СЕКЦІЯ 2.
АКТУАЛЬНІ ПИТАННЯ ОБЛІКУ ТА АУДИТУ В УКРАЇНІ

Grinenko Julia,
Postgraduated Student, Audit Department
State University «Kyiv National Economic University»
named after Vadym Hetman

CHARACTERISTICS OF THE OPERATING CONDITIONS OF TRANSFER PRICING IN THE MARKET

The regulations establish that the Commissioner will evaluate the results of the trans- action as actually structured by the taxpayer unless its structure lacks economic substance. However, the Commissioner may consider the alternatives available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances [1].

For transfer pricing purposes, the subject transaction involves the transfer of property or services between related companies that belong to the same multinational enterprise group. These transactions are referred to as controlled transactions, or non-arm's-length transactions.

Controlled transactions are distinctly different from uncontrolled transactions. Uncontrolled transactions occur between companies that are assumed to operate independently from each other, or on an arm's-length basis.

For financial accounting purposes, the Financial Accounting Standards Board offers a similar position in ASC 820 by stating, a fair value measurement is for a particular asset or liability. Therefore, when measuring fair value a reporting entity shall take into account the characteristics of the asset or liability if the market participants would take those characteristics into account when pricing the asset or liability at the measurement date [2].

These characteristics often include the condition and location of the asset, and whether or not there were any restrictions on the sale or use of the asset at the time of the transaction.

Comparing the two standards from a broad perspective, it is evident that both standards attempt to evaluate the economic structure of the subject transaction based on the transaction characteristics that unrelated parties would use to determine a price for the subject transaction.

Adjustments to the structuring of the transaction can occur in the arm's-length price, but only if the Service believes the structure lacks economic substance (i.e., was not comparable to an uncontrolled transaction of similar nature).

For intercompany transfer pricing purposes, the context of the subject transaction is analyzed from a dual prospective. That is, in a transfer pricing analysis, the interests of both the buyer and the seller, both dealing at arm's length, are evaluated to determine a price for the subject transaction.

By comparison, the objective of a fair value financial accounting analysis is to determine an exit price that would be received to sell an asset or paid to transfer a liability, which effectively is a one- sided perspective.

Transactions that consider only one perspective can result in a value that is different than if both the buyer's perspective and the seller's perspective are considered. This is because by only considering the transaction from the perspective of the seller, and not the buyer, the analyst may omit pertinent information about what the buyer stands to gain in the transaction.

In other words, the potential benefits of the subject transaction, negotiated from the buyer's perspective, can have an influence on the arm's-length price of the subject transaction.

Thus, arm's-length price attempts to estimate the price of a transaction by including factors that are relevant to each specific buyer and seller. The inclusion of such factors in an analysis leads the arm's-length price standard towards a more subjective and company-specific value conclusion. Fair value, which as noted is a one-sided perspective, generally leads to a more objective valuation analysis and value conclusion.

For transfer pricing purposes, analysts typically use methods that rely on comparable uncontrolled transactions. These comparable uncontrolled transactions provide market-based transactional data involving property comparable to the subject property that was transacted under circumstances comparable to the subject transaction.

The lack of data on such comparable transactions can make a particular method more or less reliable, and even inapplicable. The comparable transactions are referred to as uncontrolled transactions because the parties involved in the transactions are independent of each other.

In the context of both arm's-length price and the fair value standard, a comparison between a controlled transaction and a comparable transaction may be required. In the process of selecting and analyzing potentially comparable transactions, the two standards diverge in a few subtle, but important, ways. The primary differences relate to the following: the reference transaction, the market where the reference transaction occurs, the participants involved in the reference transaction.

These three differences are discussed next.

a) The Reference Transaction

When performing an analysis within the arm's- length price and the fair value context, one consideration is the reference transaction. The two valuation frameworks differ on what types of reference transactions should be analyzed in the valuation.

According to the regulations, when estimating the true taxable income of a controlled taxpayer, the standard to be applied in every case [3] is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer (i.e., unrelated or unaffiliated).

The controlled transaction meets the arm's- length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.

However, because identical uncontrolled trans- actions can rarely be located, whether a transaction produces an arm's-length result generally will be determined by reference to the results of comparable transactions under similar circumstances [4].

By comparison, ASC 820 does not require an actual transaction to have occurred in order for it to have a fair value. According to ASC 820, fair value is based on an orderly transaction between market participants.

An orderly transaction is not necessarily a real transaction. In fact, an orderly transaction can be a hypothetical transaction that is assumed to have taken place on the measurement date. This hypothetical transaction assumes that the subject asset has been exposed to the market for the usual and customary period of time for marketing activities.

In this regard, the fair value standard directly conflicts with the arm's-length price standard. In other words, the two standards are different with regard to the reference transaction. This is because the reference transaction in a fair value analysis may include hypothetical comparable transactions and, conversely, the reference transaction in an arm's-length analysis are typically considered to be actual comparable transactions.

b)The Reference Market

The market in which the reference transaction is expected to have taken place is also a noteworthy difference between the two standards. Fair value assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market to the reporting entity [5].

Within the principal market, the reporting entity is able to sell the asset or transfer the liability at the price that maximizes the amount that would be received for the asset or, minimizes the amount that would be paid to transfer the liability.

The regulations offer different guidance on selecting the comparable transactions, noting that comparable transactions should be derived from a comparable geographic market in which the taxpayer operates and how there may need to be adjustments based on location savings.

This guidance implies that the comparable trans- action need not occur in the principal or most advantageous market. This is an important consideration, because there may be significant differences in the economic conditions between markets and countries (i.e., the actual market may not be the same as the most advantageous market).

c) The Participants

The regulations indicate that comparable transactional data involving unrelated parties provide the most objective basis for determining whether a controlled transaction is at arm's length. In this context, unrelated parties are generally considered to be unrelated, actual market participants.

By comparison, the fair value standard sup- ports the use of hypothetical market participants. According to ASC 820, a reporting entity need not identify specific market participants. Rather, the reporting entity shall identify characteristics that distinguish market participants generally.

The difference between the two frameworks' interpretation of the reference transaction participants is, as mentioned above, whether or not they are actual or

hypothetical participants. Arm's-length price supports the use of actual market participants involved in actual market transactions.

The fair value standard does not require the use of actual transaction and supports the use of hypothetical market transactions involving hypothetical market participants.

In comparing the analytical processes of the arm's- length price standard and the fair value standard, both standards are transactional and price based. Although the actual analytical process is quite similar between the two standards, there are two important differences that can yield materially different values in most instances.

The Treasury regulations and the accounting standards have differing aspects on how the property involved should be taxed and by what application (e.g., the use of the asset) they should be assessed. These two issues are discussed next.

Fair value analyses prepared for financial accounting purposes are generally prepared on an after-tax basis. Buy-in price analyses prepared for transfer pricing purposes are sometimes prepared on a pre-tax basis.

The issue with these procedures, and where they conflict, is that something that is transacted is, by its very nature, a pretax transaction price, regardless of the basis used to determine that price.

In both fair value and the arm's-length standard, it is assumed that both the buyer and seller are knowledgeable of the relevant facts and are rational. Rational and independent parties would consider the tax consequences of transactions when evaluating price, which could cause different buyers to estimate different values for the same subject property.

In general, the relative reliability of an application of a method also depends on the degree of consistency of the analysis with the assumption that uncontrolled tax-payers dealing at arm's length would have evaluated the terms of the transaction, and only entered into such transaction, if no alternative is preferable. In principle, this comparison is made on a post-tax basis but, in many cases, a comparison made on a pre-tax basis will yield equivalent results.

The tax treatment under the regulations is meant to provide a shortcut that ensures both the buyer and the seller are willing to enter into the transaction in question after tax costs and benefits are taken into account. The different tax treatments used in the two standards of value may lead to differences in the analysis conclusion.

Estimating the value of an asset or liability under the fair value standard assumes the asset will be used at the highest and best use. According to ASC 820: highest and best use is determined from the perspective of market participants, even if the reporting entity intends a different use. However, a reporting entity's current use of a nonfinancial asset is presumed to be its highest and best use unless market or other factors suggest a different use by market participants would maximize the value of the asset [6].

The definition provided by FASB considers that the highest and best use of an asset (i.e., the use that provides the most profit return on the asset) is the one for which it is to be used.

By comparison, the arm's-length price standard attempts to estimate the price of a transaction based on the results of comparable transactions. In some cases, application of a pricing method will produce a single result that is the most reliable measure of an arm's length result. In other cases, application of a method may produce a number of results from which a range of reliable results may be derived. A taxpayer will not be subject to a transfer pricing adjustment if its results fall within such range (an arm's length range) [2].

Based on the highest and best use analysis, and assuming all other factors are held constant, the fair value standard may result in the same, or greater, value than the arm's-length price standard. This is because the fair value standard uses a single-sided perspective from the side of the seller.

That is, using the highest and best use will maximize the asset value by assuming the subject property is sold into the most advantageous market, even if the subject asset currently is not being used in that market.

On the other hand, the arm's-length price appears to take a more unbiased (or neutral) prospective with regard to the subject market. This is because arm's-length price considers both the buyer and seller (i.e., it employs a dual-sided perspective).

This discussion provided an overview and comparison of the arm's-length price standard and the fair value standard. The arm's-length price standard and the fair value standard are distinct standards of value that differ in several significant aspects.

The arm's-length price standard considers the motivations of both buyers and sellers in transactions. That is, it attempts to perform the analysis from an unbiased, dual-sided perspective. The arm's- length price standard relies on actual comparable uncontrolled transactions to estimate the arm's-length price of a controlled transaction.

The analysis conclusion of an arm's-length price analysis is typically a range of prices from which the original transaction is compared and adjusted based on company-specific factors. Accordingly, the arm's-length price standard offers a subjective and entity-specific analysis.

The fair value standard, unlike the arm's-length price standard, develops a one-sided value conclusion based on the perspective of the seller. Instead of including information about the buyer in the analysis, or developing a range of values, the fair value standard requires the analyst to assume the highest and best use for the subject property, regardless of the intended or actual use of the subject asset or liability. In general, the fair value standard offers a more objective analysis.

Analyses performed for different purposes, using different standards of value, can result in different value conclusions. The arm's-length price standard and the fair value standard have inherent conceptual differences which can result in the difference between a subjective value conclusion and an objective value conclusion.

References

1. OECD Standard for automatic exchange of financial account information. Retrieved from: http://www.oecd.org/.

2. U.S. GAAP Accounting Standards Codification Topic 820: Fair Value Measurements and Disclosure. Retrieved from: http://www.fasb.org/.

3. OECD Revised Section E on Safe Harbors in Chapter IV of the Transfer Pricing Guidelines. Retrieved from: http://www.oecd.org/

4. OECD Standard for automatic exchange of financial account information. Retrieved from: http://www.oecd.org/

5. OECD Action plan on Base Erosion and Product shifting. Retrieved from: http://www.oecd.org/

6. Farrar J. Debt-equity limitations in thin capitalization rules: Canadian evidence (CAAA) 2008 Annual Conference Paper.
Retrieved from: http://ssrn.com/abstract=1080639.

Korinko Mykola,
Doctor of Economics, Professor,
Head of the Department Audit and Entrepreneurship,
National Academy of Statistics, Accounting and Audit

AUDIT QUALITY: TERMS, OBJECTS, EVALUATION

Changes in the organization and management of auditing in Ukraine, due to the implementation of the Law of Ukraine "On Auditing Financial Statements and Auditing" dated 21.12.2017 № 2258-8, necessitated changes in the quality management system of services provided by auditing entities. One of the key issues that have a debatable manifestation at different levels of this system is the formation of the conceptual apparatus in the quality management system. The study of laws, regulations and literature sources on this issue, provided an opportunity to form some provisions, which are listed below.

Regarding the concept of "quality".

According to the dictionary of the Ukrainian language, the term "quality" contains the following definitions, in particular:

«... 1. The internal certainty of the subject, which is the specificity that distinguishes it from all others.

2. The degree of value, value, suitability of something for its intended use.

3. One or another characteristic feature, property, trait of someone or something "[2].

Regarding the concept of "quality", the National Standard of Ukraine ISO 9000: 2015 has the following definitions:

"..The quality of products and services of the organization is determined by the ability to satisfy customers, as well as the intended and unforeseen impact on relevant stakeholders.

The quality of products and services covers not only their intended functions and characteristics, but also their perceived value and benefit to the customer… "[3, p.2.2.1.].