News Flash

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Aggregation of controlled transactions in transfer pricing documentation in Slovakia – When is it possible?

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There are mutual transactions between the members of the Group of companies, which must be documented in the transfer pricing documentation. In practice, however, it often happens that there are several controlled transactions between two related companies, for example, if one company provides a loan, also management or other services, or products, etc. In this situation, is it always necessary to consider the individual transactions separately in the transfer documentation, or is it sometimes possible to aggregate them and consider them as a group of transactions?

The principle of independent relationship

First, it should be emphasized that according to the Slovak Income Tax Act, as well as in terms of the OECD Transfer Pricing Guidelines, the arm's length principle is defined as a comparison of conditions that would exist between unrelated companies in comparable transactions and under comparable circumstances. This means that this principle adheres to an approach that considers Group members as separate entities rather than as inseparable parts of a single unified enterprise. In demonstrating the arm's length principle, attention must be paid to the nature of the transactions between these Group members and whether their conditions differ from those that would be obtained in comparable uncontrolled transactions.

Processing of transfer pricing documentation

Due to the reduction of administrative burden during applying the arm´s length principle, or to reduce the costs of preparing transfer pricing documentation, companies often switch to an aggregated approach. This means that they combine several mutual transactions into one and only then analyse whether the conditions of this aggregated transaction meet the conditions of arm´s length principle. However, this procedure is not always correct. The processing of transfer pricing documentation using an aggregated approach can be one of the risk factors from the point of view of the tax administration. The tax administration assesses in the first step whether the conditions for aggregating transactions have been met. In practice, it happens that if the tax administration has doubts about the correctness of setting the aggregated approach, the taxpayer is additionally required to submit additional documents, information and explanations about individual transactions, which increases the administrative burden of the taxpayer.

How should the principle of independent relationship be applied?

Ideally, to achieve the most accurate approximation of independent conditions, the arm´s length principle of should be applied at the level of individual transactions. Likewise, the OECD Guidelines recommends applying the arm´s length to individual transactions separately. However, there are often situations when individual transactions are so closely connected to each other that their adequate individual assessment is not possible.

The aggregation of transactions must not take place automatically

However, the aggregation of transactions cannot be done automatically. If segmented data for individual transactions is available, it is necessary to assess individual transactions separately, as such data can provide better reliability and comparability. In general, it is possible to aggregate transactions that are:

a) of the same type and concluded under comparable conditions,

b) mutually closely connected and mutually conditioned, or

c) comparable in terms of assets used, functions and risks.

When is this necessary to assess transactions between group members separately?

Below we have prepared for you examples of when it is necessary to assess transactions between Group members separately (so-called "transaction approach") and when it is possible to combine these transactions into one group (so-called "aggregate approach").

Example no. 1

Company A have two transactions with its parent company B located abroad. The first transaction is the provision of intragroup loan to company A by company B based on a Loan agreement. The maturity of the loan is 5 years.

The second transaction is the production of finished products, which are sold directly to the parent company B. Production is carried out by company A based on a "Nomination letter", according to which the company has a guaranteed sale of products to company B for a period of 15 years.

Since these are transactions that are not of the same type and each of them is concluded based on different conditions, in this case these two transactions cannot be aggregated. It is necessary to value the intragroup loan transaction separately, e.g., using the comparable uncontrolled price method (CUP) and separately value the transaction of production of finished goods, e.g., using the cost plus method (Cost +).

Example no. 2

Company A carries out two transactions with its parent company B located abroad. The first transaction is the purchase of material from company B. Company A purchases inputs from its parent company, which it then processes in the production. The second transaction is the sale of finished products to parent company B.

In this case, although the transactions are of a different nature and of different types, they are closely connected and mutually conditioned. In such a case, it would be possible to aggregate transactions and evaluate them together on the output side of the transaction, e.g., using the cost plus method (Cost+), since material costs are included in the product price calculation, which indirectly proves the transfer price on the input side.

Example no. 3

Company A produces two types of products. In the transaction, production of product no. 1, company A acts as a contract manufacturer, i.e., that it produces these products exactly according to the Group's procedures and through the Central Purchase and Sales Department at the headquarters of the parent company B, it has a guaranteed sale of its production.

In the transaction, production of product no. 2, company A acts as a fully-fledged manufacturer, i.e., carries out independent research and development, does not have a guaranteed sale of its production and carries out marketing activities independently.

In this case, although the transactions are of the same nature and of the same type, they are carried out under different conditions and are not comparable in terms of functions, risks and assets. Therefore, they cannot be aggregated.

If you suppose that your company may be subject to the obligation to process transfer pricing documentation, or you have doubts as to whether your current transfer pricing documentation is prepared correctly and you would like to obtain additional information, our experts in the field of transfer pricing will be happy to advise you on this area.

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About Accace Slovakia

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