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IRS Issues Transfer Pricing Audit Roadmap



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The Internal Revenue Service's (IRS's) Transfer Pricing Operations (TPO) of the Large Business and International (LB&I) division on February 14 released its **Transfer Pricing Audit Roadmap** to the public. The roadmap provides examination teams, in particular IRS persons involved in the audit of transfer pricing issues, with a broad set of tools and audit techniques to assist with the planning, execution, and resolution of transfer pricing examinations.

The roadmap holds the promise of better upfront risk analyses, earlier issue identification, and more targeted information gathering. Better upfront risk analyses may benefit taxpayers and the IRS by identifying and focusing attention on meaningful issues, saving both time and resources that might be wasted looking for, or defending against, unsupported adjustments. Earlier issue identification may benefit taxpayers and the IRS by allowing for more targeted information gathering, thereby easing compliance with the November 4, 2013, LB&I Directive on Information Document Requests Enforcement Process. There is no doubt that if early risk assessment takes transactions off the table, everyone benefits.

The roadmap demonstrates the IRS's commitment to conducting better, more careful, and stronger transfer pricing examinations. The more a taxpayer prepares to demonstrate early in the process the reasonableness of its transfer pricing, the greater the likelihood that it will be able to join with the IRS in avoiding unnecessary, intrusive, and costly transfer pricing audits. Conversely, if a taxpayer is not able to demonstrate convincingly the reasonableness of its transfer pricing early in the process, the roadmap provides the examination team with clear guidance and helpful tools to move quickly into an in-depth transfer pricing examination.

Another clear benefit the roadmap offers taxpayers is insight into the extent the TPO provides examination teams with the guidance and tools necessary for the audit team to identify and apply resources to appropriate transfer pricing examinations, to perform the transfer pricing examinations more efficiently, and to do so in a way that results in adjustments supported strongly by the facts, law, and sound economic analyses. In doing so, it offers taxpayers and the IRS the opportunity to set appropriate expectations for the transfer pricing audit process and to better defend its transfer pricing.

The TPO makes clear that taxpayers will be expected to quickly provide a great deal of information. Absent appropriate prior preparation, taxpayers may find it difficult and costly to produce that information on short notice. For example, examination teams are encouraged to request through an Information Document Request (IDR) an in-depth transfer pricing orientation from the taxpayer. The scope of the information to be discussed during the transfer pricing orientation is extensive. The roadmap encourages the examination team is encouraged to reassess the scope of the transfer pricing examination following the transfer pricing orientation. This gives the taxpayer an early opportunity to have the examination team remove from the audit plan transactions for which the taxpayer provides compelling arguments for, and strong support of, its transfer pricing.

Roadmap Structure and Themes

The roadmap consists of:

- an introduction addressing its key themes;
- a model timeline providing a visual expression of the nine Transfer Pricing Audit Stages overlaid on the three Quality Examination Process (QEP) phases;
- a roadmap index listing categories of activities for each phase and links to the sections in the roadmap document containing the guidance and tools for that stage; and
- links interspersed throughout the roadmap to guidance, materials, tools, and resources to assist in the examination.

The roadmap highlights four key themes the audit team should keep in mind during any transfer pricing examination:

- upfront planning and risk analyses;
- factual development;
- reasonable results given the facts and circumstances of the given case; and
- effective presentation.

The key themes reflect the TPO's desire to provide meaningful guidance for the conduct of transfer pricing examinations. They emphasize upfront planning including identifying those transfer pricing issues not worthy of pursuit; factual development and recognizing that "[t]ransfer pricing cases are usually won or lost on the facts;" the importance of reaching a reasonable result under the facts and circumstances; and the importance of an effective presentation of the case addressing all relevant facts and the applicable legal and economic principles.

As might be expected, the suggested timelines for the transfer pricing audit stages overlap one another, and some of the transfer pricing audit phases carry over from one QEP phase to the next. The first three stages align generally with the QEP's Planning Phase. They consist of the following stages:

- Pre-Examination Analysis;
- Opening Conference/Transfer Pricing Orientation; and
- Preparation of Initial Risk Analysis, Exam Plan, & Key Milestones.

The next three stages align with the QEP's Execution Phase. They consist of the following stages:

- Fact Finding and Additional IDRs/Functional Analysis;
- Mid-Cycle Risk Assessment; and
- Issue Development and Preliminary Reports.

The final three stages align with the QEP's Resolution Phase. They consist of the following stages:

- Pre-Notice of Proposed Adjustment (NOPA) Issue Presentation;
- Resolution Discussions; and
- Final NOPA and Case Closing.

For each of the transfer pricing audit stages, the roadmap provides detailed steps to be considered, tools that may be used, core audit team members who might be involved in the particular stages, and links to other guidance and materials, including links to materials in the Internal Revenue Manual, Internal Revenue Forms and instructions, and outside resources for business financial analytics.

Most important, throughout the roadmap the TPO emphasizes the need for judgment in considering the tools and steps used in a particular transfer pricing examination, and in the time and timeline needed and appropriate for the particular transfer pricing examination.

The transfer pricing audit roadmap provides important guidance to, and sets forth key expectations for both, IRS examination teams and taxpayers for the conduct of a transfer pricing examination. It starts with the assumption that the taxpayer prepared strong transfer pricing documentation and is prepared to discuss thoroughly its transfer pricing. The repeated exhortation is to communicate fully and openly to produce either an agreed or fully developed unagreed case. While

the roadmap may be seen as placing additional burdens on taxpayers during the examination process, it provides opportunities to resolve cases at the lowest level possible if both sides prepare and approach the process with open minds.

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