

## TRANSFER PRICING AUDIT ROADMAP

### Introduction

In recognition of the strategic importance of transfer pricing, LB&I has established a dedicated team of transfer pricing specialists (Transfer Pricing Operations or TPO) headed by an executive and encompassing both the Advance Pricing and Mutual Agreement Program (APMA) and the Transfer Pricing Practice (TPP). This team has developed this Transfer Pricing Audit Roadmap (Roadmap) to provide the transfer pricing practitioner, whether employed in TPO or International Business Compliance (IBC), with audit techniques and tools to assist with the planning, execution and resolution of transfer pricing examinations.

The Roadmap is a practical, user-friendly toolkit that is organized around a basic audit time-line and that provides advice and links to useful reference material. It is not intended as a template – every transfer pricing case is unique, and the team will need to exercise its own judgment about how to best use these guidelines. The Roadmap is a “work in process” – users are strongly encouraged to contact the Income Shifting Issue Practice Networks (IPN) with any corrections, proposed additions or deletions, or other suggestions for improvement.

The following paragraphs summarize some of the key themes that run through the Roadmap and that should be kept in mind by the exam team in any transfer pricing case:

*As with any complex project, up-front planning is essential.* LB&I seeks to maintain currency in its inventory. At the same time, proper development of a transfer pricing position may take as much as 2-3 years or more. Accordingly, transfer pricing specialists must be involved in assessing potential transfer pricing issues at the earliest possible stage – ideally, before the official audit commencement date. Their early involvement will ensure that the audit plan and timeline are appropriate given the complexity of the case and the resources available. Transfer pricing specialists can provide valuable guidance in staffing decisions, including identification of necessary expertise. Transfer pricing specialists can help weed out issues that are not worth pursuing, thereby preserving resources for more important work.

*Transfer pricing cases are usually won and lost on the facts.* The key in transfer pricing cases is to put together a compelling story of what drives the taxpayer’s financial success, based on a thorough analysis of functions, assets, and risks, and an accurate understanding of the relevant financial information. Fact development is the “bread and butter” of our exam teams – it’s what they are trained for and good at. An effective story explains the taxpayer’s value chain, competitive position in its industry, and financial results, in a clear and compelling fashion. If indications are that the tax result claimed by the taxpayer is at odds with common sense and economic reality – “too good to be true” – chances are it is a good candidate for further scrutiny. Early identification and aggressive pursuit of cases that have this potential is important. Conversely, if indications are that the taxpayer’s financial results are reasonable, and the taxpayer’s method fits its fact profile, it may not be worth pursuing the issue.

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*The objective in a transfer pricing audit is to determine a reasonable result under the facts and circumstances of any given case.* Effective enforcement of the arm's length standard requires the exercise of judgment. A "working hypothesis" developed early, based on initial basic fact development is a necessary guide to further detailed examination. The exam team should keep an open mind at all times during the examination and the working hypothesis should be adjusted (or discarded) depending on new facts that come to light. This iterative process of developing the facts and evaluating the hypothesis should be documented as the examination advances. Focusing and documenting the investigation in this way promotes efficiency, addresses the taxpayer's concerns about "fishing expeditions" (theories in search of facts) and offers a good foundation for organizing and formulating a complete analysis at the end of the examination process. It also bolsters our position in the event IDR enforcement proves necessary. It is critical that, in every case, the team address in full the taxpayer's analysis – the taxpayer may well have the more compelling position on the issue.

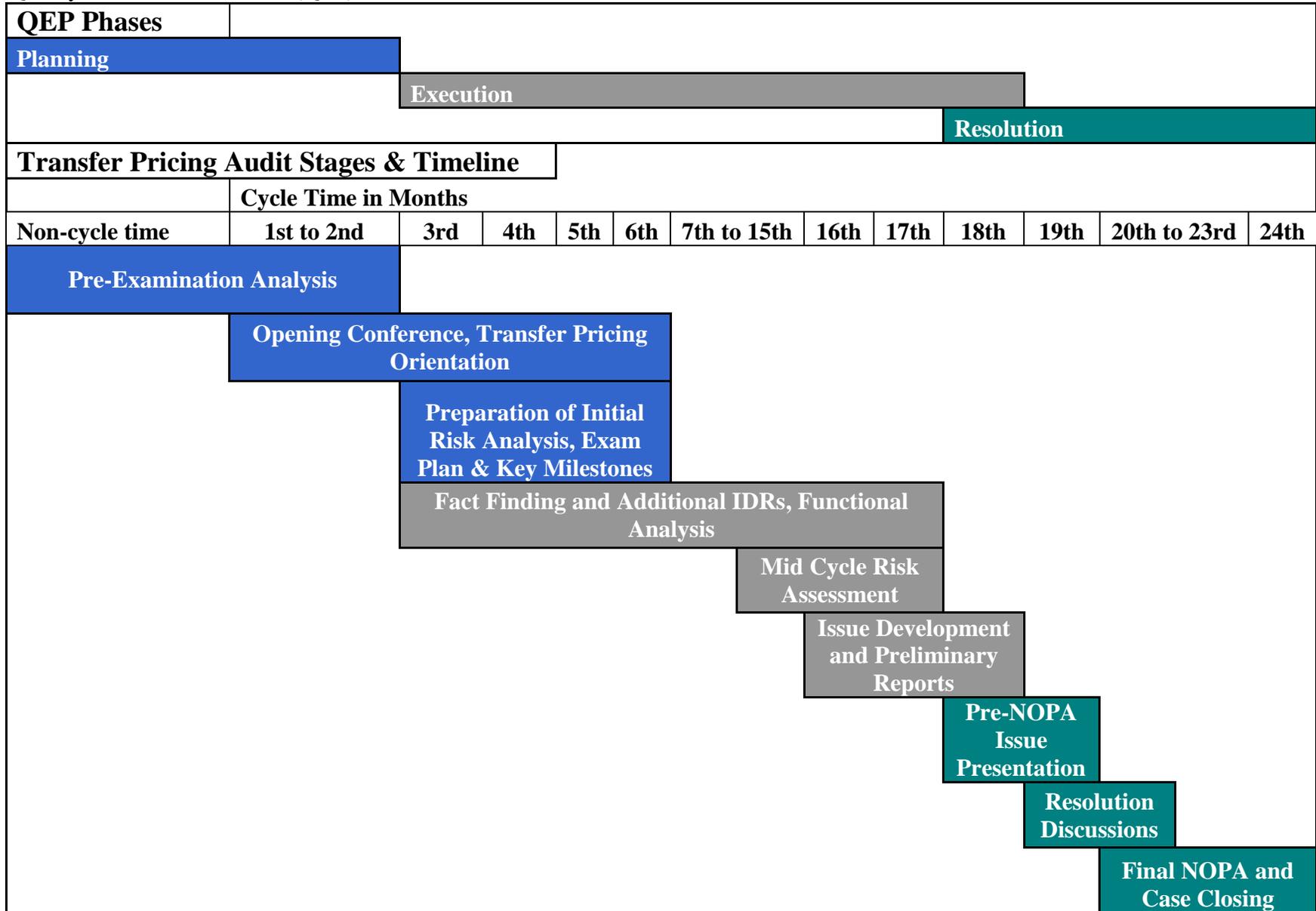
*Effective presentation can make or break a case.* Even a strong position may not be sustained on review if it is not presented clearly and persuasively. A Notice of Proposed Adjustment (NOPA) should have logical structure, and should weave the facts and applicable legal and economic principles together in a story-line that resonates with the reader. All of the relevant facts – good and bad – should be addressed. The conclusion should come across as "inevitable." This sort of presentation lends credibility to the proposed adjustment, and increases the odds of early resolution or sustention on review.

In summary, the Roadmap provides the transfer pricing practitioner with a comprehensive toolkit to address the key themes underlying a transfer pricing examination. As with every toolkit, not every tool, or audit step, will be necessary to get the job done in a particular case. You will need to use your judgment to apply the recommendations contained in the Roadmap to your specific case including the time and timeline needed to complete your examination. And, as previously said, this Roadmap is an evolving tool. If you are aware of new or different audit tools or techniques, you are encouraged to share these contributions through the Income Shifting IPN.

February 2014

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### Quality Examination Process (QEP)



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Transfer Pricing Audit Roadmap Phases	Timeline
<p><b>Planning Phase (up to a 6 month process)</b></p> <p><b>A. <u>Pre-examination Analysis</u></b></p> <ul style="list-style-type: none"> <li>• <u>Preliminary assessment of potential</u></li> <li>• <u>6662(e) Documentation Review</u></li> <li>• <u>Planning Meetings</u></li> </ul> <p><b>B. <u>Opening Conference</u></b> (starts the 24 month cycle)</p> <p><b>C. <u>Taxpayer Orientations</u></b></p> <p><b>D. <u>Preparation of Initial Risk Analysis and Examination Plan</u></b></p> <ul style="list-style-type: none"> <li>• <u>Initial Risk Analysis</u></li> <li>• <u>Examination Plan, Timelines and Key Milestones</u></li> </ul>	<p>Pre-exam analysis occurs before the cycle begins</p> <p>Opening Conference starts the 24 month audit cycle</p> <p>Planning activities occur during months 1 to 6 of the audit cycle</p>
<p><b>Execution Phase (up to a 14 month process)</b></p> <p><b>A. <u>Fact Finding and Information Gathering</u></b></p> <ul style="list-style-type: none"> <li>• <u>Additional IDRs</u></li> <li>• <u>Functional Analysis</u></li> <li>• <u>Mid Cycle Risk Assessment</u></li> </ul> <p><b>B. <u>Issue Development</u></b></p> <ul style="list-style-type: none"> <li>• <u>Economic Analysis</u></li> <li>• <u>Preliminary Report and Findings</u></li> </ul>	<p>Fact finding and issue development occurs during months 3 to 17 of the audit cycle</p>
<p><b>Resolution Phase (up to a 6 month process)</b></p> <p><b>A. <u>Issue Presentation</u></b></p> <p><b>B. <u>Issue Resolution</u></b></p> <p><b>C. <u>Case Closing/RAR</u></b></p>	<p>Issue Resolution occurs during months 18 to 24 of the audit cycle</p>

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### Planning Phase Pre-examination Analysis

#### Preliminary assessment

#### Core members:

International Examiner  
(IE)  
IE Manager  
Computer Audit  
Specialist (CAS)  
Team Coordinator  
(TC)  
Economist  
Transfer Pricing  
Practice Personnel  
(TPP)

**NOTE: The following steps are not necessarily presented in any particular order of completion. Some steps will take place consecutively and some concurrently and timing of any given activity may vary based on specific case situations.**

- Review tax return for controlled transaction. Utilize the International Information Returns (IIR) tool that was developed to display and analyze data from Forms 5471, 5472, 8858 and 8865. Additional forms to analyze include, but are not limited, to:
  - Form 5471 - Information Return of U.S. Person with Respect to Certain Foreign Corporations
  - Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business
  - Form 8833 - Treaty-Based Return Position Disclosure
  - Form 8858 - Information Return of U.S. Persons with Respect to Foreign Disregarded Entities
  - Form 8865 - Return of U.S. Persons with Respect to Certain Foreign Partnerships
  - Form 926 - Return by a U.S. Transferor of Property to a Foreign Corporation
  - Uncertain Tax Positions (UTP) Disclosures
  - Schedule M-3 analysis

Contact your team's CAS or visit the CAS website for tools to conduct analysis on e-filed data from many of the forms identified above.

#### Helpful References:

IRM 4.61.3 - [Development of IRC 482 Case](#)  
[OJI Training Pre-examination Analysis](#)  
[IRS.GOV LB&I Schedule UTP Guidance](#) and [Schedule UTP](#) and [UTP Guidance and Procedures](#)

**Review prior cycles' audit results, reports and Appeals Case Memoranda (ACM).**

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**Use tax return information and available research tools to compute the key financial ratio analysis for multiple years, make industry comparisons and consider whether cross border income shifting is occurring:**

- [Tax Information Gateway \(TIG\) Report](#) for company financial data, worldwide profitability analysis and historical information
- Financial Ratio Analysis
- [Capital IQ \(CIQ\)](#) analysis to compare results to available industry information

Contact your team's CAS or visit the CAS website for tools to conduct multi-year ratio and comparative analyses on e-filed data.

*Caution:* Financial ratio analysis and CIQ must be used carefully. Financial ratios may be useful as a diagnostic tool to help focus the audit; however, they do not provide a definitive indication of the arm's length nature of a taxpayer's controlled transactions. Even if financial ratios indicate potential non-arm's length transfer pricing issues, the team nonetheless needs to complete rigorous development of the issue facts and circumstances.

### **Research taxpayer background, history and core business operations.**

Because transfer pricing studies are generally based on book financial information, it is helpful to become familiar with qualitative and quantitative information found in publicly available documents. SEC Form 10-K is particularly useful. It contains audited financial information as well as a comprehensive overview of the company's business and financial condition. Other detailed information particularly useful for a transfer pricing review includes:

- research and development activity and location
- descriptions of patents, trademarks and other IP
- geographic and organizational structure
- segmented operational and profitability levels

Research tools such as CIQ and Compustat also have pre-formatted reports that can be

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helpful to understanding a company's overall business and profit drivers.

*NOTE:* The information gathered and analysis done to this point will become part of the "Background" section of any transfer pricing NOPA and the related economist report. Begin to document and organize this information in the [audit workpapers](#) and continually update the file throughout the audit process.

### **Helpful References:**

[Securities and Exchange Commission Website](#)

[Capital IQ \(CIQ\)](#)

Taxpayer's website

**Analyze statute of limitations (SOL) on the primary return under audit and related returns (e.g., Form 1042).**

**Coordinate with the Team Coordinator (TC) on statute controls (ensure Forms 895 are completed).**

*Caution:* When a transfer pricing adjustment is made, a deemed distribution or other conforming adjustment(s) may occur and potentially be subject to withholding. Ensure that the Form 1042 statute remains open. Also see Treas. Reg. §1.482-1(g)(3) and Rev. Proc. 99-32 for a discussion of conforming adjustments.

**Prepare the IRC § 6662(e) mandatory Information Document Request (IDR) and issue with the initial examination contact letter.**

- Required 30 day taxpayer response time starts with the date of initial examination contact letter
- This request for documentation includes a request for principal documents and an index for background documents
- Use this 30 day period to perform the company background/overview analysis and tax return(s) review
- The 30 day response time is defined by statute and is an exception to the new IDR and related enforcement processes as described in LB&I IDR [Directives](#)

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### Helpful References:

[Transfer Pricing Compliance Memorandum](#)

[IRM Exhibit 4.46.3-5 Transfer Pricing Compliance Processes](#)

### **Prepare an IDR requesting a transfer pricing orientation meeting and issue the IDR with the initial examination contact letter and § 6662(e) IDR:**

- Orientation should be provided early in the planning phase of the examination but after the financial statement and accounting records orientation is held
- Ideally, documentation provided by the taxpayer in response to the § 6662(e) IDR should be analyzed before the transfer pricing orientation is held. However, if the taxpayer engages in many intercompany transactions, holding the orientation early in the review may help focus the risk analysis and audit plan.

**Coordinate with the TC to issue an IDR with the initial examination letter requesting a financial statement orientation to be provided within 30 days from the opening conference.**

**Coordinate with the TC and the CAS to issue an IDR to request accounting records, including the worldwide, geographic and segmented accounting data and financial statements necessary for transfer pricing review.**

**Consider obtaining information or foreign based documentation from Treaty partners using “collateral requests,” “requests for information pursuant to treaties,” and the “Simultaneous Examination Program.”**

### **Develop and outline preliminary working hypothesis(es) and transfer pricing risk assessment with consideration of:**

- Worldwide effective tax rate and whether the taxpayer’s overall tax position is such that income shifting would be beneficial from a financial accounting/cash flow standpoint
- Potential applicability of a tax treaty
- Source of income and tax credit availability

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- Potential impact of Subpart F
- Other potential impact such as other collateral adjustments

**Document the audit steps taken, facts discovered and the preliminary risk assessment in the audit file and begin to outline a “fact statement” that will be updated throughout the examination process.**

**Note: Typically a member of the Transfer Pricing Practice (TPP) and/or Economist will participate in these preliminary assessments as well as other planning activities discussed below, though not in a lead capacity. The role and involvement of the TPP will continue to be evaluated as the issue assessment progresses with possible levels of engagement ranging from advisory to lead examiner.**

**Evaluate the need for internal specialist assistance (economist, engineer, etc.) and make SRS referrals as appropriate.**

**Helpful Reference:**

IRM 4.60.6 - [International Referral Criteria & Procedures](#)

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### Planning Phase Pre-examination Analysis

#### Documentation Review

#### Core members:

Team Coordinator  
IE and IE TM  
CAS  
Economist  
TPP team member

**Review and analyze § 6662(e) documentation and note areas that require further development, confirmation or inquiry.**

- The IE, economist and TPP should coordinate on their initial assessment and hypothesis
- The economist, in collaboration with the IE and TPP, should begin to evaluate the taxpayer's best method selection and the potential applicability of various methods
- Consider whether documentation meets the requirements of the § 6662 Regulations.

#### Helpful References:

IRM 4.60.8.3 - [IRC Section 6038A](#)

[Audit Tool to Determine Compliance with IRC § 6662\(e\)](#)

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### Planning Phase Pre-examination Analysis

#### Planning Meetings

#### Core members:

Team Coordinator  
IE and IE TM  
CAS  
Economist  
TPP team member

**NOTE: The following steps are not necessarily presented in any particular order of completion. Some steps will take place consecutively and some concurrently and the timing of any given activity may vary based on specific case situations.**

**Conduct the preliminary planning meeting(s) with the taxpayer.** Besides general agenda items for all aspects of the examination including timeframes and key milestones, topics specific to the transfer pricing examination would include:

- Identify the key taxpayer personnel responsible for assisting the exam team in the transfer pricing review
- Request accounting data and records including segregated P&L's for specific product(s) / product line(s)
- Discuss the expectations that a comprehensive transfer pricing orientation should cover business operations, key functions, worldwide structure, title flow, product flow, service flows, transfer pricing policies, and documentation and be held soon after the financial statement orientation
- Discuss the potential need for interviews of operations personnel
- Discuss the IDR process (formulation of questions, taxpayer input, response times, and dealing with delays)
- If applicable, discuss the § 6038A rules and procedures governing foreign-based documentation

**Note:** Various planning meetings and informal discussions may be held depending on the complexity and size of the return, the planned scope of the exam and the resource commitments required.

**Upon a determination that there may be an issue with respect to a transaction that involves a treaty partner, the exam team/TPP should notify relevant APMA personnel of treaty partner implications.**

#### Helpful References:

IRM 4.46.3.2.2 - [Conduct Formal Planning Meeting](#)  
[IRM Exhibit 4.46.3-1 Agenda for Planning Meeting](#)

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### Planning Phase

#### Opening

Conference (starts the 24-month audit cycle)

#### Core members:

IE and IE TM  
Economist  
Engineer  
CAS  
Financial Products  
Field counsel, TPP  
Domestic Team

**Plan for and conduct a formal opening conference with the taxpayer.** Agenda topics specific to transfer pricing examination should include:

- The QEP and the three key phases of the process: Planning, Execution and Resolution [QEP Publication 4837](#)
- Transfer pricing compliance process [IRM Exhibit 4.46.3-5 Transfer Pricing Compliance Processes](#)
- Preliminary scope of the transfer pricing examination and general timelines
- Review of this Roadmap as applied to the case
- IDR and related enforcement processes as described in LB&I IDR [Directives](#)
- Discussion of NOPA and resolution processes: 30 day standard
- Any potential claims, including setoff issues anticipated under IRC § 1.482-1(g)(4) and [Rev Proc 2005-46](#)
- Expectation for financial statement orientation meetings to be held within 30 days of opening conference
  - Identify employees responsible for accounting records
  - Include segmented financial statements and records
- Transfer pricing orientation to be held after financial statement orientation
  - Request employees involved in planning and structuring of transactions be available
  - Request personnel responsible for transfer pricing study be available
  - Emphasize expectations that the transfer pricing orientation should be a comprehensive presentation not an overview of the § 6662(e) documentation
- Quality of documentation
- Potential need for interviews and site visits, if known
- Anticipated additional information needs, order and priority
- Notification to the taxpayer regarding statute of limitation protection on foreign affiliates' returns IRM 4.60.2 - [International Procedures – Mutual Agreement Procedures and Report Guidelines](#)

#### Helpful References:

IRM 4.46.3.2.3 - [Conduct Formal Opening Meeting](#) (scroll down)

[IRM Exhibit 4.46.3-2 Agenda for Opening Meeting](#)

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### Planning Phase Taxpayer Orientations

### Financial Statement Orientation and Transfer Pricing Orientation

*F/S orientation to be held  
within 30 days of opening  
conference*

*Target transfer pricing  
orientation to be held soon  
after F/S orientation is held*

**Core Members:**  
IE and IE TM  
Industry Specialists  
Economist  
Engineer  
CAS  
Financial Products  
Field counsel, TPP  
Domestic Team

**Hold a financial statement / books and records orientation including but not limited to:**

- A walk-through of the legal entity organizational charts and functional organizational charts
- Reconciliation from geographic trial balance to 10-K's consolidated financial statement
- Segmented financial statements and roll ups to the consolidated financial statement
- Mapping from tax return to trial balance to general ledgers
- Working paper for book/tax differences
- Year-end and month-end adjusting entries
- True-ups
- Chart of accounts
- List of cost centers and profit centers
- Taxpayer's accounting practice and policies

**Hold transfer pricing orientation with the taxpayer to include but not limited to:**

- Taxpayer's background and the history of intercompany transactions
- Discuss all intercompany transactions in the year(s) under exam
  - Gain understanding of the taxpayer's rationale for entering into the transactions
  - Gain understanding of the taxpayer's value chain(s) associated with the intangible, services and/or tangible goods
  - Gain understanding whether the intercompany transaction is associated with the transfer of an income stream, or contribution to the value, of any intangible
- Discuss the functions performed, assets employed, and risks assumed by each controlled party of the respective intercompany transaction
- Understand how the preparer of the transfer pricing study gained knowledge of each controlled party's functions performed, assets employed and risks assumed and request supporting documents (interview notes, minutes)
- Discuss whether to request background documentation
- Identify persons responsible for structuring the transaction from the tax

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planning perspective

- Discuss the need to request additional documentation including contracts and agreements not previously requested
- Gain an understanding of the transfer pricing methods selected by the taxpayer for significant transactions.
- Discuss the process for requesting follow-up meetings and clarifications

### **Hold a reassessment meeting with IE, economist, TPP, field counsel and their respective managers:**

- Determine which transaction(s) need(s) further development, which transactions may be closed or which transaction(s) need(s) to be eliminated from further analysis
- Determine the level and scope of TPP involvement going forward
- Discuss any new information and reassess/adjust working hypothesis(es)
- Assess level and scope of counsel involvement and begin to consider any discrete legal issues
- Assess resource / outside expert needs. **NOTE:** In any transfer pricing case that may require any outside expert consideration ensure the TPP is informed or involved early in the examination process. Documented concurrence of a TPP Territory Manager must be provided with any request for outside expert assistance on transfer pricing issues.
  - [IRM 4.46.3.8.11 - Selection and use of outside experts](#)
  - [Outside Expert Committee Documents](#)
- Continue to document, organize and outline transactions determined to warrant further development and analysis based on information gathered to date
- Begin to formulate the best method analysis to include assessment of the taxpayer's selected method
  - If there is doubt as to whether the taxpayer's selected method is the best method, assess the reliability and comparability of the taxpayer's assumptions and data
  - Determine additional accounting data and records needed for this assessment or for application of any methods being considered as a best method

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**Document and update the audit steps taken, facts discovered and an updated risk reassessment to the audit file. Continue to update, correct and refine your fact statement.**

**Work with the TPP and field counsel to request outside experts, as necessary.**

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<p><a href="#">Back to Roadmap Index</a></p> <p><b>Planning Phase</b></p> <p><b>Preparation of Initial Risk Analysis and Audit Plan</b></p> <p><b>Prepare Initial Risk Analysis</b></p> <p><b>Core Members:</b></p> <ul style="list-style-type: none"><li>IE and IE TM</li><li>Industry Specialists</li><li>Economist</li><li>Engineer</li><li>CAS</li><li>Financial Products</li><li>Field counsel, TPP</li></ul>	<p><b>Request all information not previously obtained during the Planning Phase, plus:</b></p> <ul style="list-style-type: none"><li>• Additional items that are identified from reading § 6662(e) documentation, including items identified from the index of background documentation</li><li>• Follow-ups and clarification to the financial statement and the transfer pricing orientation</li><li>• Other follow-up data and information necessary to test the working hypothesis and the best method assessment</li></ul> <p><b>Helpful References</b></p> <p><a href="#">IRM Exhibit 4.46.3-5 Transfer Pricing Compliance Processes</a> <a href="#">Check List for Sec. 482 Transfer Pricing Examination</a></p> <p><b>Prepare an initial risk analysis for the transfer pricing examination based on the reassessment. Use <a href="#">Form 13744</a>.</b></p> <ul style="list-style-type: none"><li>• Submit risk analysis and audit plan for approval by International Team Manager, Territory Manager (TM), and Economist Manager and coordinate inclusion with overall risk analysis with the TC and TM</li><li>• Provide the risk analysis to the taxpayer along with the audit plan and timeline</li><li>• Risk assessment is an iterative process that will take throughout the audit and updated and documented at different stages</li></ul> <p><b>Helpful Reference:</b></p> <p>IRM 4.46.3.2.2.2 - <a href="#">Risk Analysis and Risk Management</a></p>
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### Planning Phase Preparation of Initial Risk Analysis and Audit Plan

### Examination Plan, Timelines and Key Milestones

**Core Members:**  
IE and IE TM  
Industry Specialists  
Economist  
Engineer  
CAS  
Financial Products  
Field counsel, TPP

*Target 6<sup>th</sup> month of the  
audit cycle to complete  
Planning Phase*

### Establish an estimated audit timeline and key milestone dates for completion of the transfer pricing examination

- Consider this Transfer Pricing Audit Roadmap when establishing the audit plan
- To be done within the six months from the opening conference
- Include date for mid cycle risk analysis; usually twelve months after opening conference
- To be provided to the taxpayer with the audit plan and the initial risk analysis

*NOTE:* Continuous communication with the taxpayer and team throughout the planning phase is critical.

A general timeline that would apply to a 24 month examination cycle follows:

- Last IDR to the taxpayer: **17<sup>th</sup> month**
- Discuss the government's findings with the taxpayer prior to the issuance of the last NOPA, ascertain the taxpayer's position and discuss resolution with the taxpayer of the last issue: **18<sup>th</sup> and 19<sup>th</sup> month**
- Issue last NOPA to the taxpayer: **20<sup>th</sup> month**
- Taxpayer response to last NOPA due by: **21<sup>st</sup> month**
- Issue RAR/30-Day Package to the taxpayer: **22<sup>nd</sup> month**
- Taxpayer's 30-Day Protest due: **23<sup>rd</sup> month**
- Rebuttal to the taxpayer's protest: **24<sup>th</sup> month**
- Closing case: **24<sup>th</sup> month**

These time frames assume no extraordinary or unusual events or demands. The 24 month examination model is used to demonstrate how milestones and audit phases are sequenced

**Complete the audit plan and provide to the taxpayer along with the risk analysis and timeline after securing managerial approvals.** [Form 4764](#)

### Helpful Reference:

IRM 4.46.3 - [LB&I Guide for Quality Examinations -- Planning the Examination](#)

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<p><a href="#">Back to Roadmap Index</a></p> <p><b>Execution Phase</b></p> <p><b>Fact Finding</b></p> <p><b>Functional Analysis</b></p> <p><b>Core members:</b></p> <ul style="list-style-type: none"><li>IE and IE TM</li><li>Industry Specialists</li><li>Economist</li><li>Engineer</li><li>CAS</li><li>Field counsel</li><li>TPP</li><li>TC</li><li>IPN(as appropriate)</li></ul>	<p><b>Perform a comparability and functional analysis, including a review and analysis of accounting data, interviews, plant tours and site visitations:</b></p> <ul style="list-style-type: none"><li>• Work with the taxpayer to identify key personnel for interviews/site tours</li><li>• Work with the taxpayer to identify plan and site for tour(s)</li><li>• Work with core members to prepare for interviews and tours</li><li>• Consider and evaluate need for foreign travel</li></ul> <p>NOTE: A functional analysis (IRM 4.61.3.5.1) identifies the economically significant activities performed in connection with the transaction. An economically significant activity is one that, at arm’s length, materially affects the following: a.) the price charged in a transaction and b.) the profits earned from a transaction.</p> <p>In planning and performing your functional analysis you should consider information needed for any Subpart F functional analysis as some of the fact finding for the two can overlap.</p> <p>Key IRM References: IRM Exhibits 4.61.3-3 &amp; -4 - <a href="#">Audit Tool - Transfer Pricing Functional Analysis Questionnaire</a> IRM Exhibit 4.61.3-2 - <a href="#">Audit Tool for Developing Transfer Pricing Issues</a> IRM 4.61.3 - <a href="#">Development of IRC 482 Issues</a> IRM Exhibit 4.61.3-1 - <a href="#">On-site Visitations</a></p> <p><b>NOTE:</b> A functional analysis is a critical aspect of any transfer pricing examination and is best conducted as a team, including IE, TC, TPP, Economist, Engineer, Field Counsel, with roles understood, robust internal communication, and on going discussions with the taxpayer to further understand its business operations.</p> <p><b>Meet with the taxpayer to confirm material facts that the IRS developed during the examination:</b></p> <ul style="list-style-type: none"><li>• Provide the draft fact statement and request written confirmation from the taxpayer (or explanation of differences)</li></ul>
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- Consider a full, open discussion / presentation with the taxpayer – preferably including the relevant operations personnel – regarding the team’s working hypothesis (es) and initial conclusions
- Issue additional IDRs as necessary

**Reassess the risk analysis and refine the working hypothesis(es) based on an analysis of new information and the taxpayer’s input:**

- Determine which transaction(s) need(s) further analysis
- Determine which transaction(s) need(s) to be eliminated from the work plan
- Determine additional IDRs as necessary
- Reevaluate the need for additional internal and outside experts
- Identify any discrete legal issues
- Continue to document, organize and outline transactions determined to warrant further development and analysis based on information gathered to date

**Document and update the audit steps taken, facts discovered and risk reassessment to the audit file.**

**Update, correct and refine your fact statement and begin to develop a general outline of the issue.** This will help organize your thinking and analysis and will be useful when drafting the NOPA begins.

Coordinate any discrete legal issues with Field Counsel, Associate Chief Counsel International, the TPP and the IPN.

Ensure communication and collaboration with Team Managers and Territory Managers throughout reassessment process.

***NOTE: Continuous communication with the taxpayer and team throughout the execution phase is critical.***

## TRANSFER PRICING AUDIT ROADMAP

<p><a href="#">Back to Roadmap Index</a></p> <p><b>Execution Phase Fact Finding</b></p> <p><b>Mid Cycle Risk Assessment</b></p> <p><i>Target 12<sup>th</sup> month of audit cycle to complete mid –cycle risk analysis</i></p>	<p><b>Prepare a mid-cycle risk analysis to reflect updated risk reassessment.</b> Update timelines and milestones as necessary. Secure managerial approvals and provide / discuss with the taxpayer.</p> <p><b>Helpful Reference:</b> IRM 4.46.3.2.2.2 - <a href="#">Risk Analysis and Risk Management</a></p> <p><i>NOTE: Continuous communication with the taxpayer and team throughout the execution phase is critical.</i></p>
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## TRANSFER PRICING AUDIT ROADMAP

<p><a href="#">Back to Roadmap Index</a></p> <p><b>Execution Phase</b></p> <p><b>Issue Development</b></p> <p><b>Economic Analysis</b></p> <p><b>Core Members:</b> IE and IE TM Economist and TM Engineer Field counsel ACCI as necessary TPP APMA</p> <p><i>Target 17<sup>th</sup> month of the audit cycle to issue last IDR</i></p>	<p><b>Perform an economic analysis consistent with the working hypothesis (economist in consultation with IE, TPP, engineer and field counsel).</b></p> <ul style="list-style-type: none"><li>• Conduct a robust analysis of why the taxpayer’s method is or is not the best method; determine best method, as applicable</li><li>• Consider its usability for resolution purposes</li><li>• Coordinate with APMA on any country-specific considerations</li></ul> <p><b>Analyze the facts, including accounting data, to determine the applicable legal analysis (IE, in consultation with Economist, TPP other exam team members, Field Counsel and ACCI, as necessary).</b></p> <p><b>Issue additional IDRs for information as necessary.</b></p> <p><b>Complete a draft of the background and facts write up to be used in the NOPA and in the economist report assisted by audit work files and workpapers previously developed (IE and economist to coordinate with field counsel and TPP):</b></p> <ul style="list-style-type: none"><li>• Share with the taxpayer; discuss inaccuracies and points of disagreement.</li><li>• Revise draft, as necessary. Aim for an agreed set of facts</li></ul> <p><b><i>NOTE: Continuous communication with the taxpayer and team throughout the execution phase is critical.</i></b></p>
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## TRANSFER PRICING AUDIT ROADMAP

<p><a href="#">Back to Roadmap Index</a></p> <p><b>Execution Phase Issue Development</b></p> <p><b>Preliminary Report and Findings</b></p> <p><b>Core Members:</b> IE and IE TM Economist and TM Engineer Field counsel ACCI as necessary TPP APMA</p> <p><i>Target 18<sup>th</sup> month of audit cycle to issue draft NOPAs</i></p>	<p><b>Draft a preliminary economist report to include a detailed critique of the taxpayer’s method, addressing individual comparables, assumptions, etc. (Economist in consultation with IE, engineer, TPP and Field Counsel). Circulate and revise as necessary.</b></p> <p>Using the general outline and fact statement already developed; prepare a draft NOPA to include the draft economist report. Provide the draft NOPA or a preliminary analysis of the issue, key factual findings and conclusions to the taxpayer (with assistance from the field counsel, economist and TPP). Revise the draft NOPA and draft economist report based on taxpayer’s input, if any. This can be an iterative process.</p> <p><b>Helpful References:</b> IRM 4.46.6.1 - <a href="#">Workpapers and Reports Resources</a> <a href="#">Document 12034: Economist Report Writing Guide for Transfer Pricing NOPA Preparation ppt</a> Preparation of Notices of Proposed Adjustment <a href="#">Effective and Persuasive Writing Sites</a></p> <p><b>Consider applicability of IRC § 6662(e) penalty.</b> IRM 20.1.5.9 - <a href="#">IRC 6662(e) Substantial Valuation Misstatement</a> IRM Exhibit 20.1.5-4 - <a href="#">IRC 6662 penalty flowchart</a></p> <p><b>Prepare Mutual Agreement Procedure (MAP) report, if applicable. Coordinate and discuss with APMA.</b> IRM 40.60.2 - <a href="#">Mutual Agreement Procedures &amp; Report Guidelines</a> and <a href="#">Letter 1853(P)</a> and <a href="#">Schedule</a></p> <p>Inquire about any IRC § 482 setoffs when the potential transfer pricing adjustment is formulated. Request additional information including economic analysis supporting the set off as appropriate. <a href="#">Rev Proc. 2005-46</a></p> <p><i>Note: Continuous communication with the taxpayer and team throughout the execution phase is critical.</i></p>
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### Resolution Phase Issue Presentation

#### Core members:

IE and IE TM  
Economist  
Engineer  
Field counsel,  
coordinating with  
ACCI as necessary  
TPP  
Domestic Team

**Meet with the taxpayer to discuss the government's findings on all issues prior to finalizing the NOPAs. Discussions are to focus on:**

- Understanding the taxpayer's position
- Determining whether the taxpayer agrees with the facts
- Determining whether the taxpayer would agree to any issues

**Assess strength of positions, risks associated with taking the issue forward, and the best approach for issue presentation (utilizing full consultation with all members of the core team, TPP and Counsel).**

***NOTE: Continuous communication with the taxpayer and team throughout the resolution phase is critical.***

## TRANSFER PRICING AUDIT ROADMAP

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### Resolution Phase Issue Resolution

#### Core members:

IE and IE TM  
Economist  
Engineer  
Field counsel,  
coordinating with  
ACCI as necessary  
TPP  
Domestic Team

*Target 20<sup>th</sup> month of audit  
cycle to issue final NOPAs*

#### Conduct resolution meeting(s) with the taxpayer:

- Work with the taxpayer on resolution
- Understand nature of disagreements (facts or interpretations of law)
- Consider the taxpayer's input for resolution purposes

Consider pre-Appeals resolution opportunities (e.g., Fast Track) on issues that cannot reach resolution at the examination level. [IRS - Issue Resolution Techniques \(scroll down\)](#)

#### Issue the final NOPA when the issue is fully developed and resolution efforts concluded:

- Include the required mandatory reviews of the NOPA

#### If the issue is agreed:

- Consider Rev. Proc. 99-32 ramifications/ elections
- Discuss the Rev. Proc. 99-32 options with the taxpayer
- Secure a closing agreement if Rev. Proc. 99-32 relief is properly requested and granted ([Rev Proc. 99-32](#) and IRM4.60.3.3 - [Tax Treaty Related Matters](#) )

*Caution:* Make certain any agreement reached is clear as to the transactions and years to which the agreement applies. Clarify with the taxpayer any implication of the resolution on subsequent years. This will avoid inappropriate reliance on current year outcomes to future examinations and positions.

*NOTE: Continuous communication with the taxpayer and team throughout the resolution phase is critical.*

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### Resolution Phase Case Closing/RAR

*Target 24<sup>th</sup> month of the  
audit cycle close case to  
Appeals or agreed.*

#### Post Closing Activities

**If the issue is unagreed, prepare the RAR/30-Day Package and case closing workpapers:**

- Address and rebut the taxpayer's positions raised in the taxpayer NOPA response
- Issue the RAR/30-Day Letter
- Complete rebuttal to the taxpayer's 30-Day Protest by 23<sup>rd</sup> month of the audit cycle
- Include the required mandatory reviews of the NOPA and RAR including rebuttal

**Helpful References:**

[HELPFUL TIPS FOR WRITING AN EFFECTIVE UNAGREED REPORT](#)

NOTE: If the Protest contains new factual information, raises new factual disputes or presents new economic or legal theories, consider re-engaging examination processes. Re-evaluate the timeline and reset the milestone dates as appropriate.

**Hold the Appeals Pre-conference Meeting**

- Prepare the presentation for Appeals
- Coordinate with the same team members participating in the examination.
- Coordinate with the TPP

**Attend the Post-Appeals Meeting**

- Understand Appeals' rationale for the outcome
- Review and analyze the ACM
- Consider the impact to the subsequent year(s) risk assessment
- Provide feedback to the TPP as appropriate

**Helpful Reference:**

IRM 4.46.7.2.7 - [Appeals Conference](#)