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On the basis of the Article 61a of the Corporate Income Tax Law (Official Gazette of the Republic of Serbia, No. 25/01, 80/02, 80/02 – sec. law, 43/03, 84/04, 18/10, 101/11, 119/12 и 47/13),

Finance Minister of the Republic of Serbia adopts the following

RULEBOOK

on transfer pricing and methods which are applied according to the "arm's length principle" for determining of the transaction price between related entities

Article 1

This Rulebook defines in detail the form and content of documentation on transfer pricing, selection and ways of application of the method according to the "arm's length principle" for determining of the transaction price between related entities, along with a way for determining the basis for calculation of depreciation of fixed assets acquired from the transaction with a related entity, in accordance with the Article 10a and Article 59 to 61 of the Corporate Income Tax Law (Official Gazette of the Republic of Serbia, No. 25/01, 80/02, 80/02 – sec. law, 43/03, 84/04, 18/10, 101/11, 119/12 и 47/13 – hereinafter: Law).

Article 2

The taxpayer (hereinafter: Taxpayer) is submitting a documentation on transfer pricing in the form of report along with the tax balance sheet.

Documents from Paragraph 1 of this Article especially contain:

1) analysis of the group of related entities to which the Taxpayer belongs to;

2) analysis of the activity;

3) functional analysis;

4) selection of methods for the verification of compliance of transfer pricing with prices determined according to the arm's "length principle";

5) conclusion;

6) annexes.

The Taxpayer is not obliged to submit along with documents from Paragraph 1 of this Article separate documentation related to individual transactions and relations between the companies within the group.

Additional documentation from Paragraph 1 of this Article shall be submitted upon request of the competent tax authority.

Article 3

Analysis of the group of related entities to which the Taxpayer belongs to especially includes:

1) description of the business activity (economic activities) within which the group of related entities operates;

2) organizational and legal structure of the group, including shareholders, history and general financial information;

3) general description of business operations and business policy of the group, with a special emphasis on potential changes to the business policy compared to the previous tax period;

4) general information on the Taxpayer: history, ownership and organizational structure, overview of financial operations, business policy, key business factors;

5) basic information on related entities – members of the group, within which the Taxpayer conducts transactions which are covered by the obligation of stating transfer pricing and its compliance with the "arm's length principle".

The Taxpayer must state all related entities in accordance with the Article 59 of the Law, and to define the way in which a relation with a particular entity was determined.

Article 4

The Taxpayer prepares a description of all activities in which it participates, regardless of the activity which was defined by the Taxpayer as predominant, which especially includes:

1) defining and classification of the activity;

2) information on market conditions in the Taxpayer's field of activity: general overview of market conditions, overview of particular and separate legal provisions if they exist, overview of the market share, overview of main competitors, suppliers and buyers;

3) description of factors influencing determining of prices within a particular activity, as well as profitability of corporate entities specializing in a particular activity;

4) defining of risks related to operations within a particular activity.

Exceptionally, the Taxpayer is not obliged to prepare analysis of the activity from Paragraph 1 of this Article if the Taxpayer has not defined such activity as a predominant activity and if the Taxpayer generates less than 10% of total revenues from performing of such activity.

Article 5

The Taxpayer must describe in detail and define transactions with related entities.

Documentation from Paragraph 1 of this Article especially includes:

1) information on the types of transactions with individual related entities (defining of the types of transactions, their description, whether contracts in a written form were concluded, the most

important elements of concluded contracts, if there is a possibility for each transaction to be regarded individually, justification of reasons for the application of collective or individual approach from Article 60, Paragraph 4 of the Law);

2) description of assumed activities (hereinafter: functions) and risks, as well as assets engaged in transactions from Item 1) of this Paragraph;

3) description of determining factors which have influenced the determining of prices in transactions with related entities;

4) determining of the actual economic position of the Taxpayer in transactions from Item 1) of this Paragraph;

5) description of the planned development of business relations and transfer pricing policies with related entities.

Article 6

The Taxpayer describes decisive reasons for adoption of conclusions on which method for verification of compliance of the transfer pricing with prices determined according to the "arm's length principle" meets the needs to the greatest extent of circumstances under which certain transactions were conducted.

In accordance with a determined method the Taxpayer defines comparable transactions or comparable non-related corporate entities on the basis of which the Taxpayer determined the price or the range of prices in accordance with the "arm's length principle", if the Taxpayer cannot use internal (own) information on comparable transactions. During selection of comparable non-related corporate entities and comparable transactions, the Taxpayer above all uses information which relate to the Republic of Serbia. If, in this way, it is not possible to determine comparable information, analysis can be extended to other countries as well, taking into consideration comparability of business conditions on markets of these countries and the market of the Republic of Serbia.

Article 7

The Taxpayer determines in the conclusion whether prices in transactions with individual related entities are in accordance with prices determined according to the "arm's length principle" or they must be corrected in accordance with selected method for verification of compliance of the transfer prices with prices determined according to the "arm's length principle".

Article 8

The Taxpayer provides an overview of information used for determining of prices according to the "arm's length principle" or the price range determined according to the "arm's length principle" in accordance with a selected method for verification of compliance of the transfer prices with prices determined according to the "arm's length principle", and especially the information on comparable domestic or foreign transactions, and companies.

Article 9

Compliance of the Taxpayer's prices in transactions with related entities with prices, and the range of prices which were determined by the application of a method for verification of compliance of transfer pricing with prices determined according to the "arm's length principle" is verified by the tax authority according to the documentation supplied by the Taxpayer which is compliant with this Rulebook.

The competent tax authority may request additional documentation from the Taxpayer in case it determines that the Taxpayer's documentation is not sufficient for the verification of compliance of the transfer pricing with prices determined according to the "arm's length principle" in Taxpayer's transactions with individual related entity.

In regard to the request from Paragraph 2 of this Article the competent tax authority will keep in mind expenses to be incurred by the Taxpayer concerning preparation of additional documentation and the overall ability of the Taxpayer to supply such additional documentation.

The competent tax authority leaves a suitable deadline to the Taxpayer for submitting additional documentation.

If, during the control procedure, the competent tax authority determines that documentation on transfer pricing which was submitted by the Taxpayer was not prepared in a way which provides adequate basis for determining of compliance of the Taxpayer's transfer pricing with prices determined according to the "arm's length principle", the tax authority may, without sending request for completion of the documentation, engage in independent drafting and supplementing necessary documentation in transfer pricing by applying provisions of this Rulebook.

Article 10

The Taxpayer must select the most appropriate method for determining prices of transactions according to the "arm's length principle" for analysis of transfer pricing, and the method which best suits the circumstances of each particular case.

Selection of the method is based on analysis of facts, and it is also necessary to review:

1) the nature of transactions which are the object of analysis;

2) availability and reliability of information for analysis;

3) degree of comparability between transactions conducted according to the transfer pricing with transactions which are conducted with or between non-related entities when these transactions are used for verification of compliance of the Taxpayer's transfer pricing with prices determined according to the "arm's length principle";

4) suitability of use of financial information of non-related entities for analysis of compliance of the transfer pricing according to the certain types of transactions which are conducted by the Taxpayer with related entities;

5) the nature and reliability of assumptions.

For the needs of application of this Rulebook the term non-related entity shall be considered to mean the entity which has no related entities according to the Article 59 of the Law.

Article 11

Method for analysis of the price
transferring is selected at the level of the type of transaction.

In certain cases it is possible to use a combination of several methods.

Each selected method must be practically applicable and must have as a final effect and result a reasonable evaluation of results in accordance with the "arm's length principle".

Article 12

The method of comparable uncontrolled price compares the price of product or service in transactions between related entities with the price of product or service in transactions between non-related entities, while transactions being compared are conducted under comparable circumstances.

The method of comparable uncontrolled price is applied when:

1) the Taxpayer provides a service or sells a product in similar quantities, on similar markets and according to the similar conditions to related and non-related entities (internal comparable price);

2) a non-related entity renders a service of sells a product in similar quantities, on similar markets and according to the similar conditions (external comparable price), providing that information with the use of which it is possible to determine conditions according to which this transaction is being conducted is publicly available;

3) the taxpayer receives a service or buys a product in similar quantities, on similar markets and according to the similar conditions from related and non-related entities (internal comparable price);

4) a non-related entity receives a service or buys a product in similar quantities, on similar markets and according to the similar conditions (external comparable price), providing that information with the use of which it is possible to determine conditions according to which this transaction is being conducted is publicly available.

Article 13

The most important comparability factors for the needs of application of the method of comparable uncontrolled price are:

1) similarity of the object of transaction;

2) contractual terms and conditions;

3) economic and market conditions.

Article 14

Transaction can be considered comparable even though there are differences compared to the transaction which is being conducted at the transfer price if:

1) the differences between transactions being compared can be reliably quantified or are such that they cannot significantly influence the price, and

2) if a reasonable adjustment can be applied in order to eliminate the differences.

Article 15

The resale price method starts from the price according to which a product is being sold to the non-related entity, which is then reduced by comparable gross margin so the price according to the "arm's length principle" could be determined for the same product which was acquired from a related entity.

The gross margin is determined in the following way:

$$\text{Gross margin} = \frac{\text{Sale revenue} - \text{Cost of goods sold}}{\text{Sale revenue}}$$

Article 16

The following can be used as a comparable gross margin:

1) gross margin realized by the Taxpayer or member of the group in a comparable transaction with a non-related entity (internal comparable margin), or

2) gross margin realized by non-related entities in a comparable transaction (external comparable margin).

The Taxpayer uses information on gross margins of the member of the group from Paragraph 1, Item 1) of this Article if the information on these margins is available to the Taxpayer.

Article 17

If transactions are not completely comparable and if the differences have material effects on the price, the Taxpayer should conduct adjustments in order to eliminate the effect of differences. If functions, risks and assets in a controlled and non-controlled transaction are comparable to a significant extent, the resale price method will enable more reliable evaluation of results in accordance with the "arm's length principle".

The resale price method is the most acceptable in transactions in which the trader – seller directly adds a relatively small value to products. If a greater value is added to the products being distributed through functions performed by the seller, reliability of application of the resale price method is reduced.

Aside from circumstances stated in Paragraphs 1 and 2 of this Article, during analysis of comparability of transactions it is necessary to take into consideration the elements of comparability determined by Article 13 of this Rulebook.

Article 18

Internal comparable resale margins have an advantage compared to external resale margins.

If there are no conditions for the application of internal comparable margin, a market range of the resale margin is determined in accordance with the rules for determining of market range in the case of application of transaction margin method.

Article 19

The cost plus method increased by the usual profit starts from expenses stemming from the transaction (sale of goods or rendering of services) which are then added gross margin depending on performed functions, risks undertaken and assets being used.

Article 20

For the needs of application of the cost plus method increased by the usual profit it is possible to use as comparable gross margin:

1) gross margin recorded by the Taxpayer or a member of the group, within a comparable transaction with a non-related entity (internal comparable margin), or

2) gross margin recorded by non-related entities within a comparable transaction (external comparable margin).

The Taxpayer uses information on gross margins of members of the group from Paragraph 1, Item 1) of this Article if records on these margins are available to the Taxpayer.

In regard to comparability of transactions the Article 13 of this Rulebook shall be applied.

Article 21

For the needs of application of methods based on expenses, the following expense categories are available:

1) direct expenses (i.e. raw material expenses);

2) indirect expenses (i.e. maintenance expenses);

3) operational expenses (i.e. sale expenses, administrative expenses).

The cost plus method increased by the usual profit is applied to direct and indirect expenses of production or rendering of services.

Article 22

In order for transaction to be considered comparable, the cost basis, to which a margin is added, must be determined in the same way within the transaction from which the transfer pricing originated and transaction with a non-related entity, and between non-related entities, taking into consideration functions, risks and assets used. In case there are differences in cost basis, comparability can be achieved by adjustments which are suitable in a particular case.

Article 23

Historical expenses, direct and indirect, vary over periods, so during establishing of the cost basis the mean value of these expenses can be used for a certain period. The average value of expenses can also be applied in the case of determining of the cost basis for a group of products and other groupings which are necessary for the purpose of achieving greater comparability.

Article 24

Internal gross margins have the advantage over external gross margins.

If there are no conditions for the application of internal gross margin, a market range of the gross margin is determined in accordance with the rules for determining of the market range in the case of application of transactional net margin method.

For the needs of determining the range of gross margin, for comparable entities the gross margin is determined according to the following formula:

$$\text{Gross margin} = \frac{\text{Revenues from the sale of goods or services} - \text{Cost of products or services}}{\text{Cost of products or services}}$$

Article 25

During the application of the transactional net margin method, net profit margins recorded by the Taxpayer in transactions with related entities are compared to net profit margins recorded in similar transactions with non-related entities, and between non-related entities.

Transactional net margins represent a relation between net operational profit and a corresponding basis which can represent an amount of operating expenses, operating revenues or assets. Exceptionally, with certain forms of transactional net margins, a relation between the gross profit and operating expenses can be used ("berry" indicator).

During determining of transactional net margin recorded by the Taxpayer in a transaction from which the transfer pricing originated, as per rule, only those operating revenues and operating expenses are taken into account which relate to such transaction, and then only to the extent to which they contributed to generating of the net revenue in such transaction.

Article 26

Transactional net margin generated by the Taxpayer in a transaction with related entity is compared to the transactional net margin generated by non-related entities which predominantly deal with similar transactions, by applying a statistical method which separates net margins in transactions between non-related entities into quartiles (first quartile, median – second quartile, third quartile).

Information which is below the first quartile represents the minimum analyzed data cluster, while information above the third quartile represents a maximum analyzed data cluster.

Transactional net markups between non-related entities are determined as a pondered net average of recorded transactional net markups in the period between three and five years, while the final year of the mentioned period should be the year for which the necessary financial information is available in publicly available databases used by the Taxpayer.

The market range of transactional net margins represents net markups which range between the first and third quartile (interquartile range).

Article 27

The taxpayers should, depending in particular circumstances and cases, above all use the following transactional net markups:

1) operating profit compared to the sale, which is calculated according to the following formula:

$$\text{Transactional net margin} = \frac{\text{Net profit}}{\text{Sale revenues}} \times 100$$

while this form of transactional net markup is especially applicable to transactions concerning the acquisition of goods from related entities for the purpose of sale to non-related entities;

2) operating profit compared to the operating expenses, which is calculated according to the following formula:

$$\text{Transactional net margin} = \frac{\text{Net profit}}{\text{Operating expenses}} \times 100$$

while this form of transactional net markup is especially suitable for transactions within which the Taxpayer renders services or performs production activities;

3) operating profit compared to assets, which is calculated according to the following formula:

$$\text{Transactional net margin} = \frac{\text{Net profit}}{\text{Assets}} \times 100$$

while this form of transactional net markup can be used for production activities which require significant engagement of assets, as well as in the case of financially intensive capital activities. For this purpose the business assets shall mean: land, construction facilities, production facilities, equipment, intangible assets (know-how, patents), supplies, financial claims from buyers (reduced by liabilities towards suppliers);

4) "berry" indicator, as a form of transactional net markup is determined with the application of the following formula:

$$\text{Transactional net margin} = \frac{\text{Gross profit}}{\text{Operating expenses}} \times 100$$

while the application of this form of transactional net markup is suitable for analysis of intermediary activities.

Provisions from the Paragraph 1 of this Article are instructive and the Taxpayer may also apply other transactional net markups, and adjust in a particular transaction the way of application of transactional net markups from Paragraph 1 of this Article, but in this case the Taxpayer must provide a detail justification for such approach in the documentation on transfer pricing.

Article 28

The profit split method application is especially recommended in the following cases:

1) activities of related entities are merged in a way which makes it very difficult to conduct a separate analysis of individual transactions between them; or

2) the existence of valuable intellectual and unique intellectual property prevents finding of comparable information which would enable for each related entity to separately analyze compliance of its transfer pricing with prices determined according to the "arm's length principle".

Article 29

During the application of the profit split method it is necessary to:

1) determine the total amount of profit being generated by related entities on the basis of transaction being controlled. As per rule, the amount of operating profit is being determined which is generated as a result of transaction which is being controlled, while financial expenses and income tax expenses are not being taken into consideration. Exceptionally, in justified cases, the amount of total profit can be determined which is being generated on the basis of a transaction being controlled;

2) split the profit generated on the basis of a transaction being controlled into individual related entities which are participating in the transaction being controlled according to the "arm's length principle".

Article 30

Depending on particular circumstances of a transaction being controlled the split of profit in accordance with the "arm's length principle" into related entities which are participating in a transaction being controlled is determined:

1) on the basis of analysis of a contribution in acquiring of the profit within the transaction being controlled which is generated on the basis of routine activities, use of assets and assuming of risks. When for acquiring of the profit within a transaction being controlled having special intellectual property is not of greater importance, it would not be necessary to perform additional analysis for the split of profit generated on the basis of a transaction between related entities;

2) by allocating profit which exceeds the amount of profit that would be generated by non-related entities in a transaction which is comparable to the transaction being controlled after the allocation of profit on the basis of routine activities, use of assets and assuming of risks – residual analysis.

Article 31

In conclusion of the documentation on transfer pricing the Taxpayer first determines the amount of correction of transfer pricing for each individual transaction with individual related entities, and for each type of transaction with individual related entities in accordance with Article 60, Paragraphs 5 through 7 of the Law.

By adding amounts of corrections from Paragraph 1 of this Article the Taxpayer determines the total amount of transfer pricing correction on the basis of transactions with individual related entity.

In accordance with Article 60, Paragraph 8 of the Law the Taxpayer has the right to reduce the total amount of transfer pricing correction on the basis of transactions with individual related entity from Paragraph 2 of this Article by:

1) the amount of negative difference between revenues on the basis of transaction with such individual related entity at the price determined by the application of the "arm's length principle" and revenues on the basis of this transaction according to the transfer price, or

2) the amount of negative difference between expenses on the basis of transaction with such individual related entity according to the transfer price and expenses on the basis of such transaction at the price determined according to the "arm's length principle".

For the needs of application from Paragraph 3 of this Article, when during determining of the transfer pricing according to the "arm's length principle" its range has been determined:

1) it shall be considered that transfer pricing of such transaction is not different than its price according to the "arm's length principle" if the value of the transfer pricing is within such range;

2) price according to the "arm's length principle" is equal to the mean value of determined range when the transfer pricing is out of determined range.

The amount of reduction of transfer pricing from Paragraph 3 of this Article cannot exceed the amount of correction of transfer pricing from Paragraph 2 of this Article.

Upon reduction of the amount of correction of transfer pricing on the basis of transactions with individual related entity from Paragraph 3 of this Article the Taxpayer determines the final amount of correction of transfer pricing on the basis of transactions with individual related entity.

The Taxpayer includes into tax basis the sum of all final corrections of transfer pricing on the basis of transactions with all individual related entities from Paragraph 6 of this Article.

Article 32

This Rulebook comes into force eight days from the day when it was published in the Official Gazette of the Republic of Serbia.

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In Belgrade, on July 5th, 2013

Minister,

Mladjan Dinkic