

AUDIT AND RISK

The outcome of an effective audit process is two fold:

- (i) Increased future compliance (which indirectly contributes to future tax revenue and protection of the tax base) and
- (ii) Increased current tax revenues (where cases are successfully audited).

The chapter has the following paragraphs

- 1. Organizations and Staffing of Transfer Pricing Audits:
 - Administrative Aspects
 - Staffing and Resourcing

2. Selection of Taxpayers for Transfer Pricing Examination – Risk Assessment

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The risk classification provided here as an example assists the risk profiler/assessor in the evaluation of each of the following in

Types of approach

- There`

Risk factors/risk flags: Certain “flags” can point to the need for further examination.

- They should not be treated as decisive in determining that non arm's length pricing has occurred, of course – at most they point to a higher than normal likelihood of such mis pricing.
- See Chapter 4 for additional indicators of risk; commonly agreed risk indicators include:
- **6. The Risk Assessment Process**

The basic steps of the risk assessment process can be described as follows:

- Initial review and identification of the possible risks;
- High level quantification of the possible risks;
- Gathering of other intelligence;
- Decision as to whether to proceed;
- More in depth risk review including high level review of documentation and functional analysis to confirm initial findings;
- More detailed quantification of possible risks;
- Initial interactions with taxpayer; and
- Decision as to whether to proceed to audit by way of specialist reviews or committee based/panel reviews.

Risk assessment findings

- It is important that the outcomes of a risk identification and assessment process be documented and signed off for governance and control purposes and preferably saved in a central repository (i.e. a database of cases assessed whether or not proceeding (including all workings)).

Planning for transfer pricing examination

- Formation of Examination Team
- Supervision of Examination
- Issues for Examination/Examination Plan
- Audit Timetable
- Information already in hand
- Information to be collected
- Statute of limitations as provided for in the domestic law
- Approvals and sign off

Preliminary Examination

- Desk Audit
- Understanding the Taxpayers' Business
- Understanding the industry in which the taxpayer operates
- Approval

Audit procedure

- Audit approach
- Notification to taxpayer

Gathering of information

- Sources

Narrowing of issues – development of tax authorities' position

- Refining understanding of the taxpayer's business
- Refining understanding of the taxpayer's industry
- Refining functions and risk analysis

Choice of transfer pricing method

- After refining the functional and risk analysis, the examination team will choose the transfer pricing method in the light of that analysis. See Chapter 6 on selection of appropriate methods.
- Examiners' interim opinion or economist's report
- Draft proposed adjustments
- Formal notification to taxpayer of proposed adjustment
- Issuance of Adjustment/Correction
- Settlement opportunities

Case closure

- The case closure needs to be properly documented, as every decision taken can potentially be subject to litigation. The table below provides a clear documentation process to ensure the information needed is recorded and to guarantee that the required process has been followed.
- Relationship between transfer pricing audits and APAs
- As an example, the following measures are taken, in Japan: