, especially in the sphere of transactional relations with related foreign legal entities, putting emphasis primarily on cross-border restructuring.

However, as the youngest member of the EU, Croatia still has some undefined segments in the domain of taxation of transfer pricing. But although there are no official data on the specific, monetary benefits of more precise regulation of transfer pricing issues, in the past few years tax authorities have increased the intensity of transfer pricing audits, i.e. they focused their attention on the prices applied in transactions with related legal entities.

Out of the former Yugoslavian countries with the status of candidate for EU membership, Serbia has focused its attention on legal framework of the transfer pricing application. However, the tax authorities in Serbia do not perform audits on a regular basis, they are usually performed every three to five years, and due to the lack of practical experience of tax inspectors, the examination of transactions with related parties is usually carried out to a somewhat limited extent.

Unlike in Serbia, in Montenegrin tax legislation the issue of transfer pricing is still not considered to be a field that deserves more attention. Audits are usually conducted once in three to five years, covering all taxes. In this phase of developing rules of transfer pricing, due to the lack of specific audit practice, there is a need for a substantial level of sophistication regarding the review of transactions between related legal entities.

In Macedonia, tax authorities have a discretionary right to initiate a tax audit in accordance with the set audit plan, where the probability of an annual audit, as well as the probability of transfer pricing being reviewed as a part of that audit, becomes reasonably high. However, the probability that the used transfer pricing methodology will be assessed as inadequate is medium.

In terms of Bosnia and Herzegovina, country with the status of a potential EU candidate, it is noted that the Republic of Srpska and the Federation of BIH have devoted more attention to the legal regulation of transfer pricing than the Brčko District, regulating certain issues in a relatively similar manner. However, a significant part of the problem remains open and unresolved, where some deadlines, thresholds and ranges of prescribed penalties for the same offenses vary between the entities. This type of mismatch and incompleteness of the laws and regulations ruins and distorts the unique approach to and success of the transfer pricing tax treatment within the same country. But what seems to be encouraging is the almost complete and systematic presentation of all relevant applicable legislation in the Republic of Srpska and the Federation of BIH, as opposed to the Brčko District.

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