TRANSFER PRICING AUDIT FEATURES IN THE COMPANY

In order for the process to be transparent, it is considered a good practice for a taxpayer that uses comparables to support its transfer pricing, or a tax administration that uses comparables to support a transfer pricing adjustment, to provide appropriate supporting information for the other interested party (i.e. tax auditor, taxpayer or foreign competent authorities) to be able to assess the reliability of the comparables used.

The goal of the article is determining the transfer pricing characteristics of audits and proposals for its improvement, identifying key factors applying transfer pricing and the development of organizational and economic measures for the implementation of the mechanism of transfer pricing in Ukrainian enterprises. In based by

To determine the arm’s length principle, OECD recommends various methods to establish whether the conditions imposed by parties are consistent with the arm’s length principle. According to the OECD Guidelines and Tax Code of Ukraine, there are five different methods for determining the transfer pricing which can be categorized into two main groups: the traditional methods based on the analysis of the transaction and the method based on the analysis of the profits. The difference between them is that the transactional traditional methods are based on comparing prices whilst the transactional profit are sustained by the comparison between transactions among related enterprises and among unrelated entities taking into consideration the profit of that transfer.

As part of the process of selecting the most appropriate transfer pricing method and applying it, the comparability analysis always aims at finding the most reliable comparables. Thus, where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. This does not mean that there is a requirement for an exhaustive search of all possible sources of comparables as it is acknowledged that there are limitations in availability of information and that searches for comparables data can be burdensome.

Below is a description of a typical process that can be followed when performing a comparability analysis. This process is considered an accepted good practice but it is not a compulsory one, and any other search process leading to the identification of reliable comparables may be acceptable as reliability of the outcome is more important than process (i.e. going through the process does not provide any guarantee that the outcome will be arm’s length, and not going through the process does not imply that the outcome will not be arm’s length).

Process for performing a comparability analysis include steps:
- Step 1 - Determination of years to be covered.
- Step 2 - Broad-based analysis of the taxpayer’s circumstances
Step 3 - Understanding the controlled transaction(s) under examination, based in particular on a functional analysis, in order to choose the tested party (where needed), the most appropriate transfer pricing method to the circumstances of the case, the financial indicator that will be tested (in the case of a transactional profit method), and to identify the significant comparability factors that should be taken into account.

Step 4 - Review of existing internal comparables.

Step 5 - Determination of available sources of information on external comparables where such external comparables are needed taking into account their relative reliability.

Step 6 - Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of a transactional net margin method).

Step 7 - Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to be regarded as potentially comparable, based on the relevant factors identified in Step 3 and in accordance with the comparability factors.

Step 8 - Determination of and making comparability adjustments where appropriate.

Step 9 - Interpretation and use of data collected, determination of the arm’s length remuneration.

Source: Compiled by the author based on OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

In practice, this process is not a linear one. Steps 5 to 7 in particular might need to be carried out repeatedly until a satisfactory conclusion is reached, i.e. the most appropriate method is selected, especially because the examination of available sources of information may in some instances influence the selection of the transfer pricing method. For instance, in cases where it is not possible to find information on comparable transactions (step 7) and/or to make reasonably accurate adjustments (step 8), taxpayers might have to select another transfer pricing method and repeat the process starting from step 4.

The review of the controlled transactions under examination aims at identifying the relevant factors that will influence the selection of the tested party (where needed), the selection and application of the most appropriate transfer pricing method to the circumstances of the case, the financial indicator that will be tested (in the case of a transactional profit method), the selection of comparables and where relevant the determination of comparability adjustments.

Transfer price allows managers of responsibility centers make better management decisions, increase their interest in the growth performance, so the effective management of transfer pricing is particularly important at the level of top managers. The use of transfer pricing creates opportunities for operational cost control and performance at different levels of the company. There is no universal approach to the formation process of transfer prices, so depending on the goals of the company's financial position, financial and economic service should implement appropriate transfer pricing cycle formation or develop your own that adapted to certain conditions and allows studies.