

Transfer Pricing In The Balkans*

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ABSTRACT

This study aims to show the recent developments and differences in the transfer pricing applications of several Balkan states. Transfer pricing applications in Bulgaria, Greece, Romania, Albania, Macedonia, Serbia and Turkey are examined respectively according to OECD Transfer Pricing Guidelines. OECD is considered as the highest authority in transfer pricing practices but findings indicate that some Balkan states' transfer pricing legislations do not integrate with OECD's transfer pricing policies. Therefore, EU's Code of Conduct for TP Documentation for Associated Enterprises and local legislations of the mentioned Balkan states are additionally analyzed in the research.

Keywords: *Transfer pricing, Balkan countries.*

Jel Classification: *M48.*

Balkanlarda Transfer Fiyatlaması

ÖZET

Bu çalışma Balkan ülkelerindeki transfer fiyatlaması uygulamalarındaki gelişmeleri ve farklılıkları incelemektedir. Transfer fiyatlaması konusunda OECD'nin transfer fiyatlaması yönetmelikleri belirleyici bir rol oynamaktadır. Bu nedenle, Bulgaristan, Yunanistan, Romanya, Makedonya, Arnavutluk, Sırbistan ve Türkiye'deki transfer fiyatlaması uygulamaları OECD'nin transfer fiyatlaması yönetmeliklerine uygun olarak karşılaştırılmıştır. Balkan ülkeleri arasında transfer fiyatlaması konusunda bir birliktelik olmadığı, transfer fiyatlaması yönetmeliklerinin bazılarının OECD'nin yönetmelikleri ile uyumlu olmadığı çalışmanın bulguları arasındadır.

Anahtar Kelimeler: *Transfer fiyatlaması, balkan ülkeleri.*

JEL Sınıflandırması: *M48.*

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1. INTRODUCTION

The world has become more globalized by the easier means of global transport and improved technology. As international investments and the global economy are developing rapidly, movement in goods, services, and capital becomes faster and easier. International firms are setting up new branches to extend their market or allocate their operations. Thus, they become responsible for international regulations and guidelines. Transfer pricing is one of these international regulations.

Transfer pricing is a common tax evasion method for multinational firms. Although companies should establish prices in harmony with the international arm's length method, it is regularly adjusted to shift profit to countries with tax advantages. Transfer pricing is also used to charge costs to those countries that offer expedient subsidies. Briefly, it is an important vehicle for the international tax planning and is the scope of this study.

Southeastern Europe is known as the Balkans. Romania, Croatia, Slovenia, Serbia, Albania, Bulgaria, Greece, Macedonia, Kosovo, Montenegro, and Turkey are part of the Balkan range. These states are considered as emerging markets and have been attracting the attention of multinational firms for decades. Although economically and culturally related, they have different legal and political structures. Greece, Romania, and Bulgaria are the members of European Union, and the European Union coordinates their domestic regulations. As a result of that, these countries have similar legislations. Furthermore, Turkey and Greece is a member of the OECD, and their fiscal policies comply with the OECD Guidelines and Model Conventions. Although not members of OECD, other Balkan states adopt to OECD principles in their financial regulations such as transfer pricing guidelines. Besides, all of the OECD transfer pricing guidelines and methods are not acceptable by tax administrations in these states. As a result, transfer-pricing applications differ between these countries.

Studies regarding transfer pricing have been gaining interest since multinational companies have developed divisional organizations in which some separate divisions as profit centers. The problem of pricing the goods and services between such divisions are attracting the attention of academics since the 1950s. Paul W. Cook (1955) and Hirshleifer (1956) suggested the use of market-based prices; on the other hand, Joel Dean (1955) recommended negotiated competitive prices in his paper titled decentralization and intra-company pricing. These papers can be the cornerstones of international transfer pricing thought. Since then, academics are analyzing the issue of transfer pricing with various methodologies like building indexes (Marques and Pinho, 2016), and measuring the transfer pricing framework strictness by countries. While others (Bhattacharjee and Moreno, 2017) tried to analyze opponents emotions as information signals during accounting bargaining by benefiting from psychological research measures. Several studies have analyzed the subject utilizing surveys (Hummel et al., 2017), case studies (Ylönen et al., 2015) and accounts (Muhammadi et al., 2016).

It is hard to find cross-cultural research in the relevant literature since this paper compares the transfer pricing practices of several countries. An inspiring study by Jingyi Wang (2016) analyses the reasons for the perceived aggressiveness of Chinese tax authorities and the inconsistency between statutory endorsement of the arm's length principle and the approach adopted in practice by tax authorities. Sukurai (2002) did interviews with the tax managers of multinational companies of US, UK, and Japan to compare cross-cultural regulatory styles and processes in dealing with transfer pricing.

The paper's results suggest that different regulatory styles practiced by US, UK and Japanese tax managers have both merits and shortcomings regarding transfer-pricing rules. The goal of our paper can be considered similar as it focuses on the regulatory differences between Balkan countries.

Transfer pricing applications in Bulgaria, Greece, Romania, Albania, Macedonia, Serbia, and Turkey are examined respectively according to OECD Transfer Pricing Guidelines. OECD is the highest authority in transfer pricing practices, but findings indicate that some Balkan states' transfer pricing legislations do not integrate with OECD's transfer pricing policies. Therefore, this research refers to the EU's Code of Conduct for TP Documentation for Associated Enterprises and local legislations as well.

The first part of this study begins with a literature review. Brief knowledge regarding traditional transfer pricing methods is the second section. The third part is the findings and the paper closes with some conclusions about the analysis.

2. TRADITIONAL TRANSFER PRICING METHODS AND DOCUMENTATION

Transfer pricing methods are mentioned in Chapter II of the OECD Transfer Pricing Guideline. Five methods are explained in the guideline.

- a) Traditional Transaction Methods:
 - 1. Comparable Uncontrolled Price Method;
 - 2. Resale Price Method;
 - 3. Cost Plus Method.
- b) Transactional Profit Methods:
 - 1. Transactional Net Margin Method;
 - 2. Transactional Profit Split Method.

The purpose of the method selection is always to find the most appropriate method for each transaction with a related party. Brief knowledge about those methods is shown in table 1.

Table 1. Brief information about traditional transfer pricing methods

Method	Necessary of Comparability	Approach	Opinion
Comparable Uncontrolled Price	Very High	Prices are benchmarked	Very difficult to apply as very high degree of comparability required
Resale Price Method	High	Gross Profit amounts are benchmarked	Difficult to apply as high degree of comparability required
Cost Plus Method	High	Gross Profit amounts are benchmarked	Difficult to apply as high degree of comparability required
Transactional Net Margin Method	Moderate	Operating Profit margins are benchmarked	Complex Method, providently used
Transactional Profit Split Method	Moderate	Operating Profit margins are benchmarked	Most common method.

Companies may use comparable uncontrolled price (CUP) method in the case of prices determined in a transaction are compatible with the similar transaction as set price in arm's length transaction. This approach predicates on comparison directly to the prices and is acceptable only when the goods are available in a free market. Guideline state that if it is possible to apply CUP method, it will be the most appropriate concerning the arm's length principle.' (OECD, Transfer Pricing Guidelines, para 2.14.).

The Resale Price Method is based on the gross profit or difference between the price at which a product is obtained and the price at which it is traded to an unrelated party. That is considered appropriate for distributors and resellers.

Cost plus method is used to adjust the arm's length price for the transfer of tangibles, intangibles or services. A gross profit mark-up is added to the cost of goods or services for adjusting the arm's length price. The crude profit mark-up is adjusted by base on the functions performed by the taxpayer or by considering to comparable uncontrolled transactions. Manufacturing companies for resale of goods to related distributors usually select this method. The cost plus method is a gross profit method rather than the net profit method, because of that; mark up is applied to the indirect and direct costs of production (Tp Catalyst, 2015).

The transactional net margin method (TNMM) examines a net profit indicator, i.e. a ratio of net profit relative to an appropriate base (e.g. costs, sales, assets), that a taxpayer realize from a controlled transaction (or from transactions that are appropriate to aggregate) with the net profit earned in comparable uncontrolled transactions (OECD, Transfer Pricing Guidelines, para. 14). This method is useful in practice for the providing service between related parties, for instance, management fees and distribution of products where resale price method can not be sufficiently applied.

The profit split method splits the consolidated operating profit or loss, which is occurred by a transaction to related entities in a manner that reflects the profit sharing that in an arm's length arrangement. It is used in the case of that when business is divided to many related transactions and become difficult to evaluate every transaction separately (Tp Catalyst, 2015).

Another important aspect of transfer pricing is the documentation requirements. It is a legal obligation, and proof that the related party transactions pricing applied is compatible with the pricing that is being implemented to the transactions with unrelated parties. The OECD clarified an approach for documentation in 1995. OECD TP Guidelines refers documentation requirements in the fifth chapter, which the member states of OECD can adopt to follow. The purpose of the material is for the multinational companies to guide that the method used by the multi national companies in the determining of the transfer price can identify by the local tax authorities and for the multi national companies prove it corresponds an arm's length price. Due to these documentation requirements, the local fiscal authorities get information on how to prepare the local documentation rules, hence scope and shape of documentation that the tax authorities may claim from the taxpayers in a tax audit.

The OECD published action Plan on Base Erosion and Profit Shifting (BEPS) on 2013. BEPS treats to tax planning strategies which are used by MNEs that trespass on the legal loopholes in tax legislations for shift their profit to the countries where have the lower tax rates (OECD, About BEPS).

Countries should appropriate a standardized approach for documentation according to OECD. This method approves a three-tiered structure for documentation that consists of a master file, local file, and country-by-country reporting. The master file should give an extensive overview of the multinational company business, which contains global transfer pricing policies, global operations, global allocation of profit and economic activities; thus tax authorities could evaluate transfer pricing risk of the company with the overall perspective. The Country-by-Country report will be lump to overall information about the global allocation of the profit, taxes paid and indicators of the location of economic activity where the multinational company operates (OECD, Action Plan 13).

3. ANALYSIS AND FINDINGS

Although there are twelve Balkan countries in the Southeastern Europe, only seven of them are analyzed to obtain efficient results and comparisons. We excluded Croatia, Kosovo, Bosnia and Herzegovina, Montenegro and Slovenia from the analysis.

Bosnia and Herzegovina have two different regional and governmental entities, as a result of that Bosnia and Herzegovina is divided into two separate autonomous regions, and it has two distinct tax authorities. These two entities have separate legislations and applications for transfer pricing. Because of the complex transfer pricing regulations and the country did not have a request integrity inland, the study does not cover Bosnia and Herzegovina. Although Kosovo and Montenegro have transfer-pricing provisions in their legislations, they are recently established and provided with limited sources for the research.

Transfer pricing applications in Bulgaria, Greece, Romania, Albania, Macedonia, Serbia, and Turkey are compared respectively according to the arm's length principle, OECD transfer pricing guidelines, related parties, transfer pricing methods, documentation requirements, tax audit procedures and transfer pricing penalties.

Before going on through distinctive facts about transfer pricing regulations, the following table provides a general view of the mentioned countries.

Table 2. General View to Turkey and Balkan States

Country	Population	GDP per capita (\$)	Corporate Tax Rate (%)	Member of OECD	Member of European Union
Turkey	75.932.348,00	10.529,60	20	✓	x
Bulgaria	7.226.291,00	7.712,80	10	x	✓
Greece	10.957.740,00	21.682,60	26	✓	✓
Romania	19.910.995,00	9.996,70	16	x	✓
Albania	2.894.475,00	4.619,20	15	x	x
Macedonia	2.075.625,00	5.455,60	10	x	x
Serbia	7.129.428,00	6.152,90	15	x	x

Source: World Bank Database – 2015

Turkey has the highest population; moreover, its population is more than the sum of other Balkan countries. Nevertheless, Turkey has the second largest GDP in the figure. Bulgaria and Macedonia have the lowest tax rate in the figure; on the other hand, Greece has the highest corporate tax rate and GDP per capita in the illustration. Turkey and Greece are members of the OECD and, Bulgaria, Greece and Romania member of the European Union. Albania, Macedonia, and Serbia are not member both of the organizations.

The next part of the study deals with the differences according to the arm's length principle and the OECD transfer pricing guidelines.

Table 3. Comparison of the arm's length principle

Country	Defined in Local Legislation		No Definition in Legislation
	Direct	Indirect	
Turkey	✓		
Bulgaria	✓		
Greece	✓		
Romania	✓		
Albania		✓	
Macedonia		✓	
Serbia	✓		

Arm's length principle is the rudiment of the transfer pricing. The countries that are the member of the OECD and the European Union and Serbia legislated it directly by the term of arm's length in their tax legislations. Concordantly, affect of the OECD Transfer Pricing Guidelines and European Union's Code of Conduct for Transfer Pricing Documentation for Associated Enterprises on this countries' transfer pricing legislation may be seen obviously. While these countries take the term into their laws

under global definitions, other countries, Macedonia and Albania has a definition about the arm’s length but not exactly same with the OECD and the European Union.

Table 4. OECD Transfer Pricing Guidelines

Country	Accordance Level to the Guidelines			
	High	Medium	Low	Non
Turkey	✓			
Bulgaria		✓		
Greece	✓			
Romania	✓			
Albania	✓			
Macedonia				✓
Serbia	✓			

Although Romania, Albania, and Serbia are not a member of OECD, their transfer pricing regulations, are almost integrated with the OECD Transfer Pricing Guideline. Turkey is almost integrated with the OECD Transfer Pricing Guideline. Even though only domestic law is the legislated source and it avoids direct impact of the OECD Guidelines. Guidelines are considered by the tax authority in the process of enact; consequently, legislation integrates with Guidelines. Greek transfer pricing regulations are incorporated into the OECD Guidelines as an OECD member. Greece merely applies a bit differently three issues from the OECD Guidelines about the methods and documentation. Bulgaria considers both of OECD Guidelines and Code of Conducts of the EU on the regulation of transfer pricing rules apart from local legislation.

Table 5. Transfer Pricing Methods

Country	Traditional Transaction Methods			Transactional Profit Methods		Method Selection Has a Hierarchy?	Which Methods Has Priority?
	Comparable Uncontrolled Price Method	Resale Price Method	Cost Plus Method	Transactional Net Margin Method	Profit Split Method		
Turkey	✓	✓	✓	✓	✓	✓	Traditional Transaction Methods
Bulgaria	✓	✓	✓	✓	✓	✓	Traditional Transaction Methods
Greece	✓	✓	✓	✓	✓	✓	Traditional Transaction Methods
Romania	✓	✓	✓	✓	✓	✓	Traditional Transaction Methods
Albania	✓	✓	✓	✓	✓	x	X
Macedonia	✓	x	✓	x	x	✓	Taxpayer should select to cost plus method in the case of no possibility for the selection of other method.
Serbia	✓	✓	✓	✓	✓	✓	Traditional Transaction Methods

Turkey, Bulgaria, Greece, Romania, and Serbia have the same application for the selection of transfer pricing method. Albania is not incorporated to the OECD Transfer Pricing Guidelines, therefore has differences in this application.

The related party has similar definitions in all those countries. The term of relative, shareholder, control the business decision process and monitoring the management are regarding the associated person for the countries. Bulgaria is the broadest in scope country for the related persons. On the other hand, Romania is only using term of voting right and shareholder for the definition of related party.

Table 6. Related Parties

Country	Scope of The Related Party			
Turkey	Shareholders of the Corporation	Juristic persons or individuals who have a relation with the corporations or its shareholders	Juristic persons or individuals who has direct or indirect control on the Corporation as management or capital	Juristic persons or individuals who are controlled directly or indirectly by the Corporation
Bulgaria	Spouses, relatives who has directly kindred ship and second degree and third degree relatives, The Persons who has labor relations, The partners, The persons, whom has management right on the its subsidiary	The entity who is managing or controlling bodies participates one and the same corporate body.	An entity which has an activity under the control of a third party or its subsidiary, The entity which has control on the third party or its subsidiary, The person who is agent of the other	The person who grant a compensation to other, The person who involved the management directly or indirectly, has control or share on other, The persons, in whose manage or control bodies participates one and the same corporate body or individual, including when the individual represents another individual
Greece	If a entity has direct or indirectly 25 percent or more shares or voting right of the other entity, or has management power on other entity	one entity has directly or indirectly, including the shareholding of related entities, a minimum of 25 percent of the shares or voting rights in the two entities.	if two individuals has a line of descent up to the third degree, they are regarded as related parties according to legislation	
Romania	If a entity has direct or indirectly 25 percent or more shares or voting right of the other entity, or has management power on other entity.	one entity has directly or indirectly, including the shareholding of related entities, a minimum of 25 percent of the shares or voting rights in the two entities		
Albania	If person control or hold the 50 percent or more voting rights of the other entity	If person can control the structure of the board of directors of the other entity	If person is a relative or a relative of the a related person	If person has control over the business decisions of other entity
Macedonia	in the case of holding 10 percent or more share in the capital	In the case of control over at 20 percent or more of the voting rights	In the case of a legally independent company over which another company (the controlling company) has a direct or indirect controlling influence	In the case of companies that have concluded an agreement for the purpose of acquisition or assignment of voting rights, or for exercise of voting rights with the purpose of having a joint policy towards the company
Serbia	A person related with a resident shall be understood to mean an individual or legal entity in	The possession of 50 percent or more or the largest single portion of shares or interests shall	A person related with a resident shall also be understood to mean a legal individual in which, like in the	

whose relations with the resident, there is a possibility of exercising control over or exerting considerable influence on business decisions	mean that control over the taxpayer is possible. Besides the case referred to in paragraph 3 of this Article, influence on a taxpayer's business decisions also exists when a person associated with a resident has more than 50% or the largest number of votes individually in the resident's controlling bodies.	resident, the same legal entities participate in control, supervision or capital in the way determined in paragraphs 3 and 4 of this Article
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Table 7. Documentation Requirements

Country	Who Should Provide Documentation	Disposition of the Documentation is Defined by Tax Authority	Deadline for the Provided Documentation	Deadline for the Provided Documentation Request Being Made by Authority	Language of the Documentation
Turkey	Taxpayers who have transactions with related parties	✓	End of the corporate tax declaration deadline	15 Days	Turkish
Bulgaria	Taxpayers who have transactions with related parties	✓	x	14 Days	Bulgarian (Foreign Language is acceptable but certified translation could be requested.)
Greece	Taxpayers who have transactions with related parties and amount of the annual transactions should be more than 100.000 and entity's turnover more then 5.000.000 Euros	✓	Until the following four month after the fiscal year	30 Days	Greek (Foreign Language is acceptable but certified translation could be requested.)
Romania	Taxpayers who have transactions with related parties	✓	x	3 Calendar Months	Romanian
Albania	Taxpayers who have transactions with related parties	✓	x	30 Days	Albanian (English Language is acceptable but certified translation could be requested.)
Macedonia	Taxpayer just proof to arm's length, legislation does not require any specific documentation.	X	x	x	x
Serbia	Taxpayers who have transactions with related parties	✓	Declare with Corporate Income Tax Return	30 Days	Serbian

We observed significant differences regarding documentation requirements. While terms and scopes are similar to the transfer pricing, it is not analogous to the documentation procedures. The reason is that OECD Transfer Pricing Guidelines provide an opportunity to local tax authorities to regulate domestic documentation rules. Therefore every country, which is trying to adopt OECD Transfer Pricing Guidelines regulate the documentation section in its local legislation.

Table 8. Penalty Regulations

Country	Penalty
Turkey	One fold of the tax loss + interest
Bulgaria	20 percent of the difference
Greece	One-off penalty at the rate of 1% of the entity's gross revenues is imposed and amount of the penalty should not be less than 10,000 Euros and should not exceed 100,000
Romania	If taxpayer is not provide to documentation = RON 12.000-14.000. The additional taxable profits resulting from this approximate or any adjustments on the tax base are subject to the 16% tax and interest
Albania	Adjustments for transfer pricing matters regarding to tax audits, the penalty imposed will be 5% of the unpaid liability for each month of delay, capped at 25%.
Macedonia	Taxpayer has obligation to burden of proof transactions with related parties are in accordance with arm's length principle, if not taxpayers will be liable to a penalty up to 3.000 Euros.
Serbia	Penalty is the amount of income tax rate 15 percent and delay interest penalty which is between 1 percent and 25 percent at least 100.000 RSD. If the taxpayer do not indicate its transactions with related parties on the corporate tax declaration, it could be a penalty between 100.000 RSD and 2.000.000 RSD

Countries have different regulations regarding penalties for the transfer pricing issues. OECD does not guide to taxpayers or authorities about the punishment regulations. Governments legislate provisions about the penalties and announce them to the public.

For instance, if a company has a transfer pricing adjustment about 100.000 Euro for the related transaction (ruling out the interest), penalty information is given in the below table.

Table 9. Penalty Amounts

Country	Penalty (Euro)
Turkey	100.000,00
Bulgaria	20.000,00
Greece	10.000,00
Romania	16.000,00
Albania	5.000,00
Macedonia	3.000,00
Serbia	15.000,00

According to this table, Turkey has the highest penalty amount. Bulgaria, Greece, Romania, and Serbia show the same status with average penalties; however, Albania and Macedonia have lower penalties.

4. CONCLUSION

In line with international trends, for budgetary pressures and the continuing modernization of their tax systems, transfer pricing has been the subject of increasing attention in several of the countries in the region. However, regional factors did not affect the countries about their legislations. Some of the countries in the Balkans show similarity with Turkey but have different transfer pricing structures. Transfer pricing is a global phenomenon, and the OECD, the European Union, and multinational entities are influential in transfer pricing regulations. Tax authorities should try to adopt their local legislation to the global regulations. For instance, Macedonian transfer pricing system is more locally based, and their legislations are underdeveloped. Bulgaria, Romania, and Greece are the member of European Union, Turkey is the member of OECD, and Serbia is adopting local legislation concerning the OECD Guidelines. Therefore, transfer-pricing applications in these countries have a considerable similarity even though there are some little differences because of the local regulations. Albanian amendments that are announced by the Ministry of Finance in 2014 was the adaptation of the OECD Transfer Pricing Guidelines - 2010.

An important constraint of the study is that on March 16, the Turkish Revenue Administration released a proposed transfer pricing communiqué relating to the adoption of the country-by-country (CbC) reporting requirement under the OECD's base erosion and profit shifting (BEPS) Action 13 recommendations. The regulations -- Draft Transfer Pricing General Communiqué No. 3 -- follow the three-tier documentation approach contained in the OECD's "Transfer Pricing Documentation and Country-by-Country Reporting Final Report" issued on October 5, 2015, and would require:

A master file with global information about a multinational enterprise (MNE) group (which has 250 million TL or more assets or revenue in the previous year), including specific information on intangibles and financial activities;

A local file with detailed information on all relevant intercompany transactions of the particular group entity (transactions equal or above the TL 30,000) in Turkey; and a CbC report of income, earnings, taxes paid, and certain measures of economic

activity. The MNE's must prepare a CBC report if they have more revenue than the amount, which will be determined by the Revenue Administration. The amount of revenue for reporting periods starting from 2017 will be determined in local currency; however, it will always be equivalent to €750 million or more, as it mentioned in the OECD Action 13 Final Report.

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