Overview of the IRS Transfer Pricing Roadmap

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In February 2014, the Internal Revenue Service (IRS) overhauled its guidance on the conduct of transfer pricing examinations by publishing the Transfer Pricing Roadmap. The Roadmap is aimed at the IRS Large Business and International Division teams that conduct transfer pricing audits, and is intended as a tool for use by those teams. It is organized around a notional 24-month audit timeline and includes recommended audit procedures, along with links to reference materials.

The Roadmap does not represent formal or binding guidance, but it does incorporate various parts of the IRS Internal Revenue Manual, the primary official source of IRS internal guidance to caseworkers. It seems the IRS intends that IRS examiners give the Roadmap a certain weight in conducting transfer pricing audits, and that taxpayers take heed of it.

Overview of the Roadmap

The Roadmap is organized around the following key stages, which are explained below:

- **Planning (up to six months)**
- **Execution (up to 14 months)**
- **Resolution (up to six months)**

The Planning Phase

This phase comprises four separate sub-phases:

- The pre-examination analysis sub-phase (which does not start the 24-month audit cycle and therefore could be as long in duration as is required in practice) involves a preliminary assessment of the potential transfer pricing risk involved, and also includes the gathering of necessary information.

- The opening conference sub-phase starts the 24-month audit cycle and involves a formal opening conference with the taxpayer.
The taxpayer orientation sub-phase involves a study of the taxpayer’s particular circumstances. The Roadmap recommends that this study include, for example, a walkthrough of the legal entity organization charts and a functional analysis of each relevant controlled party.

The preparation of initial risk analysis and examination plan sub-phase involves preparation of the formal risk assessment and the creation of a timeline for its resolution. The Roadmap recommends that the timeline contain key milestone dates for completion of the inquiry, and states that this sub-phase must be completed within six months of the opening conference sub-phase.

The Execution Phase

The execution phase is broken down into two sub-phases. The first is the fact-finding and information gathering sub-phase, which involves a detailed engagement with the taxpayer. The second is the issue development sub-phase, which involves, for example, a consideration of whether the taxpayer’s method is the best method.

The Resolution Phase

Following the execution phase, the final phase of the Roadmap commences. The resolution phase is broken down into three key sub-phases:

- The issue presentation sub-phase involves a meeting with the taxpayer to discuss the IRS’s findings on all issues prior to finalizing a Notice of Proposed Adjustments (NOPA).
- The issue resolution sub-phase provides the taxpayer with the opportunity to give input on the resolution process. During this sub-phase, the NOPA also is issued.
- The resolution sub-phase involves the preparation of rebuttals to the taxpayer’s response to the NOPA (if the adjustment is contested) and the preparation of case-closing papers.

Key Themes in the Roadmap

In addition to the specific phases, the Roadmap contains several key themes:

- Up-front planning in the conduct of a transfer pricing inquiry is critical. The Roadmap states that the proper development of a transfer pricing position may take two to three years (or possibly even longer), and that transfer pricing specialists must therefore be involved in the process.

- Transfer pricing cases are generally won or lost on the facts. The Roadmap recognizes that facts are central to a transfer pricing audit and that a detailed understanding of a taxpayer’s supply chain is critical.

- Effective presentation is important. The Roadmap recognizes that any NOPA must clearly present the facts (as well as the legal and economic arguments) in a cogent manner.
Reception of the Roadmap

The Roadmap is a welcome tool in many respects and has generally received a positive response from taxpayers and practitioners involved in transfer pricing work. The Roadmap provides taxpayers with a concrete framework for the resolution of a transfer pricing audit, together with assurances of internal reviews, active monitoring of the process and involvement of cross-disciplinary IRS teams (from economists and transfer pricing specialists to general fieldworkers).

The Roadmap is an element of the enhanced engagement process supported by the Organisation for Economic Co-operation and Development (OECD) and embraced by the IRS; as such, it places a heavy emphasis on collaboration, mutual trust, communication and exchange of information. It also demonstrates a desire on the part of the IRS to better understand the businesses with which it is dealing.

While some disappointment has been expressed at the notional two-year timeframe laid down by the Roadmap, it is considered to be a realistic approach on the part of the IRS.

Conclusion

The Roadmap reflects appropriate principles and priorities for transfer pricing examinations. As always, the issue is whether in specific situations the taxpayer and IRS teams can coordinate in a cooperative and efficient manner to address and resolve the issues that may arise. Where such effective cooperation takes place, the Roadmap timelines may be longer than is needed for resolution, even in major situations. On the other hand, where such cooperation does not exist, the timelines may be unrealistically short. It is too early to conclude whether the Roadmap will reduce the timeframe for resolving transfer pricing audits. What is clear, however, is that the Roadmap is a step in the right direction; to that extent, it is a welcome development, in principle, from a taxpayer perspective. As the OECD passes the halfway point in its ongoing base erosion and profit shifting (BEPS) project, many taxpayers will be eager to ensure that changes to established international tax principles will not result in double taxation and irreconcilable disputes with tax authorities. It is hoped that the Roadmap will be a helpful tool in ensuring that IRS-initiated transfer pricing audits in the post-BEPS world can be resolved speedily and collaboratively.

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