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# Preparing Transfer Pricing Documentation

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Amendments to the Tax Code of the Russian Federation regulating transfer pricing and respective tax control issues entered into force from Jan. 1, 2012.

The introduction of new transfer pricing rules implies that taxpayers need to exercise additional functions in order to comply with the new requirements of the RF Tax Code (for example, identify controlled transactions, monitor current prices, prepare transfer pricing documentation, and interact with the tax authorities).

To exercise transfer pricing functions, a company can use internal resources, engage external consultants or exercise these functions by leveraging its own resources, but drawing on the methodological guidance of external consultants.

It goes without saying that the decision as to how a company should organize work to ensure compliance with the requirements of new transfer pricing legislation is contingent on a number of factors that differ for each company, for example:

The number of controlled transactions. It is highly likely that the scope of work relating to the analysis and monitoring of the level of prices and preparation of documentation on one, albeit complex controlled transaction, will not provide one transfer pricing specialist (let alone a department) with enough work for one year. Consequently, if the number of controlled transactions at a company is low, it makes more sense to allocate transfer pricing functions between existing employees or to outsource them to external consultants.

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If on the other hand the company performs a significant number of similar controlled transactions, it makes more sense to establish a transfer pricing department/hire a transfer pricing specialist or consider a combined option, where the methodological guidance is provided by professional external consultants, while the company's employees exercise routine functions.

The complexity of the transactions. Different types of transactions require the application of different methods to analyze the compliance of the prices of these transactions with the market level. For example, as part of the comparable market price method, in order to substantiate the compliance of the prices of products sold in a controlled transaction, information on the stock exchange quotations of this product may be used. Consequently, the function of monitoring and substantiating prices on this transaction will to a large extent involve constant monitoring of stock exchange quotations. At the same time, the comparable market price method is fairly transparent from the perspective of the methodology to be applied. Consequently, in this case the most rational option for a company for transfer pricing purposes would be to delegate price monitoring to its own specialists.

In the case of complex transactions, selecting the correct methodological approach is key (for example, to determine the margin to be used, the basis for allocating profits, the criteria for selecting comparable, companies, etc.), while the monitoring of prices plays a secondary role. Therefore, here it would be advisable to engage an external highly qualified consultant for the analysis of complex transactions.

Volume of transactions. If the total volume of controlled transactions is significant, the risks related to errors made when establishing transfer prices or preparing arguments to substantiate such prices may also be significant. Here, in order to mitigate these risks, it would make more sense for a company to engage external consultants with high qualifications.

Structure of group transactions. If there is a chain of intra-group transactions, the establishment of prices in each transaction affects the interests of all or most of the group companies. In these cases, engaging an external consultant who is not under the influence of individual group companies reduces the likelihood that decisions will be adopted owing to the influence of intra-group factors, which are not the best decisions from a tax perspective.

In addition to factors that are intrinsic to each company, a number of objective factors should be considered when deciding on the best way of organizing internal transfer pricing controls. The following constitute such objective factors:

Costs. It is often the case that the fees of external consultants appear high for a company. At the same time, however, if a company decides to engage an external consultant on an ongoing basis, it derives an economic benefit from the fact that the consultant will perform most of the work during the first year of cooperation with the company. Subsequently, if the structure of transactions remains unchanged, documentation will only require updating annually. The cost of such updates tends to be materially lower than the initial cost on its preparation.

If a company decides to hire its own transfer pricing staff, it should bear in mind that the labor market has an extremely limited number of qualified transfer pricing specialists at present. It is therefore not surprising that engaging qualified transfer pricing specialists may well prove to be an expensive endeavor for a company.

Training specialists internally may also prove to be an inefficient method for the company: training a specialist to the necessary level will entail significant time costs and expenses. (In addition, at the initial stages it is highly likely that transfer pricing issues requiring qualified professional judgment will arise and that the resolution of these issues will necessitate the engagement of external consultants).

Effectiveness. After deciding to create your own transfer pricing department or to allocate such functions among existing employees, you should not be surprised if these specialists are initially ineffective owing to the need to develop and fine-tune new business processes within the company. As a rule, external consultants have a clear-cut view of business processes, while a number of material enhancements enable them to perform the tasks facing the company more effectively than the company.

In addition, as a rule the external consultant has access to numerous information resources, and may also leverage the experience of consulting practices in other countries with developed transfer pricing legislation.

In deciding to establish a transfer pricing department or retrain existing employees, the company limits the competence of its own department to the knowledge and skills of one or several specialists.

In the case of external consultants, several specialists competent in different transfer pricing aspects are engaged in work on a project, from analysis of transactions and preparation of documentation to participation in special tax audits and representation of the client's interests in court.

Risks. If a company hires its own transfer pricing specialist, it should consider the risks related to any interruption in transfer pricing work owing to the vacation/sickness/dismissal of the employee, and also risks related to investments in the training of its own specialists.

As a number of issues have arisen at present relating to the application of the provisions of new transfer pricing legislation and there is no arbitration practice in this area, companies face material risks related to the potential subjective nature of decisions adopted by employees responsible for transfer pricing. If external consultants are hired, this risk is mitigated owing to participation in the project of several specialists, and also the multilevel system used to verify project results.

In the case of external consultants, please note that owing to the abrupt growth in demand for transfer pricing services, companies and specialists will appear on the market offering such services, but lacking sufficient experience and qualifications to provide them. Therefore, when selecting a consultant, you should find out whether he or she has experience in implementing similar transfer pricing projects (preferably for a company in the same sector), about the qualifications of the specialists who will implement the project and also the ability and volumes of the guarantees provided by a consultant regarding the quality of the services that it provides.

Consequently, when deciding to exercise new functions related to a change in transfer pricing legislation by engaging external consultants or using internal resources, attention should be paid to the company's specific activities, the scope, complexity and number of controlled transactions, and objective factors related to the development of the labor market and the market for consulting services in the transfer pricing sector.

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