



TRANSFER PRICING EXAMINATION PROCESS

The Transfer Pricing Examination Process provides a guide to best practices and processes to assist with the planning, execution, and resolution of transfer pricing examinations consistent with the Large Business & International (LB&I) Examination Process (LEP), Publication 5125. This guide will be shared with taxpayers at the start of a transfer pricing examination so they understand the process and can work effectively with the examination team.

Transfer pricing examinations are factually intensive and require a thorough analysis of functions, assets, and risks along with an accurate understanding of relevant financial information. They are resource intensive for both the IRS and taxpayers. To ensure resources are applied effectively, LB&I is using data analytics to identify issues for examination that have the most significant risk for non-compliance. In addition, teams should continually assess the merits of issues during an examination. Our goal in a transfer pricing examination is to determine an arm's length result under the facts and circumstances of the case. Teams should keep an open mind during an examination to new facts as they are identified. Arm's length results are rarely a precise answer, but instead may be a range of results. If the facts of the case show that the taxpayer's results fall within an appropriate arm's length range, then our resources should be applied elsewhere. Likewise, teams should continually assess opportunities for issue resolution with taxpayers during the examination process.

The Transfer Pricing Examination Process provides a framework and guide for transfer pricing examinations. Every transfer pricing issue is unique, and teams should exercise their judgment on how to best apply this guide. This guide will be updated regularly based on feedback from examiners, taxpayers, practitioners, and others.

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I. Planning Phase

This phase of the examination process determines the scope of the audit. Issues selected for examination should have the broadest impact on achieving compliance regardless of the size or type of entity. The examination team will work with the taxpayer to establish a plan to complete the examination in a timely manner. The examination plan will be issue-focused and contain the following: issues identified, audit steps, timeline(s), and communication agreements. The examination plan may be adjusted throughout the examination process. Both parties must commit sufficient resources to achieve the agreed-upon case and issue timelines.

A. Issue Team Member Collaboration and Coordination

The Issue Selection and Collaboration Process will be used to determine if a specialist is assigned to an Industry Case. The team assigned to examine a specific issue, such as a transfer pricing transaction, is referred to as the issue team. For transfer pricing cases, the issue team can be composed of various individuals, including members of the Transfer Pricing Practice (TPP) and Cross Border Activities (CBA); such as the:

- Senior Revenue Agent
- Revenue Agent (RA)
- Economist
- Tax Law Specialist (TLS)

In accordance with the LEP, there should be coordination and collaboration among the team members and advisors including the:

- Case Manager
- Issue Manager
- Team Coordinator
- Senior Revenue Agent and/or the Revenue Agent responsible for international issues
- Computer Audit Specialist (CAS)
- Counsel
- Other specialists

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The issue team should coordinate to issue an Information Document Request (IDR) requesting accounting records, including geographic, tax and legal organizational charts, worldwide geographic and initial segmented accounting data, and financial statements necessary for transfer pricing review.

Best Practices:

- The roles and responsibilities for each issue team member assigned will be determined in the planning phase based on the resources available
- Involve LB&I Division Counsel early in the examination process
- The issue team should coordinate IDR requests with the entire case team to avoid duplicate IDR requests

Helpful References:

IRM 4.46.3 - Planning the Examination

IRM 4.60.6 - International Referral Criteria & Procedures

Revenue Agent Case Quality Improvement Job Aid

Memorandum of Understanding Between Internal Revenue Service Large Business & International ("LB&I") and National Treasury Employees Union concerning process for specialist referrals

B. Practice Units

Practice Units are reference and training tools for evaluating and developing potential issues encountered over the Planning, Execution, and Resolution phases of an examination. Practice Units are located on the "International Knowledge Base" site under the Tax Examination/Issues portion of the IRS Virtual Library on the Servicewide Knowledge Management (KM) SharePoint site.

Following are some examples of Practice Units that can be used to assist with the Planning Phase:

- Arm's Length Standard
- Overview of IRC Section 482
- Three Requirements of IRC 482

A list of additional Practice Units is provided in Exhibit A.

Best Practice: Check for Directives or other forms of guidance affecting transfer pricing issues.

Helpful References:

Transfer Pricing Practice Area News and Announcements

C. Initial Transfer Pricing Risk Assessment

1. Review Prior Year Workpapers

Risk assessment includes the review of prior year workpapers, if applicable, to identify potential controlled transactions. The issue team should analyze prior year documents including, but not limited to:

- Initial and mid-cycle risk analysis
- Taxpayer's transfer pricing documentation
- Revenue Agent Reports and closing agreements
- Notice of Proposed Adjustments (NOPA)
- International Examiner's Report
- Economist's Report
- Other specialist's reports
- Functional analysis
- Appeals Case Memorandum (ACM)

Best Practice: Workpapers are used to document the audit procedures performed, information gathered, analysis performed, and conclusions reached over the course of the examination. To promote efficiency, workpapers must be prepared on a timely basis. The issue team will begin documenting workpapers at the inception of the examination and continue to update the file throughout the examination process.

Helpful References:

IRM 4.10.9.7 - Workpapers

2. Collaborating with Advance Pricing Mutual Agreement Program

The issue team will collaborate with the Advance Pricing Mutual Agreement (APMA) program when the transaction involves a tax treaty country. Also, the issue team will consider obtaining information or foreign-based documentation from treaty partners

using collateral requests, information requests pursuant to treaties, and the Simultaneous Examination Program (SEP).

Helpful References:

IRM 4.60.3 - Tax Treaty Related Matters
United States Income Tax Treaties - A to Z
APMA Program Contact Information

3. Analyze the Income Tax Return

The issue team will access the CAS website for a variety of tools to conduct analysis on e-filed income tax returns. Tutorials are available for instructions and training. The Auditor's Workbench tool will be used to analyze data from Forms 1120, 1065, 1120S, 4797, 5471, 5472, 8858, and 8865. In addition to the potential for transfer pricing issues, the examiner should collaborate with CBA to identify any Subpart F or U.S. trade or business/permanent establishment issues related to the controlled transaction. Forms to analyze include, but are not limited to:

- Form 926 - Return by a U.S. Transferor of Property to a Foreign Corporation
- Form 4797 – Sales of Business Property
- Form 5471 - Information Return of U.S. Persons With Respect To Certain Foreign Corporations
- Form 5472 - Information Return of Foreign Owned Corporation
- 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 8833 - Treaty-Based Return Position Disclosure
- Schedule M-3 analysis
- Schedule UTP – Uncertain Tax Positions (UTP Disclosures)

Helpful References:

IRM 4.61.3 - Development of IRC section 482 Case
 LB&I Schedule UTP Guidance
 Auditor's Workbench Tutorials
 Auditor's Workbench Income Shifting Outbound Custom Queries
 Auditor's Workbench Income Shifting Inbound Custom Queries
 CAS and Examiner Analysis Tools

4. Analyze the Country-by-Country Report

The issue team should utilize the Form 8975, Country-by-Country (CbC) Report. It is a tool intended to provide useful information to analyze high level transfer pricing risk, Base Erosion and Profit Shifting (BEPS) related risk, and where appropriate, conduct further economic and statistical analysis. Before analyzing the CbC report, the issue team members will complete the required training. Guidance for foreign parent CbC reports will be available on the Income Shifting Practice Network SharePoint websites under Audit Tools and Reference Resources.

Helpful References:

IRM 4.61.3 - Development of IRC § 482 Case
 LB&I Country-by-Country Guidance and Procedures for Large Business and International (LB&I) Division
 ELMS 67517 Country-by-Country Report Training

5. Prepare Ratio Analysis

The issue team should perform analysis to compute key financial ratios for multiple years, make industry comparisons, and consider whether cross border income shifting is occurring. Ratios should be based on both tax and financial data. The ratios are useful as a diagnostic tool to help focus the examination. However, they do not provide a definitive indication as to whether the prices for a taxpayer's controlled transactions achieve arm's length results. To determine whether ratios indicate potential transfer pricing issues, the team should appropriately develop the relevant facts to support a transfer pricing adjustment, a subpart F adjustment, or both. Below are some of the tools that can be used to compute ratio analyses of the U.S. party and foreign related parties to the transaction:

- Tax Information Gateway (TIG) Report - company financial data, worldwide profitability analysis, and historical information
- Auditor's Workbench - ratio analysis reports (building custom queries as needed)

- Campaign and Case Built File (CBF) data provides issue-focused financial ratios and analysis
- The Service has subscriptions to other helpful tools. Subscription services may change over time, so consult the Income Shifting Practice Network with any questions.

6. Research Taxpayer's Background and Operations

The issue team will obtain an understanding of the taxpayer's history, background, overall core business operations, and profit drivers. Perform a review the taxpayer's website, Form 10-K or Form 20-F filed with the Securities and Exchange Commission (SEC), and complete an internet search of the taxpayer's name. This information may include the following:

- Overview of a taxpayer's business, including operations in various countries
- Geographical, legal, and tax organizational structure information
- Financial statements
- Segmented operational and profitability levels
- Functional activities and their locations
- Significant transactions
- Descriptions of patents, trademarks, and other intangibles
- Industry and competitor information
- Value drivers
- Merger, acquisition, and other reorganization activity

Helpful References:

SEC Website (Edgar)

United States Patent and Trademark Office

IRM 4.46.6 Workpapers and Reports Resources

7. Develop a Preliminary Working Hypothesis

The purpose of the risk assessment is to identify specific transactions between the U.S. taxpayer and its affiliates warranting examination. The goal is to gather and analyze

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information relevant to those transactions. The development of a preliminary working hypothesis is a fluid concept. It will include an issue statement that will be proved or disproved as additional information is obtained. The issue team will develop a preliminary working hypothesis taking into consideration the:

- Worldwide effective tax rate, profitability, and whether the taxpayer's overall tax position benefits from income shifting from a financial accounting/cash flow standpoint
- Industry averages, benchmarks, or reference sets, if available
- Source of income and tax credit availability
- Subpart F issues and need to collaborate with CBA
- Hybrid entities and how the taxpayer uses hybrid entities within its structure
- Net operating losses (NOLs)
- Collateral adjustments and other impacting factors
- Tax treaties and the need to collaborate with relevant APMA personnel

Caution: Treasury Regulation Section (Treas. Reg. Sec.) 1.482-1(d)(2) states that “unadjusted industry average returns themselves cannot establish arm's length results.” Therefore, unadjusted industry average returns should only be used to assess transfer pricing risk and on their own should not be used to make a transfer pricing adjustment.

Helpful References:

IRM 4.60.3 - Tax Treaty Related Matters
United States Income Tax Treaties - A to Z
APMA Program Contact Information

8. Complete Risk Analysis

The issue team will complete the risk analysis using the current Form 13744-I, as recommended. However, Forms 4764, 4764-A, 4764-B, 4764-IC, and 13745 can still be used, as appropriate:

- Submit the initial risk analysis for approval by the Issue Manager and Territory Manager (TTM)
- Update and document the risk assessment at various stages of the examination. Risk assessment is a continuous process that occurs throughout the audit. Document the audit steps taken, facts discovered, and the initial risk assessment in the audit file. Begin to outline and document the facts that will be updated throughout the examination process

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

Helpful Reference:

IRM 4.46.3.2 - Risk Analysis Process

D. IRC Section 6662(e) Documentation Request

The Initial Transfer Pricing Documentation IDR (formerly known as the Mandatory Transfer Pricing IDR) is no longer required for all cases. Follow the Interim Instructions on Issuance of Mandatory Transfer Pricing IDR in LB&I Examinations. The Senior Revenue Agent/Team Coordinator and the issue team members will collaborate on the issuance of the IDR. It is important to issue the IDR early in the audit process to start working the issue as soon as possible to close the case timely. Please review IRM Exhibit 4.46.3-4 - Transfer Pricing Compliance Processes for specific language:

- Treas. Reg. Sec. 1.6662-6(d)(2)(iii) IDR includes a request for principal documents and an index for background documents
- Internal Revenue Code Section (IRC Sec.) 6662(e) and Treas. Reg. Sec. 1.6662-6(d)(2)(iii) require that the taxpayer respond within 30 calendar days. The 30 days starts with the date of the IRC Sec. 6662(e) IDR
- 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 Directive on IDR Enforcement Process
- The issue team should use this 30 day period to perform analysis of currently available information, which may include prior tax returns and financial statements

Helpful References:

IRM Exhibit 4.46.3-4 - Transfer Pricing Compliance Processes
Interim Instructions on Issuance of Mandatory Transfer Pricing IDR in LB&I Examinations

E. Internal Planning Meeting(s)

The issue team will conduct internal planning meeting(s). General agenda items would include timeframes, key milestones, and topics specific to the transfer pricing examination:

- Discuss the initial risk analysis, preliminary audit steps, estimated audit timeline, and key milestone dates
- Discuss the accounting data and records that will be requested from the taxpayer, such as segmented profit and loss statements for specific product(s) or product line(s)
- Discuss the IDR process (formulation of questions, taxpayer input, response times, and dealing with delays)

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

Helpful References:

IRM 4.46.3.3 - Internal Planning and Internal Planning Discussions

IRM Exhibit 4.46.3-2 - Sample Agenda Topics for Internal Planning Meeting(s)

F. Issue Team Examination Plan, Timelines, and Key Milestones

The issue team will establish an estimated audit timeline with key milestone dates for completion of the transfer pricing examination:

- Coordinate with the Team Coordinator and Case Manager regarding the timeline
- Complete the examination plan after the opening conference
- Include a date for the mid-cycle risk analysis. Provide the taxpayer with the examination plan, timeline, and initial risk analysis
- Input detailed transfer pricing specific Uniform Issue Listing (UIL) codes in Issue Management System (IMS)

Best Practice: Refer to Exhibits B and C for general timelines that could apply to a transfer pricing case. The examination timeline exhibits should only be used as guides.

Each case has its own unique characteristics. The examination plan timeline should be specific for each case.

Helpful References:

IRM 4.46.3 - Planning the Examination
Treaty & Transfer Pricing UIL Codes

G. Opening Conference

The issue team will participate in the formal opening conference with the taxpayer. Agenda topics specific to the transfer pricing examination should include:

- LEP and the three key phases of the process: Planning, Execution, and Resolution (Publication 5125)
- Transfer Pricing Examination Process - ensure that the taxpayer is given appropriate information to allow it to access the most current document on IRS.gov and discuss it to facilitate understanding
- IRM Exhibit 4.46.3-4 - Transfer Pricing Compliance Processes provides references, documentation, audit planning, and IRC Sec. 6662(e) penalties
- Preliminary scope of the transfer pricing examination and general timelines
- Discuss IDR and related enforcement processes as described in LB&I Directive on IDR Enforcement Process
- Discuss IRM 4.46.3.6 - LB&I Claims Process regarding claims for refund. IRM Exhibits 4.46.3-7 - LB&I Guidelines for Reviewing Claims and IRM Exhibit 4.46.3-8 - Risk Assessing Claim Issue(s) illustrate the processes for reviewing and risk assessing claims. A claim could have an indirect or direct impact on potential issues. Claims could also change audit plans. Potential issues may need re-evaluation due to claims
- Discuss the expectation for financial statement orientation meetings to be held, ideally, within 30 days of the opening conference:
 - Identify employees responsible for the accounting records
 - Include segmented financial statements and records
 - Consider whether a CAS is available to attend the meeting
- IRM 4.46.3.7 - Issue Discussion Meetings:
 - Discuss the benefits of issue discussion meetings
 - Discuss the roles and responsibilities of the issue team and the taxpayer
 - Share the initial risk analysis and preliminary working hypothesis with the taxpayer

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- Work with the taxpayer to establish initial audit steps
- Develop a timeline for the issue
- Discuss that transfer pricing examinations may take longer than other issues to examine and a statute extension may be requested during the examination
- Discuss the impact to the timeline if the taxpayer fails to meet deadlines for IDRs or if the taxpayer fails to be transparent about facts and positions
- Identify the taxpayer personnel that will work with the issue team
- Discuss the need to schedule the transfer pricing/supply chain orientation after the financial statement orientation:
 - Request that employees involved in the planning and structuring of transactions be available
 - Request that personnel responsible for the transfer pricing study be available
 - Emphasize expectations that the transfer pricing orientation should be a comprehensive presentation that should cover business operations, key functions, worldwide structure, title flow, product flow, service flows, and transfer pricing policies
- Discuss the quality of responses received to date
- Discuss the potential need for interviews and site visits, if known
- Anticipate the additional information needs, order, and priority
- Discuss the NOPA, Economist Report, and issue resolution processes
- Discuss the IRC Sec. 6038A rules and procedures governing foreign-based documentation, if applicable. It may be necessary to obtain an authorization of agent for U.S. subsidiaries of foreign parents
- Discuss IRM 4.60.2 - International Procedures - Mutual Agreement Procedures and Report Guidelines to notify the taxpayer regarding statute of limitation protections on foreign affiliates' returns
- Issue Pattern Letter 1853(P) to allow the taxpayer to protect its foreign statute of limitations. Indicate countries of origin to be determined and amounts to be determined. This is notification to the taxpayer of potential double taxation

Helpful References:

IRM 4.46.3.5 - Opening Conference (Meeting)

Exhibit 4.46.3-3 - Sample Agenda for Opening Conference (Meeting)

IRM 4.46.5.4 - Issue Resolution Tools

Best Practices: The issue team will conduct weekly or bi-weekly discussions with the taxpayer to support communication and ensure common expectations regarding the audit progress, IDRs, and timelines.

II. Execution Phase

Stages of issue development include determining the facts, applying the law to those facts, and understanding the various tax implications of the issue. The issue team should conduct interactive discussions, including using the IDR process to develop the facts. Every effort should be made to resolve any factual differences. Open communication and continuous reassessment should continue throughout the Execution Phase.

A. Risk Assessment

1. Review IRC Section 6662(e) Response

The issue team will review and analyze the taxpayer's IRC Sec. 6662(e) documentation prior to the taxpayer orientation meetings and note areas that require further development, confirmation, or inquiry:

- Coordinate and update the initial risk analysis, timeline, examination plan, and working hypothesis with issue team members
- Evaluate taxpayer's best method selection and the potential applicability of various methods
- Consider whether the transfer pricing documentation meets the requirements of Treas. Reg. Sec. 1.6662-6(d)(2)(iii)
- Determine whether the documentation covers all material controlled transactions
- Consider whether additional information may be necessary regarding Subpart F or other tax implications

Best Practice: In evaluating the taxpayer's documentation, the issue team should consider not only whether the documentation requirements of Treas. Reg. Sec. 1.6662-6(d)(2)(iii) are met, but also whether the documentation reasonably addresses the controlled transactions and whether the conclusions reached therein can be considered reasonable.

Helpful References:

IRM 4.60.8.3.5 - IRC Section 6038A and 6038C Penalty Cases

IRM Exhibit 4.60.8-1 - Index to IRC 6038A Exhibits

Practice Unit on IRC 6662(e): Calculating the Net Adjustment Penalty for a Substantial Valuation Misstatement

Instructions for Examiners on Transfer Pricing Issue Examination Scope - Appropriate Application of IRC 6662(e) Penalties

2. Request Financial Statement Orientation

The issue team will prepare an IDR to request a financial statement orientation to be conducted within 30 days from the opening conference. The orientation meeting should be scheduled to coordinate availability of the issue team. Generally, the financial statement orientation IDR should request, but not be limited to the following:

- A walk-through of the geographic, legal entity, tax, and functional organizational charts, and all reporting platforms that exist (for example, different management reporting platforms)
- Provide the taxpayer the opportunity to voluntarily walk the issue team through its CbC report. Refer back to section I.C.4. - *Analyze the Country-by-Country Report*, of this document for additional information
- Reconciliation from the geographic trial balance to the SEC Form 10-K consolidated financial statements
- Reconciliation between foreign accounting standards and Generally Accepted Accounting Principles (GAAP), for example International Financing Reporting Standards v. GAAP
- Segmented financial statements and roll ups to the consolidated financial statements, including roll ups of Disregarded Entities into Controlled Foreign Corporation (CFC) owners
- Map from the tax return to the trial balance to the general ledgers
- Work papers for book/tax differences
- Year-end and month-end adjusting entries
- True-up entries
- Chart of accounts
- List of cost centers and profit centers
- Taxpayer's relevant accounting practice and policies

3. Request Transfer Pricing/Supply Chain Orientation

The issue team will prepare and issue an IDR requesting a transfer pricing/supply chain orientation meeting:

- The orientation should be conducted early in the execution phase of the examination but after the financial statement and accounting records orientation is held
- The orientation should be scheduled to coordinate with the availability of all members of the issue team

In order for the issue team to fully understand the taxpayer's transaction, request a transfer pricing/supply chain orientation from the taxpayer, which should include, but not be limited to:

- The taxpayer's background and the history of intercompany transactions
- Selected intercompany transactions in the year(s) under examination:
 - The taxpayer's rationale for entering into the transactions
 - The taxpayer's value driver(s) associated with the intangible, services, and/or tangible goods
 - Whether the intercompany transaction is associated with the transfer of an income stream (e.g., change in functions, assets, or risks)
- The characterization and business reason for the transaction
- Identifying persons responsible for structuring the transaction from the tax planning perspective, including any step plans for structuring/restructuring including, but not limited to, special purpose or new entities
- The functions performed, assets employed, and risks assumed by each controlled party to the respective controlled transaction
- The total profits or losses associated with each material controlled transaction and each controlled party's share of the total profits or losses
- How the preparer of the transfer pricing study gained knowledge of each controlled party's functions performed, assets employed, and risks assumed (for instance, interviews or minutes)
- The need to request background documentation or identify the taxpayer and/or preparer personnel to interview
- The need to request additional documentation, including contracts and agreements
- The transfer pricing methods selected by the taxpayer for significant transactions

Best Practice: Discuss processes for requesting follow-up meetings and clarifications.

4. Update Risk Assessment

The issue team will hold reassessment meetings throughout the Execution Phase, with the Practice Network members, LB&I Division Counsel, and respective managers:

- Discuss any new information and reassess/adjust working hypothesis(es)
- Determine which transactions warrant further development or whether issues should be closed
- Determine whether additional transactions should be added for further analysis
- Collaborate with APMA for potential issues involving a tax treaty partner
- Discuss what has been done and needs to be done to complete the issue(s). The Estimated Completion Date (ECD) may need to be reevaluated as the examination progresses
- Continually monitor and reassess the resources available for issues being examined. Assess level and scope of Counsel's involvement and begin to consider any discrete legal issues
- Assess resource/outside expert needs. In any transfer pricing case that may require outside expert consideration, TPP should be involved early in the examination process. Document concurrence of a TPP Territory Manager with any request for outside expert assistance on transfer pricing issues:
 - Work with the TPP and LB&I Division Counsel to request outside experts, as necessary
 - Review the Outside Expert Program website
- Continue to document, organize, and outline transactions determined to warrant further development and analysis based on information gathered to date
- Evaluate the taxpayer's selection of the best method:
 - Consider whether the characterization of the transaction is framed appropriately
 - Assess the degree of comparability between controlled and uncontrolled transactions and the reliability of the assumptions and completeness and accuracy of the data used in the taxpayer's selected best method
 - Determine additional accounting data and records needed for this assessment
 - Follow the Revised Instructions for LB&I on Transfer Pricing Issue Selection and Scope of Analysis - Best Method Selection. It is important for issue teams to begin the approval process as early as possible.

B. Fact Finding and Information Gathering

1. Issue IDRs and/or Summonses

The issue team will request any additional information not obtained during the Planning Phase, including:

- Follow-up on the financial statement orientation, transfer pricing/supply chain orientation, Treas. Reg. Sec. 1.6662-6(d)(2)(iii) documentation, and other data and information necessary to test the working hypothesis and the best method assessment. Clarify any items that do not reconcile or that have missing information.

Issue IDRs or summonses for factual development, including requests for interviews, plant tours, and site visits:

- Follow the requirements for issuing IDRs in accordance with the LB&I Directive on IDR Enforcement Process
- Collaborate with LB&I Division Counsel when drafting IDRs that may potentially require a summons
 - Requesting third-party information is not subject to the IDR process and may require a summons in the first instance (e.g. requests for documents from or interviews of third-parties may require third-party summonses)

Best Practices: The issue team should coordinate IDR requests with the entire case team to avoid duplicate IDR requests. Open communication between the taxpayer and the examination team throughout the process is critical. Conduct weekly or bi-weekly discussions between the examination team and the taxpayer to support communication and ensure common expectations regarding audit progress, IDRs, and timelines.

At this stage, the examination team should explain the Advance Pricing Agreement (APA) program to the taxpayer and explain its benefits as a tool to achieve certainty in transfer pricing transactions.

Helpful References:

IRM 25.5 - Summons

IRM 4.46.4.1 - Overview of the Execution Phase

IRM 4.11.57 - Third Party Contacts

Rev. Proc. 2015-41 - APMA advance pricing agreements

IRM Exhibit 4.46.3-4 - Transfer Pricing Compliance Processes

2. Review Intercompany Agreements

The issue team should perform a review and analysis of relevant intercompany agreements:

- Collaborate with LB&I Division Counsel to understand legal terms and content of intercompany agreements:
 - Determine relevant parties
 - Identify important terms of the agreement
 - Identify compensation and forms of payments
 - Assess the contractual risks assigned to the controlled parties
 - Determine if the conduct of the parties is consistent with the written agreements
 - Identify any discrete legal issues

3. Conduct Functional Analysis

A functional analysis identifies the economically significant activities performed regarding the transaction. An economically significant activity is one that, at arm's length, materially affects the following:

- The price charged in a transaction
- The profits and/or losses from a transaction

The issue team must perform a functional analysis, including a review and analysis of the accounting data. Review IRM Exhibit 4.61.3-4 - Transfer Pricing Functional Analysis Questionnaire and consider performing the following actions, as appropriate:

- Identify functions performed by each entity, with respect to the controlled transaction under analysis
- Identify risks assumed by each entity with respect to the controlled transaction under analysis and verify that the conduct of parties is consistent with the way in which risk is allocated in the intercompany agreement(s)
- Identify assets utilized by each entity

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- Identify title flow, product flow, services performed, and money flow
- Identify value drivers of the business or transaction
- Work with the taxpayer to identify key personnel for interviews and site tours
- Work with the taxpayer to identify and plan site tour(s)
- Work with the issue team to prepare for interviews and tours. If foreign travel is required, start the administrative process early and follow the procedures on the International Travel Office website
- Consider the need for a court reporter at interviews. The “Court Report Services Request” form should be initiated by the Issue Manager and signed by both the Issue Manager (if applicable) and the Case Manager. Upon completion, the request is then forwarded to both the Issue Territory Manager and the Territory Manager for approval. Please allow 45 days to process

A functional analysis is a critical aspect of any transfer pricing examination and is best conducted as a team with robust internal communication, and ongoing discussions with the taxpayer to further understand its business operations.

Best Practice: The issue team must consider the potential for other issues to maximize the efficiency and effectiveness of the examination. In planning and performing a functional analysis, consider information needed for any Subpart F, effectively connected income, permanent establishment, or other implications.

Helpful References:

IRM Exhibit 4.61.3-2 - Development of IRC section 482 Cases - General Audit Procedures and Techniques

IRM 4.61.3 - Development of IRC Section 482 Issues

IRM Exhibit 4.61.3-1 - On-site Visitations

IRM 4.61.3.5.1 - Functional Analysis

IRM 4.10.3.3 - Interviews: Authority and Purpose

IRM. 4.10.3.3.6 - Requests to Audio Record Interviews

C. Taxpayer Meetings

The issue team should meet periodically with the taxpayer to confirm material facts developed during the examination:

- Consider a full, open discussion/presentation with the taxpayer –preferably including the relevant personnel from the taxpayer’s business operations – regarding the team’s working hypothesis(es) and preliminary findings

- Issue additional IDRs, as necessary

Best Practice: A written agenda should be prepared for every taxpayer meeting and shared with the taxpayer in advance. Designate a dedicated note taker for these meetings.

D. Mid-Cycle Risk Assessment

Risk assessment is a continuous process. The issue team must use their professional judgment to determine which issues will continue to be examined or modified in scope as facts and information about the relevant transfer pricing issues are developed. New information discovered by LB&I during an examination may necessitate expanding or modifying the Examination Plan and timeline, including adding new issues or alternatively, closing one or more of the transfer pricing issues under examination.

- Reassess the risk analysis and refine the working hypothesis based on an analysis of information gathered and reviewed to date
- Determine which transactions warrant further analysis
- Determine which transactions should be eliminated/added to the work plan
- Consider additional IDRs, as necessary
- Reevaluate the need for additional internal resources and outside experts
- Document, organize, and outline transactions determined to warrant further development or analysis based on information gathered to date
- Consider the impact of any other potential audit adjustments on the transfer pricing issues under consideration. Communicate with the other issue teams, as necessary
- Document and update the audit steps taken, facts discovered, and risk reassessment in the audit file and in a potential NOPA and Economist Report
- Discuss the preliminary findings with the taxpayer and engage in a meaningful discussion about any missing facts or any misinterpreted facts that materially influence the preliminary findings

The issue team should prepare a mid-cycle risk analysis to reflect the results of the updated risk reassessment:

- Conduct an internal meeting with the issue team to discuss the progress of the audit steps taken, concerns or delays and proposed plan to address them, recommendation and timing for next steps, and any potential resolution options

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- Consider whether the Letter 1853-P should be updated and sent to the taxpayer
- Update timelines and milestones as necessary, including in IMS which would include entering an “Actual Completion Date” for all closed issues
- Secure managerial approvals
- Discuss mid-cycle risk analysis with the taxpayer

Helpful Reference:

IRM 4.46.3.2 - Risk Analysis Process

E. Issue Development

1. Economic Analysis

The issue team should work with the economist to perform an economic analysis consistent with the working hypothesis to:

- Evaluate the taxpayer’s best method analysis
 - Consider whether the taxpayer’s method, as applied, or whether the method with adjustments, would reflect an arm’s length result. If not, refer to Revised Instructions for LB&I on Transfer Pricing Issue Selection and Scope of Analysis – Best Method Selection
- Analyze the facts, including accounting data, to determine the applicable legal analysis
- Prepare a draft Economist Report, as appropriate. Arrange a meeting with the taxpayer to discuss the economic analysis to date
- When the transaction involves a treaty partner, the issue team will regularly coordinate regarding the economics of the transaction with APMA
- If the taxpayer asserts an IRC Section 482 setoff:
 - Issue additional IDRs for information, as necessary
 - Request a comparability and economic analysis that supports the potential setoff, as appropriate
 - Request the taxpayer’s support of the setoff. Generally, the taxpayer should be able to support the setoff in the same manner as the original controlled transaction under examination
 - Consider how a setoff will affect the examination plan, timeline, and ECD, if applicable

Helpful Reference:

APMA Program Contact Information
Rev. Proc. 2005-46 - setoff procedures

2. Penalties

Penalties should be considered whenever adjustments are made to a tax return. The determination whether to assert penalties, identify the appropriate penalties, and calculate the penalty amount accurately is primarily the issue team's responsibility and should take place throughout the examination process. Workpapers must support the analysis and conclusion. Issue teams should consult with LB&I Division Counsel and Associate Chief Counsel International (ACCI), as appropriate.

One potential penalty is the IRC 6662(e) penalty. Regulations require the IRS to apply penalties when the taxpayer fails to create or to timely provide IRC §6662(e) documentation or when the IRC §6662(e) documentation provided is unreasonable or inadequate, assuming the net adjustment penalty thresholds are met. IRC §6662(e) documentation does not automatically protect against penalties because the IRC §6662(e) documentation must be assessed for adequacy and reasonableness. To meet the reasonable cause exception of the penalty regulations, taxpayers must document they reasonably selected the best method for their analysis and they reasonably applied that best method. Factors to consider in evaluating the adequacy of a taxpayer's transfer pricing documentation are outlined in the regulations.

Other penalties may also apply. The Penalty Practice Network can provide assistance to issue teams in evaluating and applying penalties. As with all penalties, the manager's written approval is required before assertion of the penalty (ideally when the penalty is initially raised and, if not completed earlier, before the issuance of a 30-day letter or notice of deficiency). Documentation of that approval must be maintained in the case file.

Best Practice: The issue team should discuss the imposition of penalties at the same time as the primary adjustment. Do not wait until the end of the examination process.

Helpful References:

IRM 20.1.5.9 - IRC Section 6662(e) Substantial Valuation Misstatement
IRM Exhibit 20.1.5-3 - IRC Section 6662 penalty flowchart
IRM 4.46.4.10 - Penalty Consideration
Instructions for Examiners on Transfer Pricing Issue Examination Scope - Appropriate Application of IRC 6662(e) Penalties
Practice Unit on IRC 6662(e): Calculating the Net Adjustment Penalty for a Substantial Valuation Misstatement

3. Drafting Reports

The issue team continues to build the Economist Report and NOPA collaboratively, as a team, based on the functional analysis that was performed. The Economist Report should include:

- Executive Summary
- Factual Background and Functional Analysis of the Taxpayer and the Transaction(s) at Issue
- Summary of Taxpayer's Proposed Economic Analysis for the Transaction at Issue
- Critique Taxpayer's Methodology and Analysis for the Transaction at Issue
- IRS Determination of Arm's Length Allocation of Income/Pricing
- Summary and Conclusion

The issue team should utilize Transfer Pricing NOPA Best Practices. The NOPA should include:

- Adjustment Table
- Issue Statement
- Executive Summary of Issue
- Facts
- Law
- Taxpayer's Position
- Analysis – Government's Position
- Conclusion

Best Practices: The facts of the case should be agreed upon with the taxpayer whenever possible. Continuous open communication between the taxpayer and the issue team throughout the examination is critical. Consider whether an issue presentation meeting with the taxpayer would be beneficial at this point in the examination.

Coordinate with LB&I Division Counsel regarding the analysis presented in the reports.

Helpful References:

IRM 4.46.6 - Workpapers and Reports Resources

NOPA Preparation - Training Materials

Economist Report Template on the Economics Practice Networks SharePoint Website

4. Acknowledgement of Facts IDR

The issue team members are responsible for documenting all facts have been secured to ensure examiners reach correct conclusions. All relevant facts, including those from the taxpayer's response to the acknowledgement of facts (AOF) IDR or facts in the taxpayer's favor, should be considered before issuing a final NOPA and Economist Report. The facts of the case must be consistent in the Economist's Report, NOPA, and AOF IDR.

- Coordinate legal issues with LB&I Division Counsel, ACCI, TPP and the Practice Networks
- Ensure communication and collaboration with Case Managers and Territory Managers throughout the examination process
- Issue a statement of facts requesting taxpayer's acknowledgement following current procedures
- Resolve any factual differences and/or document factual disputes

Best Practice: An AOF IDR should be issued for **all** transfer pricing issues (whether potentially agreed or unagreed). The issue team should revise the Economist's Report and NOPA based on additional taxpayer input, as appropriate. An issue team review of the facts and findings is strongly encouraged. This review should include the issue team and applicable managers.

Helpful References:

IRM 4.46.4.9 - Written Acknowledgment of the Facts (AOF)

IRM Exhibit 4.46.4-3 - Pro-Forma IDR for Acknowledgment of Facts on Unagreed Issues

III. Resolution Phase

The goal of the resolution phase is to reach agreement, if possible, on the tax treatment of each issue examined and, if necessary, issue a Revenue Agent Report (RAR) to the taxpayer. Starting with the development of the issue and continuing through resolution, early and frequent discussions with the taxpayer are crucial for a complete understanding of the respective merits of an issue.

A. Issue Presentation and Resolution

The issue team should meet with the taxpayer to discuss results of all issues prior to finalizing the NOPA and the Economist Report. Focus taxpayer discussions on the following:

- Determine whether the taxpayer agrees with the facts as presented in the AOF IDR
- Evaluate the taxpayer's position
- Compute any offsetting/correlative adjustments, changes to foreign tax credit, net operating losses, etc.
- Engage in an open dialogue with the taxpayer to determine whether a principled resolution can be reached
- Understand the nature of disagreements (facts or interpretations of law, etc.)
- Issue additional IDRs to clarify any new information that may arise
- Utilize early resolution tools:
 - Early Referral to Appeals: For example, Fast Track is a mediated effort where the taxpayer, the issue team, and Appeals must agree to participate and agree to a mutual resolution
 - Accelerated Issue Resolution
- Include LB&I Division Counsel in drafting any closing agreement

Best Practice: The first point of contact for the taxpayer should be the issue teams and their respective managers when resolving issues.

Helpful Reference:

IRM 4.46.5.4 - Issue Resolution Tools

B. Case Closing/RAR

The issue team should follow case closing procedures appropriate to the situation. If the issue is agreed:

- Update IMS to include the input of an “Actual Completion Date” for all closed issues
- Consider Rev. Proc. 99-32 ramifications and elections
 - If penalties are proposed, the taxpayer is not entitled to Rev. Proc. 99-32 relief
 - Discuss the Rev. Proc. 99-32 options with the taxpayer
 - If Rev. Proc. 99-32 relief is requested and granted, secure a closing agreement with the assistance of LB&I Division Counsel. See also IRM 4.60.3 for Tax Treaty Related Matters
- Issue final Pattern Letter 1853(P) with the final amounts and countries of origin. This is notification to the taxpayer of potential double taxation
- Prepare the Mutual Agreement Procedure (MAP) report, if applicable. Coordinate and discuss with APMA
- 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 in future examinations and positions. Consult LB&I Division Counsel in drafting any closing agreement.

If field resolution is not reached, then the issue team will finalize the NOPA, Economist Report, and secure final approvals.

- Confirm whether 365 days remain on the statute for the taxpayer to request Appeals consideration
- A statement indicating the taxpayer's response to the AOF IDR must be included in the opening of the Facts section of the NOPA
- Prepare the RAR/30-Day Package and case closing workpapers
- Issue the RAR/30-Day Letter
- Prepare the MAP report, if applicable. Coordinate and discuss with APMA
- Taxpayer Protest/IRS Rebuttal
 - Review and discuss the taxpayer Protest among the issue team members

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- Determine the issue team members' roles and responsibilities in the preparation of the Rebuttal and address every point raised in the taxpayer's Protest
- Determine whether new facts have been raised and, if so, are additional IDRs warranted
- Collaborate to finalize the Rebuttal to the taxpayer's Protest

Best Practice: If the Protest contains new factual information, raises new factual disputes, or presents new economic or legal theories, then consider re-engaging the examination process. The issue team should re-evaluate the timeline and reset the milestone dates, as appropriate.

Helpful References:

IRM 4.60.3.1.19 - Simultaneous Appeals Competent Authority Procedure (SACAP)/Overview

Rev. Proc. 2015-40 - procedures for requesting CA assistance

IRM Exhibit 4.60.2-1 - Right to Request Competent Authority Consideration Letter 1853(P)

IRM Exhibit 4.60.2-3 - Double Taxation Issue Schedules 1853(P)/1915(P)

C. Appeals

As a best practice, the issue team will begin preparing the pre-Appeals presentation immediately after closing the case. Upon contact from Appeals that the case has been assigned, the issue team should:

- Request a pre-Appeals conference using Forms 3198 and 4665
- Contact the Appeals Officer and request examination's presence at the taxpayer's portion of the presentation
- Determine which LB&I team members should attend the pre-Appeals conference
- Determine the roles and responsibilities of the issue team members
- Hold mock presentations to prepare for the pre-conference meeting
- Hold the Appeals pre-conference meeting

Request a post-Appeals Conference and attend the meeting. The issue team should:

- Understand Appeals' rationale for the outcome
- Review and analyze the Appeals Case Memorandum (ACM)

- Consider the impact to the subsequent year(s) risk assessment

Helpful References:

IRM 4.46.5 - Resolving the Examination

IRM 4.46.5.11 - Conference with Appeals

NOPA Preparation - Training Materials

Rev. Proc. 2015-40 - procedures for requesting CA assistance

Rev. Proc. 2006-54 - procedures for requesting CA assistance for tax treaties

IRM 4.46.5.4 - Issue Resolution Tools

D. U.S. Competent Authority Request

The APMA Director is the delegated U.S. Competent Authority (CA) for cases arising under the business profits and associated enterprises articles of U.S. tax treaties (transfer pricing issues). APMA endeavors to resolve CA cases under the MAP agreement article of a U.S. tax treaty through consultations with the applicable foreign competent authority.

E. Competent Authority Request Concerning U.S.-Initiated Actions

Taxpayers are not required to wait until the conclusion of an examination to file a CA request for assistance with respect to CA issues. The taxpayer may request assistance immediately after the amount of the proposed adjustment is communicated to the taxpayer in writing, e.g., with a Form 5701, NOPA, or a Form 4549, Income Tax Examination Changes.

The taxpayer should contact CA directly to request assistance. If a request for assistance is accepted by APMA, it will assume jurisdiction over the transfer pricing issue(s) accepted. The protection of the statute of limitations continues to be the responsibility of the examination team if the case itself remains under the jurisdiction of examination.

1. Competent Authority Resolution

If the taxpayer accepts the terms of the tentative CA resolution, then APMA will close the case. APMA will provide the examination team with the results to be incorporated in the taxpayer's RAR and to the extent authorized under the applicable U.S. tax treaty,

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the CA resolution will be implemented notwithstanding any time limits or other procedural limitations under the Code and regulations. See Rev. Proc. 2015-40, Sec. 9.04.

If the taxpayer rejects the terms of the tentative CA resolution and either APMA or the foreign CA is unwilling to consult further, then APMA will formally close the case and return jurisdiction to examination.

2. Accelerated Competent Authority Procedure (ACAP)

A taxpayer may request that the terms of a CA resolution for a given taxable period be extended to cover subsequent taxable periods for which it has filed tax returns. See Rev. Proc. 2015-40, Sec. 4.01.

In appropriate cases, APMA may request that the taxpayer expand the scope of its CA request to include ACAP years.

3. Simultaneous Appeals Procedures (SAP)

SAP is an optional aspect of the CA process whereby Appeals works jointly with APMA and the taxpayer toward the development of APMA's position on an underlying U.S. initiated adjustment prior to APMA's consultations with the foreign CA. See Rev. Proc. 2015-40, Sec. 6.04(2)(a).

SAP review will be initiated only upon a taxpayer's request

Helpful Reference:

Rev. Proc. 2015-40 - procedures for requesting CA assistance

Rev. Proc. 2006-54 - procedures for requesting CA assistance for tax treaties

IV. Exhibits

A. Practice Units

Practice Units are reference and training tools for evaluating and developing potential issues encountered during the Planning, Execution, and Resolution phases of an examination. Practice Units are located on the “International Knowledge Base” site under the Tax Examination/Issues portion of the IRS Virtual Library on the Servicewide Knowledge Management (KM) SharePoint site.

Following are some examples of Practice Units that can be used to assist with the Planning Phase of a transfer pricing examination and are available on irs.gov:

- Arm’s Length Standard
- Overview of IRC Section 482
- Common Ownership or Control Under IRC 482 – Inbound
- Common Ownership or Control Under IRC 482 – Outbound
- Review of Transfer Pricing Documentation by Outbound Taxpayers
- Review of Transfer Pricing Documentation by Inbound Taxpayers
- Three Requirements of IRC 482
- Effectively Connected Income (ECI)

Following are some examples of Practice Units that can be used to assist with the Execution Phase of a transfer pricing examination and are available on irs.gov:

- Accounting for Intangibles and Services Associated with the Sale of Tangible Property Outbound
- Best Method Determination for an Inbound Distributor
- Calculating the Net Adjustment Penalty for a Substantial Valuation Misstatement
- Change in Participation in a Cost Sharing Arrangement (CSA) - Controlled Transfer of Interests and Capability Variation
- Comparability Analysis for Tangible Goods Transactions
- Comparison of the Arm’s Length Standard with Other Valuation Approaches - Outbound
- Conducting Functional Analysis for Foreign Base Company Income
- Cost Sharing Arrangements vs. Licensing Alternative
- CPM Simple Distributor Inbound

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- CPM Simple Distributor Outbound
- Distinguishing Between Sale, License and other Transfers of Intangibles to CFCs by US Transferors
- Dual Consolidated Losses Overview
- Foreign Shareholder Activities and Duplicative Services
- Foreign to Foreign Transactions 367(b) Overview
- High Value Services: Technical and Marketing Fees - Inbound
- Inbound Resale Price Method Routine Distributor
- Intercompany Interest Rates under the Situs Rule of IRC Section 482
- IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
- License of Foreign Owned Intangible Property by US Entity
- License of Intangible Property from U.S. Parent to a Foreign Subsidiary
- Management Fees
- Outbound Liquidation of US Corp to Foreign Parent IRC Section 376(e)(2) Overview
- Outbound Services by US Companies to CFCs
- Outbound Transfer of Foreign Stock
- Outbound Transfers of Property to Foreign Corporation - IRC Section 367 Overview
- Pricing of Platform Contribution Transaction (PCT) in Cost Sharing Arrangements (CSA) Initial Transaction
- Pricing of Platform Contribution Transaction (PCT) in Cost Sharing Arrangements (CSA) Acquisition of Subsequent IP
- Purchase of Tangible Goods from a Foreign Parent CUP Method
- Residual Profit Split Method - Inbound
- Revenue Procedure 99-32 Outbound Guidance

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- Residual Profit Split Method - Outbound
- Sale of Tangibles Goods from a CFC to a USP CUP Method
- Services Cost Method Inbound Services
- Using an IRC 6038(A) Summons when a U.S. Corporation is 25% Foreign Owned

Following are some examples of Practice Units that can be used to assist with the Resolution Phase of a transfer pricing examination and are available on irs.gov:

- Advance Pricing Agreements for Tangible Goods Transactions - Inbound
- Advance Pricing Agreements for Tangible Goods Transactions - Outbound
- Competent Authority Revenue Procedure 2015-40 Guidance; U.S.-initiated Adjustments
- Revenue Procedure 99-32 Inbound Guidance

The public can view these Practice Units on www.irs.gov and new units are continually added. There may be additional Practice Units relevant to the particular facts or circumstances of a transfer pricing examination that are not included in this Exhibit. Please consult the website for a complete current list of Practice Units.

B. Example of 24 Month Examination

This examination timeline should only be used as an example. Each case has its own unique characteristics. The examination plan’s timeline should be specific to the facts of each case.

TRANSFER PRICING EXAMINATION PROCESS						
PLANNING		EXECUTION			RESOLUTION	
Cycle Time in Months						
Prior to Opening Conference	1st to 2nd	3rd to 4th	5th to 6th	7th to 17th	18th to 20th	21st to 24th
Initial Transfer Pricing Risk Assessment						
Issue IRC Section 6662(e) IDR						
Internal Planning Meeting(s)						
Exam Plan/Timeline/Key Milestones						
	Opening Conference					
	Risk Assessment					
		Fact Finding/Info Gathering/Issue Development				
			Mid-Cycle Risk Assessment			
				Issue Presentation and Resolution		
				Case Closing/RAR		
				Appeals		
				U.S. CA Request		
<i>THE TIMELINE SHOULD BE USED ONLY AS A GUIDE AND MUST BE ADAPTED TO EACH CASE</i>						

C. Example of 36 Month Examination

This examination timeline should be only used as an example. Each case has its own unique characteristics. The examination plan's timeline should be specific to the facts of each case.

TRANSFER PRICING EXAMINATION PROCESS					
PLANNING					
		EXECUTION			
				RESOLUTION	
Cycle Time in Months					
Prior to Opening Conference	1st to 2nd	3rd to 4th	5th to 30th	30th to 31st	32nd to 36th
Initial Transfer Pricing Risk Assessment					
Issue IDR for IRC Section 6662(e)					
Internal Planning Meeting(s)					
Exam Plan/Time line/Key Milestones					
	Opening Conference				
	Risk Assessment				
		Fact Finding and Information Gathering/Issue Development			
		Mid-Cycle Risk Assessment			
				Issue Presentation and Resolution	
				Case Closing/RAR	
				Appeals	
				U.S. CA Request	
<i>THE TIMELINE SHOULD BE USED ONLY AS A GUIDE AND MUST BE ADAPTED TO EACH CASE</i>					