

# UNITED STATES

## TRANSFER PRICING AUDIT ROADMAP

### Introduction

On 14 February 2014, the Internal Revenue IRS (IRS) released the Transfer Pricing Audit Roadmap (the "Roadmap"), which outlines the three phases of a transfer pricing examination: planning, execution and resolution. The Roadmap highlights that, from an IRS perspective, transfer pricing audit cases are won and lost on the facts. It is a toolkit designed by the IRS to:

- Assist its agents in carrying out audits;
- Attempt to create more structure regarding audits; and
- Provide guidance to perform risk assessment of transfer pricing issues.

The Roadmap is intended for use by international examiners involved in 24-month audits. It states that transfer pricing specialists should be involved before the audit begins. The Roadmap is a useful tool for taxpayers, as it provides a timeline for the audit, as well as the type of information and documents a taxpayer is expected to provide. Most importantly, the Roadmap focuses on developing facts to determine whether a transfer pricing position can be sustained upon examination.

The overall reaction from taxpayers and practitioners has generally been favourable. Although more work is required, the Roadmap is seen as a useful tool to help the audit process progress more smoothly, as well as expand taxpayers' understanding of the IRS's transfer pricing concerns.

### Discussion

The ultimate goal of a transfer pricing audit is to determine whether a taxpayer's financial results are reasonable, given its value chain and competitive position within its industry. The Roadmap organises the progression of a transfer pricing audit into the following three phases: planning, execution, and resolution.

#### 1) Planning Phase

The Planning Phase spans between three and six months. During this time, the IRS reviews the taxpayer's business, effective tax rate, and income sourcing, to determine whether the taxpayer has shifted profits through transfer pricing. If the IRS determines that profitability is reasonable, it may conclude that further examination is unnecessary. If circumstances are not reasonable, the IRS is likely to proceed to the Execution Phase (further discussed below).

In the Planning Phase, the IRS will issue an Information Documentation Request (IDR), along with a request for a transfer pricing orientation meeting. An initial risk analysis, examination plan and key milestones are also established in this phase. The IRS is likely to request documents including, but not limited to, a comprehensive transfer pricing documentation study; accounting data such as segmented profit and loss statements; intercompany agreements or contracts; Forms 10-K and 5471/5472. The IRS may review company websites and any other relevant material for consistency. In addition, the IRS will conduct interviews with the taxpayer, initiate site visits, or prepare its own comparable searches and analyses. The IRS may also coordinate with the Advance Pricing and Mutual Agreement team and inform treaty countries of the audit.

At the conclusion of the planning phase, the audit team should have a clear understanding of the taxpayer's legal organisational structure, as well as the functional and risk profiles of the entities involved in the material intercompany transactions. These facts can either provide a clear rationale for entering into certain intercompany transactions, or signal to the audit team that a transaction warrants further substantiation and development, especially if the intercompany transaction is associated with the transfer of an income stream.

#### 2) Execution Phase

The Execution Phase, which includes fact finding and issue development, overlaps with the end of the Planning Phase. This phase spans over months 3 through 18 of the audit. The audit will enter the Execution Phase if the IRS determines that there may be issues with profit shifting and improper use of transfer pricing. In the Execution Phase, the IRS will develop its own transfer pricing study, additional IDRs, and conduct additional functional interviews. Functional interviews are intended to identify the activities that are economically significant to the taxpayer's intercompany transactions, as they have material impact on the price charged and profits earned as a result of a transaction. The IRS will also review and critique the transfer pricing documentation report provided by the taxpayer, and challenge the method(s) and assumptions employed. Transfer pricing adjustments or penalties may be considered.

#### 3) Resolution Phase

The Resolution Phase is the final phase of an audit. During this phase, the IRS will prepare its argument against the taxpayer's transfer pricing position. In order to close the audit with the best possible outcome, the taxpayer should consider coming to an agreement, or resolution, with the IRS.

The diagram below shows the three phases of the quality examination process<sup>4</sup>.

<sup>4</sup> Note:

The Transfer Pricing Audit Roadmap may be accessed on the IRS web site at <http://www.irs.gov/pub/irs-utl/FinalTrfPrcRoadMap.pdf>. The Roadmap includes many links to other documents and audit tools used by the audit team.



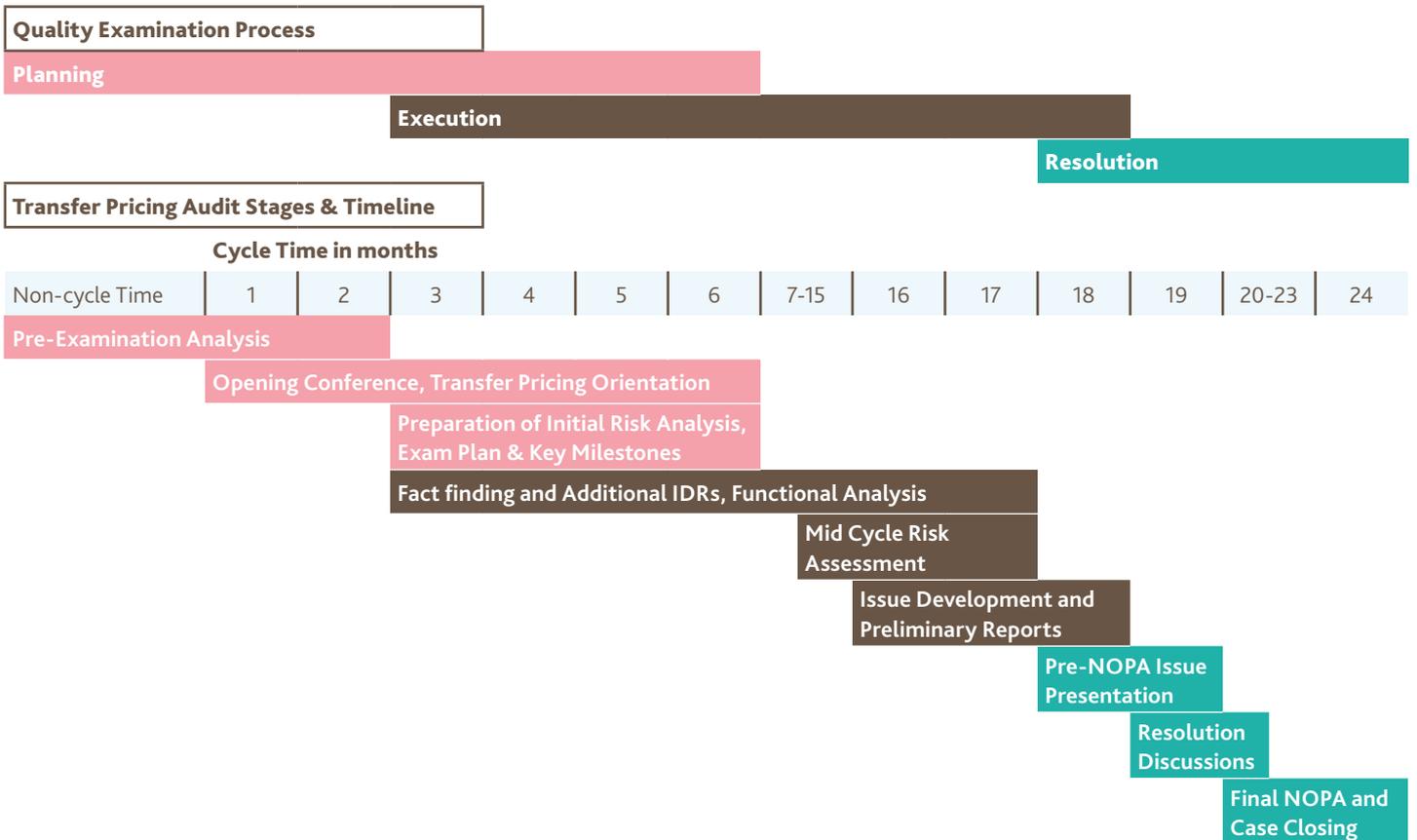


Figure 1: Quality Examination Process



**Conclusion**

The Roadmap provides valuable insights into the IRS’s transfer pricing examination process, as it explains the kinds of questions and information taxpayers should expect to provide and discuss. Taxpayers should use the Roadmap as a guide to prepare the information and documentation needed to withstand a detailed transfer pricing audit.

Viewing the Roadmap from the context of a taxpayer, the main goal is to conclude the transfer pricing examination in the Planning Phase. This means presenting the IRS with information and transfer pricing documentation that is sufficient, non-contradictory, and that effectively explains the taxpayer’s transfer pricing positions globally. In addition to the information provided, the orientation meeting conducted in the Planning Phase provides a great opportunity for the taxpayer to articulate the reasonableness of its positions. It is clear from the Roadmap that once the Execution Phase commences, a transfer pricing adjustment is imminent. However, since transfer pricing resources are limited at the IRS, it will likely only be able to move cases into the Execution Phase that if feels has a solid case for a transfer pricing adjustment.

To avoid the Execution Phase, planning and preparation are essential. In addition to assisting taxpayers in developing their transfer pricing documentation, BDO can perform a pre-audit assessment of whether transfer pricing policies are adequate and supportable. In the face of an audit, BDO can help prepare the response to the IRS’s inquiries and develop a working hypothesis that leads the IRS to conclude that further examination is not necessary.

Your BDO contact in United States:

**MICHIKO HAMADA**  
mhamada@bdo.com



### CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 19 January 2015.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Argentine Peso (ARS)	0.10032	0.11613
Singapore Dollar (SGD)	0.65062	0.75312

### LIST OF CONTACT PERSONS

Dan McGeown BDO Toronto	Tel Fax e-mail	+1 416 369 3127 +1 416 865 0887 dmcgeown@bdo.ca
Dirk Elbert BDO Frankfurt am Main	Tel Fax e-mail	+49 69 95 941 438 +49 69 95 941 326 dirk.elbert@bdo.de
Michiko Hamada BDO New York	Tel Fax e-mail	+1 212 885 8577 +1 212 697 1299 mhamada@bdo.com
Sjoerd Haringman BDO Rotterdam	Tel Fax e-mail	+31 10 242 4600 +31 10 242 4624 sjoerd.haringman@bdo.nl
Anton Hume BDO London	Tel Fax e-mail	+44 207 486 5888 +44 207 487 3686 anton.hume@bdo.co.uk
Ariel Efraim BDO Argentina	Tel Fax e-mail	+54 11 4106 7000 +54 11 4106 7200 aefraim@bdoargentina.com
Jaime Zaga BDO Mexico	Tel Fax e-mail	+52 55 8503 4200 +52 55 8503 4299 jaime.zaga@bdomexico.com
Jay Tang BDO China	Tel Fax e-mail	+86 21 2328 1506 +86 21 6321 4049 jay.t@bdo.com.cn
Philip Yeoh BDO Malaysia	Tel Fax e-mail	+603 2616 2929 +603 2616 3195 philipyeh@bdo.my
Roxanna Nyiri BDO South Africa	Tel Fax e-mail	+27 10 060 5000 +27 10 060 7000 rnyiri@bdo.co.za

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