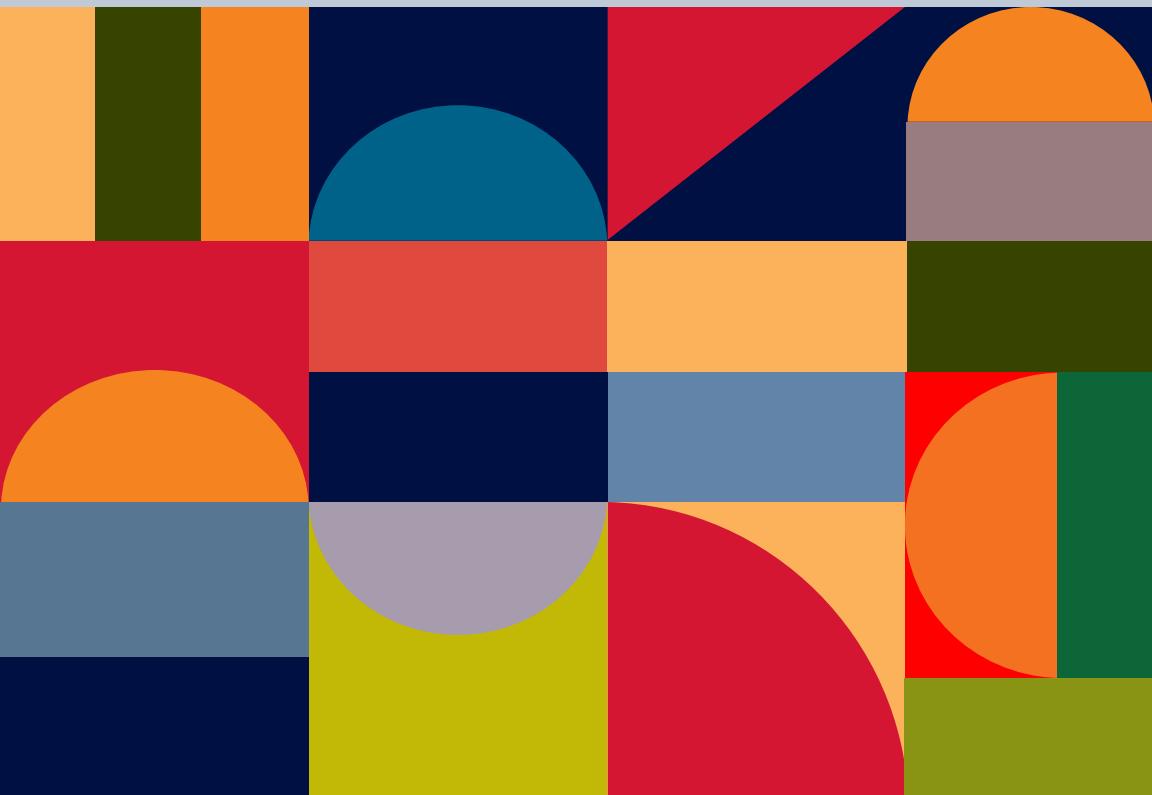


# United Nations Transfer Pricing Compliance Assurance— An End-to-End Toolkit



United Nations

# Transfer Pricing Compliance Assurance— An End-to-End Toolkit



United Nations  
New York, 2025

For further information, please contact:

United Nations  
Department of Economic and Social Affairs  
Financing for Sustainable Development Office  
New York, N.Y. 10017, USA

Website: <https://financing.desa.un.org/what-we-do/ECOSOC/tax-committee/tax-committee-home>

E-mail: [taxcommittee@un.org](mailto:taxcommittee@un.org)

# Background and Acknowledgements

## About the Committee

The United Nations Committee of Experts on International Cooperation in Tax Matters (the “Committee”) comprises twenty-five members appointed by the Secretary-General, after notifying the Economic and Social Council, to serve in their personal capacity for a four-year term. Selected for their expertise in tax policy and administration, the members reflect diverse geographical regions and tax systems. The Committee is globally recognized for its normative and policy-shaping work and for the practical guidance it provides in tax policy and administration.

## Committee Mission

The Committee develops tools and resources for governments, tax administrators, and taxpayers to help strengthen tax systems and mobilize financing for sustainable development, as well as strengthen international tax cooperation. The work aims to prevent double taxation and non-taxation while helping countries broaden their tax base, strengthen administration, and combat tax evasion and avoidance. The Committee places special emphasis on addressing the needs of least developed countries, small island developing States, and landlocked developing countries.

## Committee Working Methods

The Committee meets twice annually—in spring (New York) and fall (Geneva). Between these sessions, Subcommittees work on specific topics under the Committee’s oversight. These Subcommittees, whose participants also serve in their personal capacity, prepare proposals and draft guidance for review and approval by the Committee. This collaborative approach ensures thorough, multi-disciplinary and multi-stakeholder examination of complex tax issues, while maintaining the Committee’s ultimate responsibility for all published guidance.

## Transfer Pricing and the Sustainable Development Goals

At its Twenty-third Session in 2021, the Committee’s 2021–2025 membership decided to establish a Subcommittee on Transfer Pricing, with a mandate to consider, report on and propose guidance on transfer pricing issues that:

- Reflects Article 9 of the United Nations Model Convention and the arm’s length principle embodied in it, and is consistent with relevant commentaries of the Convention

- Identifies and considers transfer pricing topics where guidance from the Committees is most useful
- Reflects the realities and needs of developing countries at relevant stages of capacity development
- Gives due consideration to relevant work in other forums, such as the Inclusive Framework on Base Erosion and Profit Sharing (BEPS), including through broad consultation.

During its Twenty-fourth Session, the Committee approved the Subcommittee's ambitious workplan, consisting of guidance on the following topics:

- Transfer Pricing during the COVID-19 Economic Downturn
- Transfer Pricing Compliance Assurance — An End-to-End Toolkit
- Transfer Pricing of Carbon Offsets and Carbon Credits
- Transfer Pricing of Agricultural Products
- Transfer Pricing in the Pharmaceutical Industry
- Bilateral Advance Pricing Agreement/Arrangement Programmes— Frequently Asked Questions

This initiative served to develop guidance products to address priority challenges faced by developing countries in implementing effective transfer pricing regimes and make capacity development activities as practical, targeted and effective as possible. By strengthening their approach to transfer pricing, developing countries can reduce the risk of double taxation, thereby facilitating cross-border trade, fostering a more attractive investment climate, and increasing tax revenues. In turn, this can support greater domestic resource mobilization, enabling increased investment in achieving the Sustainable Development Goals (SDGs). The Subcommittee comprises a number of Committee members and other participants from tax administrations and policy-makers with wide and varied experiences related to transfer pricing, as well as people from academia, international and regional organizations, and the private sector.

## This Publication

This publication, “*Transfer Pricing Compliance Assurance- An End-to-End Toolkit*”, is part of a series of guidance products developed to strengthen transfer pricing capacities in developing countries. It provides guidance, examples and options tailored to the priorities and needs of developing country tax administrations as they establish their own end-to-end processes for compliance assurance for transfer pricing. This Toolkit, reviewed, refined, and approved by the Committee during its Twenty-fifth and Twenty-sixth Session in October 2022 and March 2023 provides countries with essential tools for improving transfer pricing compliance assurance.

## Acknowledgements

This publication has been the work of many authors. The Committee gratefully acknowledges the Subcommittee on Transfer Pricing, including the following participants contributing to this work:

Barbara Dooley (Ireland); Björn Heidecke (Deloitte, Germany); Claudia Pimentel (Brazil); David Rüll (Germany); El Hadramy Oubeid (Mauritania); Ingela Willfors (Co-coordinator); Jolanda Schenk (Shell, the Netherlands); José Troya González (Ecuador); Lorraine Eden (Texas A&M University, United States of America); Luis María Mendez (Argentina); Marcos Valadão (Getulio Vargas Foundation, Brazil); Mathew Gbonjubola (Co-coordinator); Matthew Andrew (Auckland University, New Zealand); Mauro Faggion (European Commission); Melinda Brown (Organisation for Economic Co-operation and Development); Michael Kobetsky (Australian National University, Australia); Monique Van Herksen (Simmons & Simmons, Netherlands); Nana Mensah Otoo (Ghana); Pande Oka Kusumawardani (Indonesia); Rajat Bansal (India); Raffaele Petruzzi (WU Transfer Pricing Center, Institute for Austrian and International Tax Law, Vienna University of Economics and Business, Austria); Rasmi Das (India); Ruchika Sharma (India); Stig Sollund (independent consultant, Norway); T. P. Ostwal (T. P. Ostwal & Associates, India); Trude Steinnes Sønvisen (Norway); Waziona Ligomeka (Malawi); Yan Xiong (China). The early involvement of Carlos Perez-Gomez Serrano (KPMG, Mexico) and Anthony Munanda (African Tax Administration Forum) is also recognized.

The Committee recognizes the essential support provided by the Secretariat team, particularly Caroline Lombardo, Michael Lennard, Ilka Ritter and Silva Yiu whose technical support and coordination were crucial to the development of this publication.

The Committee also extends appreciation to the Government of Austria and the Vienna University of Economics and Business for hosting two hybrid meetings of the Subcommittee and acknowledges the generous financial contributions from the Governments of Denmark, India, Norway, and Sweden as well as the European Commission to UN DESA's multi-donor project, which has strengthened support for the work of the UN Tax Committee, its Subcommittees and related capacity development activities aimed at advancing sustainable and inclusive development.

## Disclaimer

Information on uniform resource locators and links to websites contained in the present publication are provided for the convenience of the reader and are correct at the time of issuance. The United Nations takes no responsibility for the continued accuracy of that information or for the content of any external website.

# Contents

<b>Background and Acknowledgements .....</b>	<b>iii</b>
<b>1. Introduction.....</b>	<b>1</b>
1.1. Objectives .....	1
1.2. Purpose of Compliance Assurance Programmes by Tax Administrations.....	2
1.3. Introduction to the End-to-End Compliance Assurance Process .....	4
<b>2. An Overview of the End-to-End Transfer Pricing Compliance Assurance Process.....</b>	<b>7</b>
2.1. Objectives of a Transfer Pricing Compliance Assurance Programme .....	7
2.2. Developing a Transfer Pricing Compliance Assurance Programme..	8
2.3. Transfer Pricing Risk Assessments and Related Tools.....	9
2.4. Population and Individual Transfer Pricing Risk Assessments .....	10
2.5. Governance of Risk Assessment .....	12
2.6. Comprehensive Transfer Pricing Audits and Examinations .....	14
2.6.1. Risk assessments and audits .....	14
2.6.2. Audit case selection and allocation .....	14
2.6.3. Audit process.....	14
2.6.4. Post-audit processes.....	15
2.7. Validation and Continuous Improvement of the Transfer Pricing Compliance Assurance Programme.....	15
<b>3. A Road Map for a Transfer Pricing Risk Assessment .....</b>	<b>18</b>
3.1. Organizational Matters for a Transfer Pricing Compliance Programme .....	18
3.1.1. Centralized or decentralized approach to risk assessment .....	18
3.1.2. Global compared to industry-specific risk assessments.....	19
3.1.3. Taxpayer classification based on turnover .....	19
3.1.4. Transactional, jurisdiction and risk-based approaches .....	19
3.2. Sources of Information .....	19
3.2.1. Taxpayer's tax return .....	20
3.2.2. Transfer pricing documentation .....	20
3.2.3. Taxpayer's file and audit records of previous years.....	20

3.2.4. Information received through exchange of information .....	21
3.2.5. Taxpayer's financial statements, including notes to the financial statements .....	21
3.2.6. Questionnaires issued to selected taxpayers .....	21
3.2.7. Publicly available information on the taxpayer.....	21
3.2.8. Conclusion .....	23
3.3. Detailed Risk Assessment.....	23
3.3.1. Preliminary phase .....	23
3.3.2. Execution phase .....	31
3.3.3. Outcome phase .....	34
<b>4. A Road Map for a Transfer Pricing Audit .....</b>	<b>37</b>
4.1. Preliminary Phase .....	37
4.1.1. Setting up a transfer pricing audit team.....	37
4.1.2. Reviewing prior audit period work papers and risk assessment outcomes .....	37
4.1.3. Establishing a team, examination plan, timelines and key milestones .....	37
4.2. Execution Phase .....	38
4.2.1. Gathering information .....	38
4.2.2. Identifying and analysing economically relevant characteristics, including conducting a functional analysis to accurately delineate the transaction(s) .....	40
4.2.3. Reviewing intercompany agreement(s).....	41
4.2.4. Requesting to visit a site or facilities.....	41
4.2.5. Conducting interviews with managers/key staff.....	41
4.2.6. Determining the functional profile.....	43
4.2.7. Reviewing the transfer pricing methodology .....	43
4.2.8. Issue presentation and resolution .....	44
4.3. Audit Closing .....	44
4.4. Follow-up Phase.....	44

# 1. Introduction

This Toolkit provides tools and examples of good practices to support efficient and effective transfer pricing compliance assurance, with an emphasis on the priorities and needs of developing and capacity-constrained countries. As such, it is aimed primarily at the tax administrations of developing countries with transfer pricing rules in place. It also assumes that the country's corporate income tax system is primarily based on self-assessment, with audits and assessments carried out by the tax administration only in certain circumstances.

All tax administrations, but particularly those from developing countries, face resource and capacity constraints. These are often particularly acute in a specialized and relatively new area such as transfer pricing. This makes it especially important to target limited resources as efficiently and effectively as possible. Applying focused, risk-based approaches to compliance can help meet this goal.

The Toolkit discusses the development of an end-to-end transfer pricing compliance assurance programme, encompassing population-level and individual taxpayer risk assessments and comprehensive audits or examinations. It also discusses associated issues such as incorporating feedback loops to validate and foster continuous improvement. While the main focus is the practicalities of undertaking transfer pricing risk assessments and audits, the Toolkit puts these into the context of a holistic, end-to-end process, aiming to support systematic reviews of the tax environment. This helps to minimize potential gaps in both information and revenues, and to reinforce an overall goal of optimizing compliance and sound tax administration.

The Toolkit encourages greater alignment and exchanges of good practices in transfer pricing risk assessment and audits, towards reducing transfer pricing disputes that can be costly and time-consuming for all parties concerned.

This introductory section sets out the objectives of the Toolkit. It then discusses the purpose of transfer pricing compliance assurance programmes and concludes by providing an initial overview of these. Section 2 provides a more in-depth discussion of end-to-end transfer pricing compliance assurance, starting from the development of specific compliance objectives and tools, and concluding with an introduction to individual transfer pricing risk assessments and audits. Sections 3 and 4 offer detailed, practical road maps to guide transfer pricing risk assessments and audits.

## 1.1. Objectives

This Toolkit provides guidance, examples and options tailored to the priorities and needs of developing country tax administrations as they establish their own end-to-end processes for compliance assurance on transfer pricing.

Following a discussion of transfer pricing compliance assurance programmes overall, sections 3 and 4 offer road maps that detail processes for individual taxpayer transfer

pricing risk assessments and comprehensive transfer pricing audits or examinations. These road maps are intended to serve as tools that countries can use to develop their own processes, manuals or standard operating procedures, tailored to their specific priorities, needs and capacities. Sections 3 and 4 also include references to processes developed by a number of tax administrations around the world as well as recommendations and suggested approaches developed by international and regional organizations.

The specific processes or tools illustrated or referenced in this Toolkit may not be suitable in all cases. Country examples reflect the particularities of a given country, including, importantly, specific requirements for domestic transfer pricing, income tax, and administrative tax law and regulations. Overall, the Toolkit provides options, considerations and perhaps inspiration for countries to develop their own processes and tools tailored to their specific priorities, requirements and constraints.

There are many existing sources of guidance on transfer pricing risk assessments and audits.<sup>1</sup> For example, a discussion of transfer pricing risk assessment is included in the 2021 United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual) in chapters 13 and 14.<sup>2</sup> This Toolkit does not attempt to reinterpret these sources of guidance, but instead, may be helpful as a source book that brings together and points to other sources of guidance where appropriate. Reference is made to guidance and examples from a number of countries. Together, these resources can serve as a template to help countries develop and tailor their own transfer pricing compliance programmes and processes.

By describing good practices, this Toolkit may also encourage greater alignment of transfer pricing risk assessment and audit approaches around the world. This may, in turn, prevent and help to resolve disputes and double taxation.<sup>3</sup>

## 1.2. Purpose of Compliance Assurance Programmes by Tax Administrations

A tax administration can use transfer pricing compliance assurance programmes to help structure and guide transfer pricing compliance activities. Each country will have its own priorities and objectives in instituting such a programme, but in general, the overall aim is to optimize compliance. This would include preventing and reducing revenue leakage from abusive or incorrect transfer pricing arrangements, preventing and reducing costly and time-consuming transfer pricing disputes, and

1 See, for example: ATAF (African Tax Administration Forum) (2023). Suggested Approach to Tax Audit Preparation and Execution. Pretoria, South Africa: ATAF Secretariat Tax Programmes Directorate. CIAT (Inter-American Center of Tax Administrations) (2019). Cocktail of Measures for the Control of Harmful Transfer Pricing Manipulation, Focused in the Context of Low Income and Developing Countries. Panama City, Panama: Inter-American Center of Tax Administrations.

2 United Nations (2021). United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual). New York, NY: United Nations.

3 See also United Nations (2021). Handbook on Dispute Avoidance and Resolution. New York, NY: United Nations.

fostering a sound investment climate, all while maximizing the efficiency and effectiveness of scarce resources needed to manage the tax system.

In self-assessment tax systems, supporting voluntary compliance is essential as a tax administration is unlikely to have the resources to audit its way to compliance. While audits and compliance enforcement activities may always be required, ideally, these resource-intensive methods are only needed in a small minority of cases. Setting out the tax administration’s expectations of taxpayer behaviour and transfer pricing outcomes can help to encourage taxpayers that are willing to comply to do so voluntarily, without significant additional intervention by the tax administration. This approach needs to be backed by strong, credible enforcement activities, where appropriate, to act as the “stick” to complement the “carrot” of supported voluntary compliance.

Risk assessments and audits form the main components of the “detect, deter and address” part of the overall compliance assurance strategy. Effective risk assessment aims to detect risks to the revenue. Credible, visible compliance activities, both risk assessments and audits, may help to deter taxpayers from engaging in aggressive or opportunistic transfer pricing. Robust and thorough audits seek to address revenue leakage that may otherwise result from incorrect or abusive transfer pricing arrangements.

Risk assessment also supports the most effective and efficient use of scarce audit and examination resources, including in tackling areas of the highest or most consequential risks. The level or consequence of risks can be measured in various ways. For example, risks may be large but “one-off”, or they may involve smaller amounts but be commonly encountered. A risk may also be considered highly consequential if it is emerging and trending upwards or involves a relatively small number of taxpayers but is likely to expand if left “untreated”. The nature of the risk impacts how it should be addressed.

Efficient and effective deployment of transfer pricing compliance resources is essential for all tax administrations. It may be particularly critical in ensuring effective law enforcement in resource-constrained developing countries with limited transfer pricing capacity. Transfer pricing audits or examinations are, by nature, highly fact-intensive. They will often require considerable resources, not only in the audit phase but also in resolving disputes and double taxation arising as a result of an audit adjustment.

Appropriate use of compliance resources can help to build the credibility of the tax administration in the eyes of the taxpayer community. This may be especially important at or near the start of transfer pricing journeys when the need to cultivate credibility is greatest. In this respect, case selection for audits and, even more importantly, for pursuit via judicial processes can be critical, since these cases will have the greatest visibility. For initial compliance enforcement, there is an argument for selecting “low-hanging fruit” or cases where the tax administration is confident of success, even where such cases may not represent the largest amount of revenue at stake.<sup>4</sup> In all situations, focused use

---

<sup>4</sup> See also the description of a “transactional approach” to selecting cases for risk assessment in the UN TP Manual, section 13.2.3.3 et seq.

of compliance resources can benefit from considering the balance between costs and benefits and the intersections between risk magnitude and likelihood.

Even for more experienced tax administrations, ensuring that transfer pricing audits are well-chosen and adequately resourced can significantly amplify their compliance effect. In other words, if compliance resources are not well focused or are inadequate, and audit adjustments are ultimately dropped or fail in court, the credibility of the tax administration to effectively enforce transfer pricing laws may be reduced. This could undercut the effectiveness of the compliance programme in deterring abusive or aggressive transfer pricing arrangements and encouraging voluntary compliance.

It may also be beneficial for the tax administration to develop additional self-assessment tools for taxpayers to minimize the need for compliance activities targeting taxpayers willing and able to comply without additional intervention. These tools are more commonly used by tax administrations with longer experience in transfer pricing and with long-running transfer pricing activities. However, they could be usefully deployed by less experienced administrations as well.

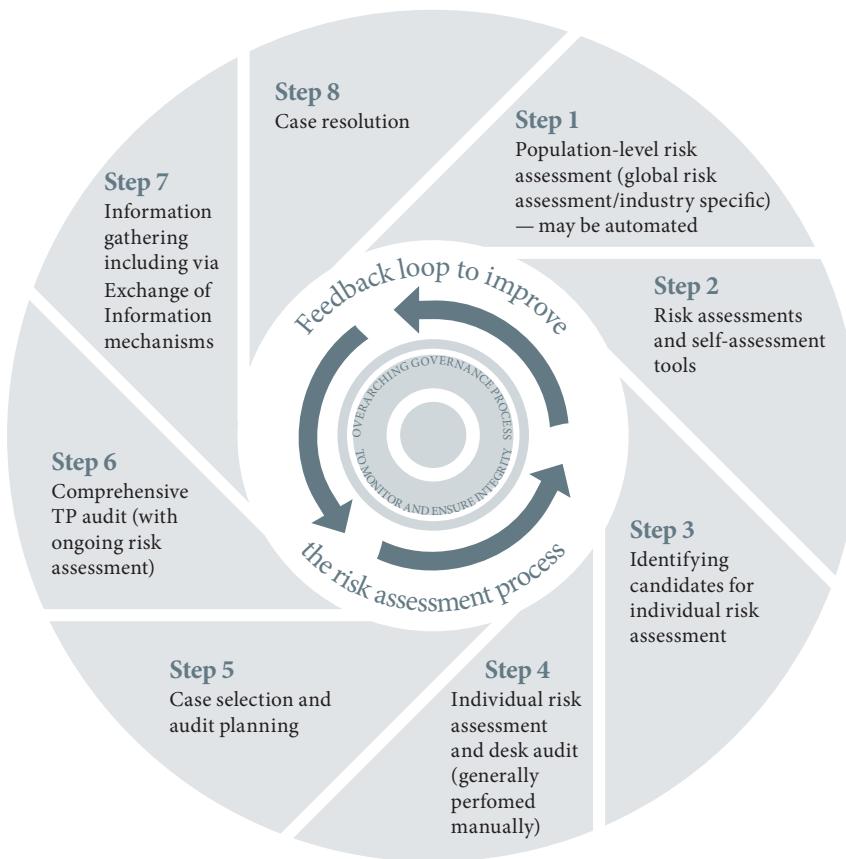
While greater transparency by tax administrations can support voluntary compliance, a balance needs to be struck to ensure that information provided cannot be used by less scrupulous taxpayers to create tax planning opportunities. This balance will vary depending on several factors. These include the credibility of the tax administration in appropriately detecting and addressing transfer mispricing and other base erosion and profit shifting behaviours, and, related to this, the level of trust between taxpayers and the tax administration.

### 1.3. Introduction to the End-to-End Compliance Assurance Process

An effective end-to-end transfer pricing compliance assurance programme includes a range of elements as illustrated in figure 1. These range from high-level risk assessment to a “longer list” case selection refined to a shortlist for individual risk assessment. From here, the short list is further considered and refined to produce priorities for more comprehensive transfer pricing audits or examinations. A transfer pricing compliance programme may also include self-assessment tools or other forms of guidance for taxpayers designed to encourage and facilitate voluntary compliance. The final element of an effective compliance programme entails measures to guide continuous improvement, including a feedback loop to verify and improve responses to risk flags following further investigation. Section 2 discusses these elements in more detail.

In terms of interrelationships among various parts of the programme, risk assessment is a key element of efficient, modern tax administration. It helps target audits appropriately to optimize compliance. Without risk assessment, audits will often be arbitrary or indiscriminate and are far more likely to waste resources. They may even have counterproductive effects on tax morale, if, for instance, careful taxpayers who take a conservative approach face audits at a similar rate as those who are far more aggressive or unscrupulous.

Figure 1: Transfer Pricing End-to-end Compliance Assurance Process



This Toolkit assumes the existence of sufficient and sound legislation and related rules requiring transfer pricing documentation, including country-by-country reporting. Such requirements are key to unlocking the benefits of risk assessment by allowing the tax administration to access much of the information necessary for assessments to be effective. While a discussion of legislation requiring transfer pricing documentation is beyond the scope of this Toolkit, guidance on these matters is available elsewhere, including in the UN TP Manual.

At the outset, a tax administration should consider the strategy and specific objectives of its transfer pricing compliance assurance programme as this may affect the mix of elements to be included or prioritized. For instance, an administration at or near the start of its transfer pricing journey may wish to include more taxpayer education elements, complemented by highly targeted audits. Alternatively, transfer pricing audits may be conducted as part of broader tax audits, where transfer pricing

has been identified as a particular risk. The targeting of such audits or the inclusion of transfer pricing as an issue of concern in a general audit should be guided by effective risk assessment, which in itself should be informed by factors such as the nature of the local economy as well as broader policy goals and objectives. For instance, if a country has a significant and high-profile mining industry, and transfer pricing is identified as a risk there due to significant cross-border investment, it may be appropriate for a compliance programme to focus on risks within that industry. This would signal the importance of transfer pricing compliance to taxpayers in all industries.

While this Toolkit separates a discussion of risk assessment from audits or examinations, the point at which an audit officially commences will vary according to the laws and practices of each country. At the same time, risk assessments or a risk assessment mindset may continue even once an audit has officially commenced. If the tax administration finds that the identified risk can be adequately explained or that the case will likely require resources that are disproportionate to the size of the unexplained risk, then the best use of resources would be to close the case and record learning from the experience to improve the case selection process going forward. Pursuing a case solely because resources have already been invested in it may not be a good approach. Given limited resources, doing so may mean other potential risks go unaddressed.

## 2. An Overview of the End-to-End Transfer Pricing Compliance Assurance Process

This section will provide definitions of key terms and concepts. It will describe the general content and purpose of a risk assessment and an audit process. In addition, it will provide an overview of risk assessment tools, including published tools to encourage voluntary compliance (e.g., “traffic lights” for taxpayers to self-assess or estimate their risk of transfer pricing compliance actions).

### 2.1. Objectives of a Transfer Pricing Compliance Assurance Programme

Transfer pricing compliance assurance programmes can have a range of objectives or priorities. Generally, they strive to optimize compliance by encouraging voluntary compliance; identifying risks; and deploying compliance resources in a focused and efficient way to address and, where necessary, enforce compliance with the law.

The risk of profit-shifting via transfer pricing is ever-present and may come in a variety of forms, including inadvertent errors in pricing; aggressive, calculated tax planning and avoidance; and deliberate fraud and evasion. Different parts of the compliance programme can address these forms with differentiated treatment options. For instance, the programme may include an advisory component and self-assessment tools to assist taxpayers who are willing to comply, providing compliance assurance with a “light touch”. At the same time, robust risk assessment processes should help detect remaining material transfer pricing risks, which can then be addressed through follow-up compliance activity. In some cases, the risk assessment itself can be a useful tool, serving as a warning to taxpayers and discouraging overly aggressive arrangements. In more serious or significant cases, a comprehensive transfer pricing audit or examination to enforce compliance will be necessary.

While it is beyond the scope of this Toolkit to thoroughly discuss penalties associated with transfer pricing adjustments, the level of penalty applied can be a useful complementary tool in steering taxpayer behaviour.

The specific objectives of a transfer pricing compliance assurance programme are likely to vary by country and over time. For instance, a programme may have a particular focus on certain types of transactions identified as risky or as an emerging risk to be nipped in the bud. These risks are likely to be dynamic and may change over time, including in response to the success of the compliance programme itself or to changes in the tax environment. A tax administration may also prioritize certain industries, counterparty jurisdictions or transaction types, based on a combination of the likely risk to the revenue as well as available capacity and resources.

Changes in tax laws, both domestically and in other jurisdictions, may prompt particular areas of focus in a programme. For instance, the introduction of special tax regimes or changes in the treatment of interest deductions may result in greater anticipated pressure on certain types of related party transactions. Changes in other aspects of the trade or regulatory environment may have similar flow-on effects for tax.

Changes in industry conditions, including general industry performance and level of competition, may also be relevant, both in terms of setting overall compliance assurance objectives and, perhaps even more importantly, in evaluating and interpreting population and individual level risk flags.

All these factors mean that in order to establish suitable objectives and targets for a transfer pricing compliance programme, it will be important to ensure adequate monitoring and intelligence gathering to detect and predict significant or emerging risks.

## 2.2. Developing a Transfer Pricing Compliance Assurance Programme

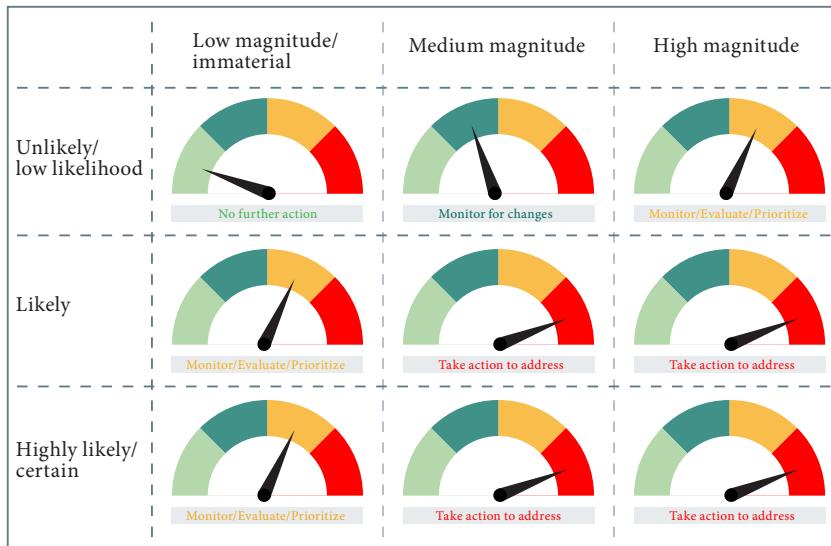
In addition to the qualitative aspects discussed above, trends or anomalies in data may also be useful for identifying compliance risk priorities. For instance, if a revenue trend involving disclosed income or certain types of payments suddenly changes course or shows a trend that cannot be readily explained, this may indicate that further investigation is warranted. Ongoing monitoring of available data will help to identify such trends and anomalies. Importantly, data available to the tax administration to carry out such monitoring will not be limited to trends in corporate income tax. Other sources of intelligence may include data on withholding taxes, data on commodity price trends, information on imports and exports from customs and other kinds of indirect taxes, and information from other government regulatory bodies, such as those that monitor foreign exchange transactions, etc.

Once a tax administration has identified the kinds of transactions, behaviours or outcomes it wishes to focus on, it will need to analyse how best to detect them from available data. In addition to data from tax returns and other sources noted above, more granular and transfer pricing specific data may often be found in associated and complementary data from filed schedules or information returns and country-by-country reports. Analysts will need to consider how transactions or behaviours are likely to manifest in available data. For example, if transactions with certain jurisdictions (e.g., those with low tax rates, creating a significant tax rate differential) are targeted, country-by-country reports may provide useful information on the MNE group's presence in those jurisdictions.

This kind of high-level risk assessment, based largely or solely on quantitative information, can often be automated, particularly once initial focus areas and risk flags have been identified. Where available, data mining and machine learning tools can analyse available data and may be effectively deployed to spot emerging trends, outliers and anomalies.

The next step will generally be to refine the long list of potential targets through manual analysis. In prioritizing potential risks for further action, the magnitude as well as the likelihood of the risk(s) may need to be considered (see box 1). Other relevant factors may include whether the potential risk is likely to expand or have knock-on effects if not addressed promptly, and the visibility of the risk or taxpayers involved. This can be particularly important to maintaining taxpayer morale. In some cases, other overall priorities identified by the administration, including those based on available capacity and resources, may also be relevant.

Box 1: Risk Magnitude/Likelihood Matrix



### 2.3. Transfer Pricing Risk Assessments and Related Tools

It may be appropriate to keep certain risk flags or specific indicators of risk confidential in order to prevent taxpayers from masking such indicators to evade detection. In some cases, however, tax administrations may consider publishing information about their compliance priorities or some risk flags, particularly the types of arrangements, behaviours or outcomes that they consider to be problematic. This can provide guidance for those taxpayers seeking to comply, putting them on notice that such arrangements, behaviours or outcomes are likely to attract the attention of the tax administration. They may then either choose to avoid these or, at a minimum, take particular care with documentation. Such information can serve as or complement taxpayer information or educational material.

In some cases, tax administrations may choose to provide this kind of information in detail in the form of an administrative safe harbour. In other cases, they may offer a self-assessment tool for taxpayers to use. For example, some administrations publish compliance guidelines that elaborate a range of results that the tax administration

regards as low, medium and high risk for a particular type of activity or transaction.<sup>5</sup> In such cases, the guidelines need to carefully specify applicable scoping criteria. The ranges should be calibrated with care. A low-risk range that is too generous is likely to become irrelevant; too far in the other direction and it may not, in fact, represent a low-risk outcome. Graded or “traffic light” approaches using multiple ranges (green for a low-risk zone; amber for a moderate-risk zone; and red for a high-risk zone) allow greater nuance than a single range or point.

Some jurisdictions may apply safe harbours for certain types of transactions to simplify and reduce compliance and administrative burdens. Where such safe harbours exist, in law or regulation, or in the form of administrative guidance, they should inform the risk assessment process. Where transactions fall within a transfer pricing safe harbour, they should be excluded from further compliance action in relation to transfer pricing.

## 2.4. Population and Individual Transfer Pricing Risk Assessments

A number of processes can guide the selection of cases for individual transfer pricing risk assessments. For instance, the UN TP Manual describes three options: a transactional approach that focuses on particular transaction types (perhaps “easier” transactions or higher risk or higher-revenue transactions); a jurisdictional approach that directs compliance resources based on the identity of the counterparty jurisdiction; or a risk-based approach that may combine elements of both.<sup>6</sup> This Toolkit focuses on the risk-based approach. Transactional and jurisdictional approaches, however, can also be accommodated within the framework described here by simply identifying particular transaction types or jurisdictions as risk flags.

Tax administrations may find it useful to apply an iterative approach to risk-based case selection, whereby initially, population-level filters or risk flags are applied to determine a ‘long-list’ of possible risks or case candidates. This is then further refined (possibly more than once) to a ‘short-list’ of possible risks or case candidates. A combination of processes may also be used. For instance, if a risk-based long-list results in a significant number of potential cases involving a particular jurisdiction, it may make sense to conduct an additional process based on a jurisdictional approach to determine a short-list of potential cases to address in a specific project. Taking a project approach allows greater efficiency since an understanding of relevant features of other jurisdictions could be applied across a number of similar cases.

Risk flags can be identified through population or industry-level data monitoring, intelligence from compliance field officers or other spontaneous sources and/or a random selection. In many cases, a combination of factors may be used to determine a longer list of taxpayers for individual risk assessment.

---

<sup>5</sup> Where specific results are provided in such guidance, tax administrations need to consider the extent to which such results will become de facto safe harbours.

<sup>6</sup> See the UN TP Manual, chapter 13, from section 13.2.3.3 et seq.

Potential cases identified through risk flags in automated or centralized data monitoring may first undergo an initial screening process. In some cases, such additional screening, particularly if conducted by an analyst with a sound understanding of the industry in which the taxpayer operates, may be able to account for risk flags and provide assurance that the risk of inappropriate transfer pricing is low. The case may then be subject to a monitoring brief (i.e., for further analysis and checking next year or as a lower priority for examination) or it may be dismissed altogether and returned to the general population pool with no special focus.

Potential cases identified through a receipt of intelligence, including through exchange of information, may benefit from some level of additional screening but will often warrant further examination through an individual risk assessment.

In some tax administrations, processes include adding cases to the ‘long list’ based on random selection. Such inclusions can be useful as an integrity measure, and to help verify and validate identified risk flags and avoid missing significant risks.

Risk assessments at a population or industry/segment level can be used to effectively target more detailed and in-depth individual risk assessments. The first stage of such an assessment will typically use only data already available to the tax administration analyst, such as tax returns and associated information, transfer pricing documentation (where routinely filed) and the country-by-country report where available, together with publicly available information on the taxpayer and its industry.

An individual risk assessment, done manually by an analyst with a sound knowledge of transfer pricing principles, focuses on whether identified risks can be adequately explained by known commercial or non-tax factors. For example, a risk flag thrown up by a reduction in profitability may be (partially) explained by a known commercial event, such as a downturn in the industry. Risk flags may have been thrown up by an error in the data set. If such errors are discovered, the risk flag may be dismissed at this point.

The risk analyst should focus on the risk hypothesis posed by the risk flag and test this against other information known about the taxpayer (e.g., the level of related and unrelated party sales, related and unrelated party sales prices/discounts, gross margins, etc.). Risk flags may be raised based on certain types of transactions, financial ratios, or mismatches or misalignments in information from different sources. In some cases, it may be possible to dismiss certain risk flags based on publicly available information and closer examination of information already in the hands of the tax administration.

Up to this point, the tax administration may not have had any direct contact with the taxpayer and may not have notified the taxpayer. If risk flags cannot be discounted, based on information already available to the tax administration, a decision will need to be made on whether the risk justifies further analysis and if compliance activities should be undertaken. Once again, the magnitude or likelihood matrix may be useful as well as risk-scoring models that combine various risks and compare the relative risk to the revenue from various potential cases, along with likely resource costs involved in pursuing the case.

If further analysis is indeed warranted, the next step may be to undertake a more rigorous individual risk assessment, sometimes called a desk audit. This may include seeking specific information from the taxpayer. Where transfer pricing documentation (e.g., a master file and local file) is not required to be filed annually but is instead made available on request, the analyst will generally seek and consider it. The analyst would examine qualitative information in the transfer pricing documentation package and create a draft summary functional analysis. This could then be compared to expected arm's length outcomes for similar activities, perhaps based on industry averages. At this stage, this cannot be described as a comparability analysis as industry averages may not indeed be truly comparable. Such approximate results, however, may give sufficient indication of the level of risk.

In considering the level of risk posed by the transactions or arrangement concerned, the analyst may also find it useful to consider the taxpayer's apparent appetite for risk more broadly, based on other information, such as their history with the tax administration (including as it may relate to other taxes) and regulatory bodies. Other indicators of taxpayer behaviour and their willingness to comply may also be relevant. For example, a taxpayer who is found to have no or grossly inadequate transfer pricing documentation is likely to pose a greater risk than one who diligently analyses and records its transfer pricing processes.

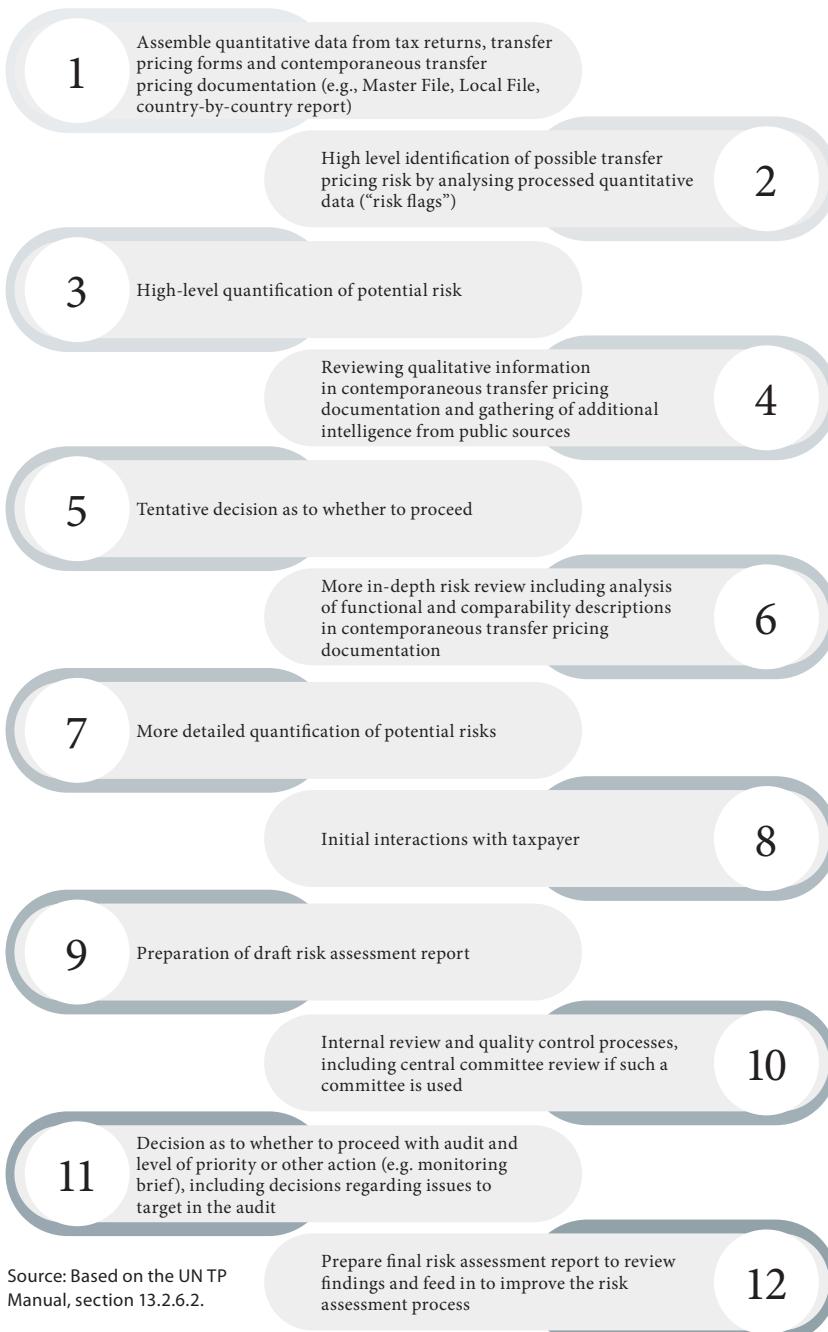
## 2.5. Governance of Risk Assessment

Throughout the risk assessment process, adequate governance mechanisms should be in place to uphold quality control, consistency and the integrity of the process. In many administrations, an important component of governance entails case reviews undertaken at various milestones (and in some cases randomly). For instance, at the end of the individual risk assessment process, a central committee review may be conducted to confirm the recommendations of the analyst regarding the outcome and status of the case (e.g., high, medium or low priority; audit or monitoring brief or no further action). Since prioritization will necessarily require comparing risks and thus potential cases for audits across the administration, a primary objective of such a centralized process is to guide the appropriate calibration of risk outcomes and resource allocation.

At the end of the formal risk assessment phase, it may be helpful to produce a brief report on the process to help improve it moving forward. This is particularly important where the outcome is a monitoring brief, as this implies that the case should be re-examined in the following period. The same applies to cases where no further action is to be taken, as this indicates that the initial quantitative risk flags threw up a false positive and may benefit from additional consideration or calibration.

The efficacy and effectiveness of risk assessment processes should be reviewed periodically to consider where improvements could be made so they remain appropriate.

Box 2: Summary of Transfer Pricing Risk Assessment Processes



Source: Based on the UN TP Manual, section 13.2.6.2.

## 2.6. Comprehensive Transfer Pricing Audits and Examinations

### 2.6.1. *Risk assessments and audits*

The line between a risk assessment and an audit or examination varies. In some cases, the distinction can be important in terms of process. Once an audit commences, there may be specific requirements around timing, both for intermediate steps and the final conclusion, as well as expectations or requirements around taxpayer cooperation, etc. While the distinction between a formal risk assessment and an audit can be important, a risk assessment mindset should continue even once an audit or examination is opened to ensure continued efficiency in using compliance resources. If it is determined that the identified risk can be adequately explained or there is little likelihood of supporting a material adjustment, then the audit should be closed without delay so that compliance resources can be redeployed more effectively.

### 2.6.2. *Audit case selection and allocation*

The risk assessment process described earlier aims to produce a prioritized list of audit candidates. Once these have been confirmed through a review process, the cases can be allocated according to priority and available resources. How cases are prioritized and allocated will vary depending on resources available. For example, in many countries, an industry approach has proven useful, allowing audit teams to gain experience and expertise in a specific industry. This can be critical to successful and efficient transfer pricing analyses. As noted above, transfer pricing audits are fact-intensive. For processes to be robust and credible, audit teams need to be sufficiently well-resourced and have access to necessary expertise. This may mean that resource-constrained administrations prioritize conducting fewer transfer pricing audits well over a greater number of audits done superficially.

### 2.6.3. *Audit process*

It can be a good practice for the audit team to establish an audit plan specifying the audit hypothesis. It can then work towards gathering evidence to support (or reject) that hypothesis. Keeping a focus on the requirements of evidence is a good practice that may be useful even in cases that will not ultimately involve a judicial process. This may impact how information is requested from the taxpayer as well as the type and rigour of the information gathering and recording process. For instance, it can be useful to confirm a summary of the facts upon which the functional analysis is based with the taxpayer so that the facts themselves are not in dispute, even if the taxpayer has a different interpretation of the facts and their impact on the appropriate transfer pricing.

A robust and thorough functional analysis will generally benefit from on-site interviews with key personnel and an inspection of the taxpayer's premises, where this is feasible. Based on the functional analysis and consideration of other economically relevant characteristics, the process of accurately delineating the transaction(s), determining the most appropriate method and conducting a comparability analysis may involve a certain amount of iteration. This can entail testing a particular

hypothesis against the available information in order to arrive at the most appropriate and reliable arm's length outcome. As discussed in the Toolkit on Addressing Difficulties in Accessing Comparable Data of the Platform for Collaboration on Tax,<sup>7</sup> while perfect comparables are generally elusive, the most critical aspect of a transfer pricing analysis is often ensuring an accurate delineation of the tested transaction(s). This is what determines the most appropriate method and forms the foundation for the search for comparables.

As with the risk assessment part of the compliance assurance process, it is important to ensure robust governance mechanisms are in place to support the audit function. In many countries, this may be achieved by having a central review process at particular milestones during the audit, for example, prior to the finalization of an interim or final position paper. A review process should aim to ensure consistency and provide quality assurance, and act as an integrity mechanism overseeing the audit function.

#### *2.6.4. Post-audit processes*

The final stage of the audit will involve reporting on outcomes and considering learning and recommendations to improve compliance assurance. Findings can be very useful in calibrating and verifying the risk assessment process and directing areas of focus for the compliance assurance programme more broadly.

Information about the nature of the industry and commercial practices can also be useful intelligence for future audit teams. This should be recorded and accessible within the tax administration. Taxpayer confidentiality is likely to be relevant here, so a redacted or anonymized report that can be more widely shared within the tax administration may be useful, perhaps combined with more sensitive information in files shared only with officials on a need-to-know basis. Box 3 summarizes the transfer pricing audit and examination process.

## **2.7. Validation and Continuous Improvement of the Transfer Pricing Compliance Assurance Programme**

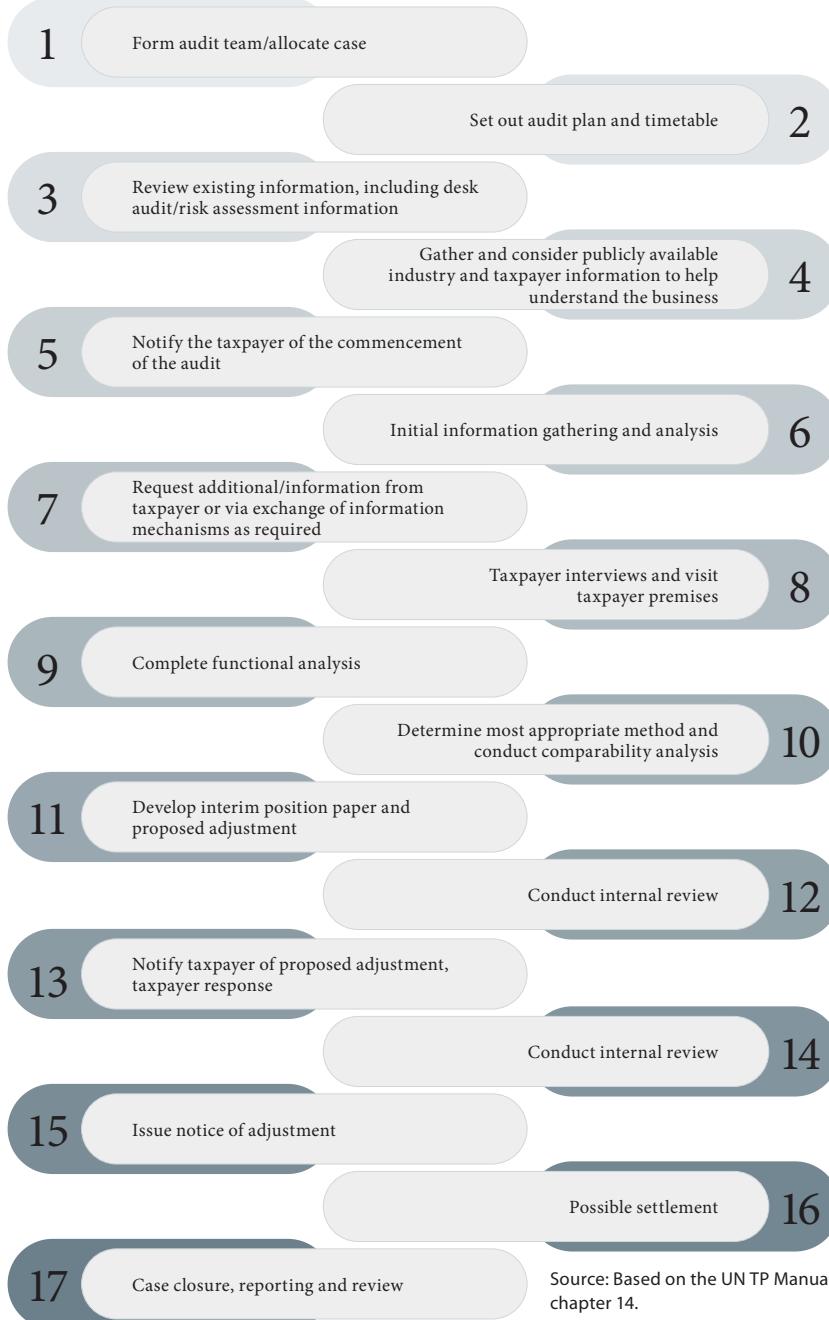
An important final step in the development of a transfer pricing compliance assurance programme is to establish an appropriate and adequate feedback loop to continuously validate and improve the programme. Information and intelligence gathered through the risk assessment and audit phases may be useful in both identifying newly emerging potential risks or trends and explaining factors erroneously identified as risk flags in the past.

Learning from risk assessments and audits should also feed into processes for conducting examinations, as well as associated objections, appeals and settlement resolution processes. In some cases, learning from audit and examination processes may even prompt legislative, regulatory or administrative reforms. These may seek to

---

<sup>7</sup> Platform for Collaboration on Tax (2017). Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses.

### Box 3: Summary of Transfer Pricing Audit/Examination Processes



Source: Based on the UN TP Manual, chapter 14.

close loopholes strengthen administrative procedures, institute more robust procedures or provide more helpful guidance to taxpayers. Feedback mechanisms from audit teams to other parts of the tax administration and the government responsible for tax policy are important.

Learning from transfer pricing audit or examination cases may also be useful in capacity-building. This is particularly true of industry and commercial knowledge that may be gained by officials conducting the transfer pricing audit. As noted, many tax administrations find it useful to take an industry or topic specialization approach to help build experience and expertise in key sectors or types of transactions or arrangements. To retain this institutional knowledge, tax administrations can develop formal case learning processes whereby, at the close of a case, the officers involved record or present key findings to a broader audience. This helps to disseminate information about the industry or transaction type that other officers can use in the future.

# 3. A Road Map for a Transfer Pricing Risk Assessment

This section offers a guide to good practices and processes in planning, executing, and resolving transfer pricing risk assessments.

## 3.1. Organizational Matters for a Transfer Pricing Compliance Programme

Tax administrations organize themselves in different ways to conduct risk assessments. An effective transfer pricing compliance programme should be developed around a three-stage approach:

- **Stage I:** definition of the risk assessment strategic plan
- **Stage II:** consolidation of risk assessment criteria and selection of a preliminary list of taxpayers to undergo a risk assessment
- **Stage III:** individual analysis of taxpayers

In developing the risk assessment strategic plan, a number of alternatives should be evaluated as outlined below.

### *3.1.1. Centralized or decentralized approach to risk assessment*

The first issue to consider in designing the programme is whether to take a centralized or decentralized approach to risk assessment.

In a centralized approach, the risk assessment is conducted centrally by a specialist risk assessment team incorporating input from the compliance function or locally by tax inspectors. This allows the application of consistent standards, and helps the risk assessment team to develop experience and judgment. It assures that specialist auditors, trained in risk assessment, will consider the risk to the tax administration in various transfer pricing contexts.

In a decentralized approach, transfer pricing audit teams conduct risk assessments. This may facilitate interaction with the taxpayer and, especially when a jurisdiction has a large population of taxpayers to assess, could allow more comprehensive coverage.

A middle course of action could be engaging local auditors to gather information for the risk assessment and provide an initial evaluation of that information. This evaluation could then go to a central board to revise the assessment and sign off on any decision to go forward with either a more in-depth risk analysis or a targeted audit of certain issues.

General advantages and disadvantages of a centralized or decentralized model for establishing transfer pricing capability are further analysed in section 11.5.2 of the UN TP Manual.<sup>8</sup>

### 3.1.2. *Global compared to industry-specific risk assessments*

A choice in designing a programme of transfer pricing compliance is whether the risk assessment should cover the global population of taxpayers or focus on a specific sector, either due to its importance for the national economy or particular base erosion and profit shifting risks.

### 3.1.3. *Taxpayer classification based on turnover*

Tax administrations may classify taxpayers based on their turnover as large, medium and small taxpayers, and decide whether one of these categories requires more monitoring activity. Typically, large taxpayers are more likely to be involved in a higher volume of cross-border activities and, given the potential for higher corporate income taxes, could be candidates for stricter risk assessment.

### 3.1.4. *Transactional, jurisdiction and risk-based approaches*

As explained in section 13.2.3 of the UN TP Manual, three different approaches to consider in developing a transfer pricing risk assessment programme include:

- The transactional approach: The focus of the risk assessment is on specific types of transactions (e.g., those with higher risks such as business restructurings, mergers, acquisitions and exits).
- The jurisdictional approach: Priority is given to the risk assessment of transactions with related entities located in specified tax jurisdictions (e.g., with very low tax rates or with aggressive corporate income tax or transfer pricing rules).
- The risk-based approach: This is, in essence, a hybrid of the transactional and jurisdictional approaches. It could consider factors other than the jurisdiction of the related party or parties and the types of transactions. Such factors potentially include the tax compliance status of the local entity, the MNE to which the entity belongs, companies with excessive and/or continued losses despite profits at the consolidated group level, etc.

## 3.2. Sources of Information

An effective transfer pricing risk assessment requires knowing the taxpayer, its global business and its industry. Therefore, the first challenge of the risk assessment is finding the right information to evaluate transfer pricing risk. Care may be needed in using information obtained by the tax administration but not originally collected for audit purposes, in order to avoid contravening relevant data protections or exchange of information conditions, etc.

---

<sup>8</sup> Where specific results are provided in such guidance, tax administrations need to consider the extent to which such results will become *de facto* safe harbours.

Potential sources of information that may be investigated during the risk assessment phase can be found below.

### *3.2.1. Taxpayer's tax return*

The starting point for any risk assessment process is a review of tax returns. Many tax administrations require taxpayers that carry out intercompany transactions to supplement tax returns with forms or other reports that disclose additional information relevant to transfer pricing arrangements. For example, there may be a specific transfer pricing return or an additional schedule that needs to be filed with the tax return setting out information such as types and values of related party cross-border transactions, names and jurisdictions of counterparties, the transfer pricing method applied, etc. The information obtained from tax returns is largely quantitative and often processed in a computerized database system at the earliest stages of a risk assessment process.

### *3.2.2. Transfer pricing documentation*

Action 13 of the Organisation for Economic Co-operation and Development (OECD)/Group of 20 Base Erosion and Profit Shifting (BEPS) project sets out a standardized three-tiered approach to transfer pricing documentation, which should include:

- (i) A country-by-country report containing certain information relating to the global allocation among taxing jurisdictions of the MNE's income and taxes paid, together with certain general indicators of the location of economic activity within the MNE
- (ii) A master file with general information about the MNE relevant to all its members
- (iii) A local file referring specifically to material transactions of MNE members resident in the local jurisdiction and setting out the taxpayer's transfer pricing methodology for such material transactions

Chapter 12 of the UN TP Manual provides more details on transfer pricing documentation and challenges faced by developing countries.

### *3.2.3. Taxpayer's file and audit records of previous years*

The taxpayer's file maintained by the tax administration, previous audit records and risk assessment reports, and any information related to other compliance interactions with the taxpayer may contain useful details to help build a complete picture of business activities. In particular, previous audit records should contain helpful information to determine how to focus the audit process if it is conducted.

Information from Advance Pricing Agreements/Arrangements (APAs) requested or agreed may also be useful. As noted in the UN TP Manual, however, in some cases, the tax administration may have imposed limitations on the use of such information for other purposes in order to encourage the uptake of APAs.<sup>9</sup>

---

<sup>9</sup> See the UN TP Manual, section 15.3.4.7.

### ***3.2.4. Information received through exchange of information***

Information received from other tax administrations, either automatically or as a result of a request, may assist in identifying transfer pricing risks. In particular, exchange of information under double tax treaties (usually regulated by Article 26 of a treaty) has been productive in some countries in identifying and tackling transfer pricing risks.

### ***3.2.5. Taxpayer's financial statements, including notes to the financial statements***

Financial statements are written records that convey business activities and financial performance. The balance sheet provides an overview of assets, liabilities and shareholders' equity at a given point in time.

The income statement primarily focuses on revenues and expenses during a particular period. Once expenses are subtracted from revenues, the statement produces a company's profit figure or net income.

Notes to the financial statement provide background explanations on items contained in it. Where there are requirements to disclose or report uncertain tax positions, this may be a good source of information on the taxpayer's activities or structuring, especially in cases where those activities/structures may be novel or more contentious.

Financial statements can provide useful information on the performance and types of operations conducted by taxpayers and can be used to compute financial ratios.

### ***3.2.6. Questionnaires issued to selected taxpayers***

Some tax administrations send a questionnaire to selected taxpayers after an initial review of tax returns. In general, this tool seems to be most often utilized in countries where there is no statutory contemporaneous transfer pricing documentation requirement. These questionnaires ask for additional information regarding transactions with related parties to help complete the risk assessment process.

### ***3.2.7. Publicly available information on the taxpayer***

A list of potential sources of publicly available information on the taxpayer includes the following.

#### *Internet search*

A search on the Internet can provide information about particular companies or industries and may allow access to some government agencies' databases.

#### *Taxpayer's website*

MNE groups usually have comprehensive websites. These will certainly promote what the group does—the services it provides or goods it sells. Major products or brands will likely be extensively described. The section on investor relations will often contain the latest financial statements as well as the latest half-yearly or quarterly figures. Such information can be used to confirm the accuracy of the functional analysis in the transfer pricing documentation and to check facts as described by the MNE to tax authorities.

*Press reports, the financial and business press and trade magazines*

Press reports on individual companies could provide information about the launch of new products, factories opening or closing, strategic partnerships or alliances the MNE is entering into, and sometimes even concrete information such as royalty rates on license agreements.

Trade magazines and other information in the public domain can yield findings on particular companies and sectors in which they operate. Information on business sectors can help decide whether declining results for a company reflect a wider malaise for that particular business sector or reveal that the sector was in fact rather buoyant during the period in question. Articles may also indicate when a competitor has launched a rival product, which might explain a decline in sales for the company being reviewed.

*Commercial databases*

Commercial databases take information from a variety of publicly available sources and provide a way of searching for companies carrying out broadly similar activities to those of the company under review. In some countries and situations, it can be useful to try and find similar but independent companies carrying out broadly similar activities, and then to compare their financial results to those of the company under review. For a transfer pricing risk assessment, the search may be fairly general, used primarily to survey how the company is performing in broad terms compared with similar companies.

A database search might show that the company under review is completely outside the range of potential comparables, which will be an indicator that the case is worth looking into in more detail. Alternatively, the company may be near the top or even outperforming the comparables, which probably, though not necessarily, means that time will be better spent focusing on other potential targets for a transfer pricing audit.

In some countries, the absence of a large base of independent companies filing financial data with government agencies will make commercial databases less useful. Further guidance on undertaking transfer pricing analyses in situations without comparables data can be found in the Toolkit of the Platform for Collaboration on Tax.<sup>10</sup> Regional comparables may be considered but careful attention should be given to differences between companies in the database and those in the local market. Further guidance on the use of “secret” comparables (i.e., comparables data or information available to the tax administration but not disclosed to the taxpayer) is available in the UN TP Manual.<sup>11</sup> Experience in transfer pricing risk assessment can greatly enhance the ability of the tax administration to draw meaningful conclusions from data relating to regional comparables.

---

<sup>10</sup> Platform for Collaboration on Tax, Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses.

<sup>11</sup> See sections 3.6.7 and 14.3.11.

### *Customs data*

It is possible to use data collected for assessing customs duties to obtain details of cross-border transactions, including those among associated enterprises. Customs data are often collected and available in real-time. Yet customs pricing and arm's length pricing are usually not the same. A cross-border movement of goods is not always indicative of a transaction, as goods often move within a group without a change of ownership, and other transactions, such as royalty flows, do not show up in customs data. Moreover, without knowledge of the ownership of the intangibles associated with many goods, it can be difficult to assess instances of under- or overvaluation. Customs data may therefore be useful in connection with other information but will not usually be a satisfactory exclusive source of data for risk assessment purposes.

### *Patent office, registries and other government agencies*

Some countries try to build a closer working relationship with the national patent office to help identify cases where cross-border transfers of intellectual property have taken place and obtain a better understanding of what intellectual property a business is developing. Patents can be very difficult to understand, however, and many transfers of intellectual property within a group take place without any notification to official registries. There may be registrations of titles and/or transfers of certain classes of assets, such as land, that can provide additional information relevant to transfer pricing analysis. As with patents and customs data, information collected for purposes other than income tax needs to be considered with care.

#### *3.2.8. Conclusion*

In every transfer pricing risk assessment, it is important to use a combination of data sources to gain as much information as possible, helping to create a full picture of the taxpayer's background and operations. An analysis of different data sources allows cross-checking and eases the identification of risks while clarifying potential issues not worth pursuing.

In evaluating the taxpayer's documentation, tax authorities should consider not only whether documentation requirements have been met but also whether documentation accurately addresses controlled transactions and if conclusions can be considered reasonable.

## **3.3. Detailed Risk Assessment**

### *3.3.1. Preliminary phase*

The risk assessment strategic plan should determine priorities and criteria to select a 'long list' of taxpayers for more detailed risk assessment.

The preliminary phase of the risk assessment should then focus on documentation and information gathering to develop a preliminary understanding of the taxpayer's background and the sector in which it operates. This calls for the following steps.

*Collection and review of the prior audit period documentation*

This includes:

- Tax returns and associated schedules, including, in particular, any transfer pricing specific returns/schedules or transfer pricing adjustment returns
- Financial statements, including notes to the financial statements
- Transfer pricing documentation (if filed), and in particular:
  - Country-by-country report (where available, see box 4)
  - Master file
  - Local file
- Information received through an automatic or spontaneous exchange of information
- Risk appetite of the MNE (compliance history, governance processes in place, etc.)
- Transfer pricing disputes in earlier years and resolution thereof
- Other publicly available information

*Understanding the taxpayer's industry*

- Analyse the taxpayer's industry to identify value (profit) drivers and detect extraordinary events disrupting or affecting global or country economies, industries and businesses during the tax year<sup>12</sup>
- Industry and competitor information
- Value (profit) drivers

*Research into the taxpayer's background and operations*

- Overview of a taxpayer's history, background and business
- Merger, acquisition and other reorganization activity
- Geographical, legal and tax organizational structure information
- Descriptions of patents, trademarks and other intangibles
- Segmented operational and profitability levels
- Functional activities and their locations
- Significant transactions

*Prepare a ratio analysis to compute key financial ratios for multiple years, make industry comparisons and consider the risk of cross-border income shifting*

Once sufficient information has been collected and a preliminary analysis performed, a quantitative analysis using profitability indicators and industry comparisons can help to conduct an initial screening of the MNE group.

---

<sup>12</sup> United Nations (2025). Transfer Pricing During the COVID-19 Economic Downturn. New York, NY: United Nations.

#### Box 4: The 2017 OECD Handbook on Effective Tax Risk Assessment

Country-by-country reporting was designed in the context of Action 13 and is one of four minimum standards within the BEPS Action Plan.

Under Action 13, all in-scope large MNEs are required to prepare a country-by-country report with aggregate data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which they operate.

As clarified by the UN TP Manual,<sup>13</sup> the report is intended to provide a general overview of the allocation of the MNE's global income and taxes paid among countries.

This should help tax authorities to better understand how local entities fit within the activities of large and complex MNE groups, and to conduct more effective risk assessments to identify taxpayers and arrangements that may pose a higher tax risk.

A noteworthy recommendation is that only MNEs with annual consolidated revenue of at least 750 million euros (or an equivalent amount stated in local currency using January 2015 exchange rates) should be required to file a country-by-country report.<sup>14</sup>

In 2017, the OECD published the Handbook on Effective Tax Risk Assessment,<sup>15</sup> which contains useful guidance on ways to use information obtained from country-by-country reports in tax risk assessment processes, the types of tax risk indicators that may be identified using the reports and challenges that may arise in the process.

The Handbook on Effective Risk Assessment is available to jurisdictions to assist in the implementation and operation of country-by-country reporting. Other publications include guidance on the interpretation of elements of the Action 13 minimum standard,<sup>16</sup> on the appropriate use of country-by-country reports,<sup>17</sup> on the use of the OECD country-by-country XML schema<sup>18</sup> and on the effective implementation of country-by-country reporting.<sup>19</sup>

13 See the UN TP Manual, section 12.2.1.5.

14 OECD (Organisation for Economic Co-operation and Development) (2015). Transfer Pricing Documentation and Country-by-Country Reporting: Action 13 Final Report. Paris: OECD Publishing.

15 OECD (Organisation for Economic Co-operation and Development) (2017). BEPS Action 13: Country-by-Country Reporting Handbook on Effective Tax Risk Assessment. Paris: OECD Publishing.

16 OECD (Organisation for Economic Co-operation and Development) (2017). Guidance on the Implementation of Country-by-Country Reporting. This guidance is updated from time to time; the latest version is available at: [www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.html](http://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.html).

17 OECD (Organisation for Economic Co-operation and Development) (2017). Country-by-Country Reporting: Guidance on the Appropriate Use of Information Contained in Country-by-Country Reports. Paris: OECD Publishing.

18 OECD (Organisation for Economic Co-operation and Development) (2017). Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers. Paris: OECD Publishing.

19 OECD, Country-by-Country Reporting Handbook on Effective Tax Risk Assessment.

The aim of a quantitative analysis is to ensure that “big fish do not escape the net” and to prioritize cases that are worth more in-depth qualitative analysis.

For this purpose, it may be helpful to compute key financial ratios for multiple years of the taxpayer’s performance and make comparisons. In fact, it is recommended that ratios should be based on both tax and financial data, and should be calculated for a sufficiently long time of observation (three to five years).

Table 1 summarizes ratios that could be useful in the preliminary stage of the risk assessment. The relevance of any particular ratio will depend on the nature of the activities performed by the taxpayer (e.g., research and development, manufacturing, service provision). In some cases, it may be useful to consider trends in these ratios over a number of years.

Table 1: Potential risk indicators and their computation

Profit margin	Earnings before interest and taxes (EBIT)/total revenues or gross profit/net sales
Effective tax rate	Income tax accrued/EBIT (consider worldwide and individual entity effective tax rates)
Profit per unit of economic activity	EBIT/number of employees or EBIT/payroll expenses or EBIT/tangibles assets
Pre-tax return on equity	EBIT/(stated capital + accumulated earnings)
Post-tax return on equity	(EBIT less income tax accrued)/(stated capital plus accumulated earnings)
Pre-tax or post-tax return on assets	EBIT/total assets or EBIT less income tax accrued/total assets
Functional intensity	Operating expenses/net sales
Reliance on intragroup transactions	Related party revenues/total revenues or related party expenses/total expenses

To identify patterns that may suggest a higher or lower level of tax risk, the indicators of the tested party should be evaluated against the indicators of potential comparables. The performance of the tested party can be compared with:

1. The standard results of companies in the same industry
2. The results of the group as a whole
3. The results of related entities operating in other jurisdictions
4. The results of the company in earlier periods

One indicator that may flag a potential transfer pricing risk is if the financial results of the company under review substantially deviate from those in the industry.

Further, the comparison of the results of the tested party with those of the group's performance as well as with those of related parties operating in other jurisdictions will allow the tax auditor to see the "big picture".

The company's financial performance over time can also be an important risk indicator. A sudden decrease in profitability may be a transfer pricing risk worthy of further investigation. In the same vein, low profits or continuous losses may not reflect the true value of the business and can, therefore, indicate a transfer pricing risk to investigate.

This initial comparison does not provide a definitive indication of whether the price for a controlled transaction achieves an arm's length result. Analysis of these initial ratios, however, may be useful as a diagnostic tool to identify issues for further examination that carry the most significant risks for non-compliance.

It is worth noting that the arm's length principle requires a transactional approach (i.e., a transaction-by-transaction analysis). At this stage, ratio analysis and comparisons are likely to be performed at the entity level.

*Develop a preliminary working hypothesis to identify taxpayers that may pose tax risks*

By this stage of the risk assessment, sufficient documentation should have been collected and a quantitative analysis performed to allow a high-level overview of the taxpayer's risk profile.

This preliminary analysis should help steer subsequent compliance activity by focusing resources on taxpayers who need further attention. In this regard, it is important to bear in mind not only risks brought to light by the available information but also potential risks that may need to be hypothesized in the absence of information. Put another way, this entails considering not only what is there but also what may not be there. For example, if there is information to suggest a taxpayer plays an important and valuable role locally (e.g., through its advertising or website) but the local footprint is disclosed elsewhere (e.g., in the transfer pricing documentation) and is minimal, this may prompt questions about the true extent and nature of local activities.

Table 2 lists a number of transfer pricing risk flags that should be evaluated at the end of the preliminary quantitative analysis. As noted above, the quantitative analysis should consider results over a number of years. One-off deviations or risk flags that appear in a single year may not pose the same level of risk as sustained deviations or trends over a longer period. Moreover, in evaluating risk flags, the question of whether the identified risk can likely be adequately explained by known commercial or non-tax factors must be examined. This table is indicative and should not be regarded as an exhaustive list of possible risk flags.

At the end of the preliminary quantitative analysis, tax authorities should be in a position to perform a preliminary cost-benefit analysis to evaluate not only the tax risks posed by a specific taxpayer but also the likely amount of tax at stake, how much tax administration resources will be required to establish the amount expected and whether time would be better spent on another case.

Table 2: Transfer pricing risk flags<sup>a</sup>

Transfer pricing risk flags	Brief description	Where to look
The footprint of a group in a jurisdiction	A group with a small footprint may have less potential to pose significant tax risk. A small footprint could be misleading, however, if the activities in a jurisdiction are more significant. Particular attention should be paid to structures such as agents and commissioners that show the intermediation fee (and not the revenue of the goods sold) in local financial accounts.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Taxpayer's tax return</li> <li>▪ Transfer pricing documentation</li> <li>▪ Financial accounts</li> </ul>
The results of an MNE group in a jurisdiction deviate from potential comparables	Differences between the local performance of the MNE and those of chosen comparables could be a consequence of transfer pricing manipulation and should be further investigated to understand the causes.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Taxpayer's tax return</li> <li>▪ Transfer pricing documentation</li> <li>▪ Financial accounts</li> </ul>
The results of an MNE group in a jurisdiction deviate from industry standards	When the results of an MNE group in a jurisdiction deviate from industry standards, this could be a consequence of transfer pricing manipulation and should be further investigated to understand the causes.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Taxpayer's tax return</li> <li>▪ Transfer pricing documentation</li> <li>▪ Financial accounts</li> <li>▪ Industry information</li> </ul>
There are jurisdictions with significant profits but little substantial activity	Profits may have been shifted away from the jurisdiction where the underlying economic activity is occurring. An investigation should explore whether the local entities of the MNE have transactions in place with related entities located in such low-substance/high-profit jurisdictions.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Transfer pricing documentation</li> <li>▪ Exchange of information</li> </ul>
There are jurisdictions with significant profits but low levels of tax accrued	A low effective tax rate can indicate that an MNE group is engaging in base erosion and profit shifting to shelter taxable income. In this case, attention must be paid to analysis of the transactions of local entities with related entities located in jurisdictions that pose BEPS risks.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Transfer pricing documentation</li> <li>▪ Exchange of information</li> </ul>

There are jurisdictions with significant activities but low levels of profit (or losses)	Profits attributable to a jurisdiction may be shifted through transfer pricing manipulation.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Transfer pricing documentation</li> <li>▪ Exchange of information</li> </ul>
A group has activities in jurisdictions with a BEPS risk <sup>b</sup>	Transactions with jurisdictions that pose a BEPS risk should be carefully investigated.	<ul style="list-style-type: none"> <li>▪ Country-by-country report</li> <li>▪ Exchange of information</li> </ul>
Transfers of intangibles to related parties	Transactions of this nature raise difficult valuation questions, especially where the intangibles are unique, and consequently, there is a lack of comparables.	<ul style="list-style-type: none"> <li>▪ Taxpayer's tax return and/or schedules</li> <li>▪ Transfer pricing documentation</li> <li>▪ Taxpayer's website</li> <li>▪ Financial accounts, including uncertain tax position disclosures</li> <li>▪ Press reports/trade magazines</li> <li>▪ Patent office</li> </ul>
Business restructuring	<p>The risks associated with a restructuring are different for the various jurisdictions affected. The country where the MNE is headquartered would face issues such as the valuation of externalized intangibles, deemed disposals of assets for capital gains tax purposes, etc.</p> <p>In addition, the headquarters' jurisdiction may have to address the classification and benchmarking of profits for the "principal/entrepreneur" remaining or created due to the restructuring. On the other hand, the jurisdictions of the subsidiary would mainly be concerned about risk stripping and loss of (future) profits.</p>	<ul style="list-style-type: none"> <li>▪ Taxpayer's tax return and/or schedules</li> <li>▪ Transfer pricing documentation</li> <li>▪ Taxpayer's website</li> <li>▪ Financial accounts, including uncertain tax position disclosures</li> <li>▪ Press reports</li> <li>▪ Patent office</li> </ul>
Specific types of payments	Certain types of payments, such as interest, insurance premiums and royalties generally pose higher risks than other transactions. This is because the underlying rights are highly mobile, and consequently, there is a risk that the payments do not reflect the true value being added by the related party.	<ul style="list-style-type: none"> <li>▪ Taxpayer's tax return and/or schedules</li> <li>▪ Transfer pricing documentation</li> <li>▪ Financial accounts</li> </ul>

Significant transactions with related parties in low-tax jurisdictions	Where transactions take place with low-taxed related entities, there is a risk that mispricing will incorrectly attribute excess profits to the low-tax jurisdiction.	<ul style="list-style-type: none"> <li>Transfer pricing documentation</li> <li>Taxpayer's tax return and/or schedules</li> <li>Financial accounts and notes</li> <li>Exchange of information</li> <li>Customs data</li> </ul>
Excessive debt	Debt that appears to be in excess of the amount that an entity could borrow on a stand-alone basis or interest rates that appear to be below or in excess of market rates.	<ul style="list-style-type: none"> <li>Taxpayer's tax return</li> <li>Transfer pricing documentation</li> <li>Financial accounts</li> </ul>
Local low-profit or loss-making companies (especially when the MNE group as a whole is profitable)	Repeated losses or local low profit (especially when the MNE group as a whole is profitable) may be evidence that reported results do not reflect the true value of the business.	<ul style="list-style-type: none"> <li>Country-by-country report</li> <li>Taxpayer's tax return</li> <li>Transfer pricing documentation</li> <li>Financial accounts</li> </ul>
The existence of centralized supply chain companies in favourable tax jurisdictions (i.e., centralized sourcing or marketing companies located in jurisdictions with low-tax or no-tax regimes) that are not the same country/region as the group's main customers and/or suppliers	The existence of centralized supply chain companies in a low-tax jurisdiction may be exploited to shift profits through transfer pricing manipulation.	<ul style="list-style-type: none"> <li>Transfer pricing documentation</li> <li>Financial accounts</li> </ul>
Material commercial relationships with companies in jurisdictions that employ safe harbours or similar rules that do not align with the arm's length principle	Substantial deviation from the arm's length principle in the transfer pricing rules in a jurisdiction may have an impact on the prices of the transactions with the related entity located in such a jurisdiction.	<ul style="list-style-type: none"> <li>Transfer pricing documentation</li> <li>Financial accounts</li> <li>Customs data</li> </ul>

A poor tax compliance history	A history of poor past behaviour of the taxpayer towards tax compliance should be carefully evaluated.	<ul style="list-style-type: none"> <li>▪ Taxpayer's tax file and audit records of previous years</li> </ul>
Lack of documentation to support transfer prices	Poor transfer pricing documentation or a lack of it may cast doubt on the reliability of transfer prices.	<ul style="list-style-type: none"> <li>▪ Taxpayer's tax return and/or schedules</li> <li>▪ Transfer pricing documentation</li> </ul>

- a The table summarizes the relevant transfer pricing risk flags laid out in section 13.2.5 of the UN TP Manual; Annex 2 of the OECD Country-by-Country Reporting Handbook on Effective Tax Risk Assessment 2017; and para. 131 of the OECD Public Consultation Draft Handbook on Transfer Pricing Risk Assessment 2013.
- b Countries are likely to have their own views on which jurisdictions pose a BEPS risk. In many cases, this may include jurisdictions that impose no or nominal rates of corporate income taxes. It may also encompass jurisdictions with specific features used by local taxpayers to avoid taxes through BEPS structures or transactions.

Where it is already evident at an early stage that a potential tax risk posed by a taxpayer is low, a decision may be made that no further assessment or compliance action is required. The more quickly that risks and concerns can be ruled out, the more resources can be focused on risks and taxpayers requiring further attention.

In this preliminary quantitative analysis, the country-by-country report can play a crucial role in providing tax authorities with useful information to better understand how the local activities of an MNE fit within its larger activities. Taxpayers can be benchmarked against other entities in the same MNE group, as well as against those in other groups to identify discrepancies that may indicate increased risk in a particular jurisdiction.

Country-by-country information, however, should not be used as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a functional analysis and a comparability analysis.

### 3.3.2. *Execution phase*

As explained above, the purpose of the initial quantitative analysis is to provide a rough indication of the general reasonableness of the outcomes of the taxpayer's overall transfer pricing.

Once a 'long list' of potential risk taxpayers has been identified, the execution phase should focus on narrowing it to a 'short list' by conducting a more detailed analysis, including information that may be specifically requested from the taxpayer.

For this purpose, the examination should move from a quantitative entity-level risk analysis towards a more qualitative transaction-level analysis. The risks identified in the preliminary phase should be connected to the transactions performed by taxpayers to understand whether transfer pricing could be the origin of such risks.

Focusing on transactions, it should be recalled that transfer pricing risks can arise in three broad scenarios:

1. Recurring transactions with related parties that have the potential to erode a jurisdiction's tax base over time: This risk can involve any tax deductible related-party payment, including sales or purchases of products or services, but there is a particular risk where intragroup payments are of a type that can be hard(er) to value. These might include payments of interest, insurance premiums, service fees, management fees and royalties.
2. A large or complex one-off transaction, including business restructurings and transfers of key income-producing assets: These transactions can have a significant effect on the tax position of entities in the year the transaction occurs, and on an ongoing basis as new related-party transactions that need to be priced are put in place.
3. A lack of effective tax control frameworks to control, document and review the pricing of related-party transactions on an ongoing basis.

During this phase, the following steps may be considered.

#### *Conduct a preliminary functional analysis*

The functional analysis aims to determine which functions are performed, which assets are used and which risks are assumed by each party. It is at the heart of every transfer pricing analysis.

Performing such an analysis helps to determine if a controlled transaction poses transfer pricing risks by developing a better understanding of the transactions and comparing them with third-party activities with similar characteristics.

As clarified in section 13.2.1.1 of the UN TP Manual, however, a risk assessment does not involve a full functional analysis. It is instead intended to identify whether a full analysis is warranted, given constraints on tax administration resources.

A preliminary functional analysis can follow a two-step approach:

- First, review the functional profiles of the companies involved in the covered transactions, taking into consideration the actual delineation of the transactions. For example, if the MNE claims it performs distribution activities through low-risk distributors, tax administrations should evaluate whether the functions, assets and risks of the distribution entities are in line with the functional profile of a low-risk distributor.
- Second, evaluate whether the transfer pricing methodology and the manner in which it is applied by the taxpayer is coherent with the identified functional profile. The coherence of the methodology may be evaluated against the transfer pricing method(s) selected (including the profit level indicator, where applicable) and the comparables (taking into account any comparability adjustments) used by the taxpayer to price the transactions under review.

At this stage, the functional analysis should be conducted predominantly based on information in documents at the disposal of the tax administrations.

Transfer pricing documentation, however, is not always immediately available to tax administrations. In this case, tax administrations may decide to send an ad hoc questionnaire to the taxpayer and ask for additional information regarding transactions with related parties. The questionnaire can include requests for financial data, other statistics (e.g., a headcount by division), functional information, details on the organizational setup and explanations of financial/economic performance. Questions can also be aimed at seeking further explanation of the transfer pricing analysis, such as the choice of method or assumptions built into an economic analysis.

Table 3 summarizes a number of recurrent issues normally met in transfer pricing analysis. It can be used as part of a checklist in performing the risk assessment, noting that the table only covers a selection of the main risks that may be found.

Table 3: Checklist for risk assessment

Type	Inbound transactions	Outbound transactions
Funding	Thin capitalization	Interest-free loans
Interest rates	Excessively high interest rates	Excessively low interest rates
Goods	1. Offshore procurement/sourcing companies 2. General mispricing	1. Offshore marketing companies to keep profits offshore 2. General mispricing
Services <sup>a</sup>	1. Excessively high fees relative to benefits provided 2. Charging when no services were received 3. Duplication of services and/or provision of shareholder services 4. Purported value-based service charges (charged by reference to a percentage of sales/revenues)	1. No charges at all 2. Excessively low fees relative to benefits provided
Intangibles/intellectual property	1. Excessively high charges 2. Duplicating charges through royalties above inflated prices	1. No charges for intangibles developed locally 2. Externalizing intellectual property without reward

Structures	1. Restructuring 2. New structures	1. Restructuring 2. New structure 3. To avoid/minimize imputation through controlled foreign corporations 4. Use of offshore branches in low-tax jurisdictions with double taxation treaties
------------	---------------------------------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Source: Table 13.T.1 of the UN TP Manual.

a A threshold test for service transactions is whether a chargeable service exists. See the UN TP Manual, section 5.1.2.

### 3.3.3. *Outcome phase*

Estimating the degree of risk is not a formulaic process. Judgment and understanding of the facts insofar as possible are required.

In quantifying the level of risks posed by a single transaction, tax authorities may evaluate:

1. The amount of tax at stake
2. The number and/or importance of risk factors identified
3. The existence of systematic or recurring risks that need to be addressed

For cases where the identified risk is low, no further compliance action needs to be undertaken. For higher risk cases, it may be appropriate to flag the case for a “watching brief” and follow-up compliance action in the future (generally for medium-risk cases) or to commence an audit (higher or systemic risk cases).

Tax authorities might consider using a “traffic lights” classification of the level of risks identified in each analysed transaction as in table 4.

Table 4: Traffic light risk classification and follow-up

Risk classification	Follow-up compliance
High risk	Tax audit
Medium risk	Monitoring activities, ongoing communication with the taxpayer
Low risk	No further actions

Audit activities can take different forms ranging from desk to on-site audits. The final decision on whether to initiate an audit and the type of audit to carry out will generally need to be considered in relative terms, i.e., prioritizing identified risks in the population against available compliance resources.

As specified in section 13.2.8 of the UN TP Manual, the outcomes of a risk identification and assessment process should be documented and signed off for governance and control purposes, and preferably saved in a central repository, such as a database of cases assessed, whether or not they lead to a detailed audit or tax assessment.

**Best practice:** Tax administrations should design templates containing relevant information about the risk assessment conducted.

Ideally, these should include:

- Statutory filing requirements
- The period analysed
- A table with the indicators computed
- A short description of the transactions analysed and information reviewed
- A measurement of the risk attributed to the transactions (e.g., based on a tax contingency estimate, perhaps combined with an estimate of the likelihood of the risk materializing)
- The final outcome of the risk assessment process, i.e., what was recommended and why

#### Box 5: Programmes of multilateral risk assessment

A new frontier in risk assessment is multilateral risk assessment, which involves the collaboration of several tax administrations. Developing multilateral risk assessment programmes is key to effectively tackling transfer pricing risks. At the same time, it is also important for taxpayers to have a certain level of tax certainty and to avoid double taxation on profits.

In the transfer pricing field, tax administrations do not always share a common interest. This is because, to prevent double taxation, a well-founded primary (upward) adjustment by one tax administration may require a corresponding (downward) adjustment by the other. This implies that the second tax administration would have to reduce its tax base, an option that most tax administrations would likely prefer to avoid, especially if it has not been directly involved in the audit.

In 2018, the OECD launched the International Compliance Assurance Programme (ICAP), a voluntary programme for multilateral cooperative risk assessment and assurance. It is designed to be an efficient, effective and coordinated approach to provide MNE groups willing to engage actively, openly and in a fully transparent manner with increased tax certainty in terms of certain activities and transactions.

Multilateral risk assessment provides benefits for both tax administrations and taxpayers including:

Fully informed and targeted use of country-by-country reports and other information held for risk assessment

- An efficient use of resources
- A faster, clearer route to multilateral tax certainty
- Cooperative relationships between MNE groups and tax administrations
- Fewer disputes entering into the Mutual Agreement Procedure

The International Compliance Assurance Programme—Handbook for Tax Administrations and MNE Groups provides an overview of the programme and guidance on how to participate.<sup>20</sup>

In 2021, the European Commission launched its own programme of multilateral risk assessment called the European Trust and Cooperation Approach (ETACA).

It brings together European Union tax administrations to perform a multilateral risk assessment of the transfer pricing policies of MNEs operating within the European internal market.

The primary objective is to improve the tax certainty of cross-border transactions in this market, avoiding as far as possible different interpretations leading to double taxation and reducing transfer pricing disputes. The programme facilitates “learning by doing together” to develop a common approach to transfer pricing risk assessment among European tax administrations.

Programme guidelines provide an overview of different phases and suggested methods to perform a high-level transfer pricing risk assessment.<sup>21</sup>

---

<sup>20</sup> OECD (Organisation for Economic Co-operation and Development) (2021). International Compliance Assurance Programme—Handbook for Tax Administrations and MNE Groups. Paris: OECD Publishing.

<sup>21</sup> European Commission (2021). Guidelines: European Trust and Cooperation Approach (ETACA).

# 4. A Road Map for a Transfer Pricing Audit

This section provides a guide to good practices and processes to assist with the planning, execution and resolution of transfer pricing audits. The goal of a transfer pricing examination is to determine an arm's length result, taking into account the facts and circumstances of the case.

Transfer pricing examinations are factually intensive and require a thorough analysis of the economically relevant characteristics of the transaction(s), including the functions performed, assets employed and risks assumed, along with an accurate understanding of relevant financial information. They are resource-intensive for both tax authorities and taxpayers.

The tax administration should start a transfer pricing audit only where the risk assessment concludes that a full transfer pricing audit of one or more issues is appropriate.

The process of an audit can be articulated in different phases, similar to the risk assessment.

## 4.1. Preliminary Phase

When tax authorities decide to start a transfer pricing audit, a number of preliminary steps should be followed.

### *4.1.1. Setting up a transfer pricing audit team*

As explained in section 14.1.2 of the UN TP Manual, ideally, a transfer pricing audit team should comprise auditors with different backgrounds. It is important to have a good mix of economists, accountants and lawyers as well as an information technology audit specialist and, where possible, an industry specialist. A key issue for a tax administration is to keep transfer pricing audit approaches uniform across the country, an objective supported by appointing managers who typically have responsibility for audits in several regions and across a range of cases.

### *4.1.2. Reviewing prior audit period work papers and risk assessment outcomes*

The transfer pricing audit team should start by analysing the findings of the risk assessment and the prior audit period work papers to understand which transactions should be audited and how they should be approached.

### *4.1.3. Establishing a team, examination plan, timelines and key milestones*

The audit team should establish an estimated audit timeline with key milestone dates for completion of the transfer pricing examination.

## 4.2. Execution Phase

The execution phase of transfer pricing audits includes determining the facts, applying the law and technical guidance to those facts, and understanding the various tax implications.

The audit team should request any additional information not obtained during the risk assessment phase.

Typically, the audit team should engage with the taxpayer, including by conducting interviews with managers and key staff as part of the functional analysis. Where possible, this may include site visits.

### 4.2.1. *Gathering information*

One major activity in a transfer pricing audit is gathering information that tax authorities consider necessary to decide whether to accept tax returns as filed or to propose transfer pricing adjustments.<sup>22</sup> Important contextual information should detail the taxpayer's industry, including the nature and levels of competition, regulatory factors and other elements that may affect the taxpayer and its environment.<sup>23</sup> Some contextual information may be available publicly.

Other information more specific to the taxpayer and intragroup transactions is less likely to be in the public domain. In this case, the principal means for the audit team to collect necessary information is through written information request(s). Certain information needed for the transfer pricing audit may already be in the hands of tax authorities. The audit team should request any information not obtained during the risk assessment.

It is important to request documents and information at the very beginning of the audit. The time given for responding is usually a few weeks unless the taxpayer is expected to take a longer time to obtain and/or prepare the required information.

Table 5 summarizes information that the audit team may consider requesting as appropriate at the beginning of the audit. All information should reflect the facts at the time of the period under audit.

As noted in section 14.3.6.2 of the UN TP Manual, much of this information can be found in the taxpayer's transfer pricing documentation, assuming that it has been prepared in compliance with the recommended standard described in chapter 12 of the UN TP Manual.

---

<sup>22</sup> See the UN TP Manual, section 14.3.3.

<sup>23</sup> See the UN TP Manual, section 3.3.1.

Table 5: Scope of information requests at the beginning of an audit

Information request
1. Corporate profile information (including the corporate group's history)
2. Organizational chart (setting out the number of employees as well as their broad categories of work and activities)
3. Transactional structure: a business flow chart or value chain analysis (from invoicing and settlement to the actual delivery flow)
4. List of distribution channels and retail outlets if applicable: location, size, opening hours, sales revenue, staffing, prices, contractual terms with customers (consignment or cash sales, etc.), including data on the latest three years for sales, revenue and staffing
5. List of directors
6. Equity structure of group companies
7. Basic business agreements, distribution agreements and other agreements with related parties (including written as well as implicit arrangements)
8. Corporate profile of the related parties
9. Documents related to the determination of an arm's length price
10. Transfer pricing method and list of margins by categories of products/services for the audit period
11. Latest financial data regarding the sales, cost of goods sold, operating expenses, operating profits and profit before tax for the audit period
12. Group global consolidated profit, loss statement and ratio of the taxpayer's sales to group global sales for the audit period
13. Segmented profit and loss statements from the related transactions of the related party (if the taxpayer is the purchaser) or the taxpayer (if the taxpayer is the seller) for the audit period
14. List of gross and operating profits by category, product and distribution channel with details of losses on the disposal of assets and losses from obsolescence for the audit period
15. Top 10 products in sales by category (name of product, purchase price and retail prices, personnel expenses, advertising expenses and sales promotion expenses) for the audit period

Source: The table is based on section 14.3.8 of the UN TP Manual.

#### *4.2.2. Identifying and analysing economically relevant characteristics, including conducting a functional analysis to accurately delineate the transaction(s)*

The UN TP Manual stresses the importance of accurately delineating intragroup transaction(s) to evaluate. After analysing contextual and other information described in the audit team should work towards accurately defining the intragroup transaction(s) that are the focus of the audit. The UN TP Manual sets out five categories of economically relevant characteristics or comparability factors to consider:

- The characteristics of the property or service transferred
- The contractual terms
- A functional analysis of the controlled transaction under examination
- The economic circumstances
- The business strategies followed by each of the parties

Detailed guidance on these factors is available in the UN TP Manual.<sup>24</sup> In many cases, the most challenging part of this process will be the functional analysis, which will therefore be the focus of the remainder of this section. It is essential, however, to consider the functional analysis together with other economically relevant characteristics and contextual factors. A transaction or activity should not be considered in isolation from the global value chain and industry in which it is carried out. This kind of additional information will help to define which functions, assets and risks are the most economically significant in a particular case.

A functional analysis identifies economically significant activities performed for the transaction. An economically significant activity materially affects the price charged in a transaction or its profits and/or losses.

The audit team should deepen the preliminary functional analysis performed in the risk assessment and verify the facts and circumstances reported by the taxpayer in the transfer pricing documentation.

The audit team should 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 the parties is consistent with the way in which risk is allocated in intercompany agreement(s)
- Identify assets utilized by each entity
- Identify title flow, product flow, services performed and money flow
- Identify value drivers of the business or transaction

To perform a proper functional analysis, the audit team should consider conducting the following activities, as appropriate.

---

<sup>24</sup> See the UN TP Manual, sections 3.3.2 and 3.4.

#### 4.2.3. *Reviewing intercompany agreement(s)*

As part of the review of contractual terms, the audit team should specifically review and analyse relevant intercompany agreements to understand their legal terms and content with the aim to:

- Determine relevant parties
- Identify important terms of the agreement
- Identify compensation and forms of payment
- Assess the contractual risks assigned to the controlled parties and determine whether parties have control and financial capacity in relation to such risks
- Determine if the conduct of the parties is consistent with written agreements<sup>25</sup>

#### 4.2.4. *Requesting to visit a site or facilities*

A visit to a site or facilities can help to better understand the economic activity performed by the taxpayer. The audit team could be accompanied on the visit by employee(s) of the taxpayer who can describe activities at particular locations and respond to questions.

The employee(s) should consider the exercise as being similar to an interview. Findings of the visit should be adequately documented.

#### 4.2.5. *Conducting interviews with managers/key staff*

To properly delineate the functional profile of the taxpayer and cross-check information in the transfer pricing documentation, the audit team should conduct functional interviews with relevant staff.

The interviews can assist the audit team in determining the functions performed by the taxpayer and related parties and evaluating potential comparable transactions. The audit team should choose personnel to interview based on the organizational charts and in collaboration with the taxpayer's representatives.

If the taxpayer is engaged in distribution activities, table 6 provides a sample of ten questions to ask to help understand its operations.

If the taxpayer is engaged in manufacturing activities, table 7 offers ten sample questions to understand its operations.

---

<sup>25</sup> Section 3.3.2.1 of the UN TP Manual discusses the importance of accurately delineating the transaction(s) to be priced and notes that: “[...] the contractual terms will generally be the starting point for the analysis (as clarified or supplemented by the parties' conduct); and to the extent that the conduct or other facts are inconsistent with the written contract, the parties' conduct (rather than the terms of the written contract) should be taken as the best evidence of the transaction(s) actually undertaken”.

Table 6: Sample questions to help understand taxpayer operations as a distributor

1. Could you describe your role and responsibilities within the company's organization?
2. What is your reporting line?
3. What degree of autonomy do you have in making strategic decisions and/or in conducting day-to-day operations?
4. Are affiliates manufacturing the same or similar products as those distributed by the taxpayer?
5. Is technology transferred between affiliates and the taxpayer?
6. Are trademarks and other marketing intangibles being used to market the product?
7. Which members of the MNE developed the trademarks and other marketing intangibles?
8. Which members of the MNE devise and carry out marketing, advertising and promotional activities?
9. Which members of the MNE created the sales tools?
10. Which members of the MNE create and maintain the list of customers?

Source: The table builds on section 14.2.2.3 of the UN TP Manual.

Table 7: Sample questions to help understand taxpayer operations in manufacturing

1. Could you describe your role and responsibilities within the company's organization?
2. What is your reporting line?
3. What degree of autonomy do you have in taking strategic decisions and/or in conducting day-to-day operations?
4. Are affiliates distributing or selling the same or similar products as those the taxpayer manufactures?
5. Is the taxpayer using the same or similar manufacturing intangibles as those its affiliates are using?
6. What patents and/or know-how are involved in the manufacturing process?
7. Is there a cost contribution arrangement in place?
8. What research and development activities are conducted?
9. What members of the MNE direct and perform research and development?
10. How are the results of research and development disseminated among members of the MNE?

Source: The table builds on questions reported in the UN TP Manual, section 14.2.2.3.

If the taxpayer is charged for intragroup services, table 8 presents nine sample questions to understand its operations.

Each interview should be adequately documented in a report signed by the interviewee and the audit team.

Table 8: Sample questions to help understand taxpayer operations related to receiving intragroup services

1. What is the percentage of intragroup service payments in relation to total operating expenses during the financial year?
2. Which components make up the intragroup services received by the taxpayer?
3. What proportion of intragroup services fees constitute third-party costs for the MNE group?
4. What supporting documents can the taxpayer furnish to show services have been received and benefits are commensurate with payments made?
5. Are there any duplicative or shareholder services for which the taxpayer is receiving a charge?
6. Does the taxpayer make payments for any standby services?
7. If the charge comes with a mark-up, can you please provide supporting analysis to establish that the mark-up is at arm's length?
8. What allocation keys is the group using for charging the taxpayer? Are there any revenue-based allocation keys?
9. Are service fees determined with reference to a percentage of sales/revenues? If so, please explain the relationship between sales/revenues and the value of the service, and why this is the most appropriate way to determine the arm's length price of the service.

#### 4.2.6. *Determining the functional profile*

The functional analysis should aim to define the functional profile of the taxpayer as well as related entities with which commercial transactions take place.

This process should also confirm (or disprove) the functional profile as reported by the taxpayer in the transfer pricing documentation.

#### 4.2.7. *Reviewing the transfer pricing methodology*

The audit team should evaluate whether the transfer pricing methodology applied by the taxpayer is coherent with the identified functional profile.

The coherence of the methodology should be evaluated against the transfer pricing methods selected and the comparables used by the taxpayer to price the transactions under review.

#### 4.2.8. Issue presentation and resolution

The audit team could benefit from meetings with the taxpayer to discuss results before finalizing the audit report. The meeting with the taxpayer should focus on the following:

- Determine whether and to what extent the taxpayer agrees with the facts as presented
- Evaluate the taxpayer's position and understand the nature of disagreements
- Engage in a dialogue with the taxpayer to determine whether a principled resolution can be reached, including a discussion of the draft transfer pricing audit report to the taxpayer, to determine areas of agreement and any apparent errors/inconsistencies

### 4.3. Audit Closing

The audit should end with a final report summarizing all audit operations carried out and the outcome of the arm's length analysis. In particular, the final report should include:

- Executive summary
- Summary of the audit operations carried out
- Factual background and functional analysis of the taxpayer and the transaction(s) at issue
- Summary of the taxpayer's transfer pricing methodology for the transaction(s) at issue
- Discussion of the taxpayer's methodology and analysis for the transaction(s) at issue
- Tax administration assessment of the remuneration at arm's length of the transaction(s) at issue
- Summary of the proposed transfer pricing adjustments
- Any settlements or agreements reached with the taxpayer, including information on final adjustments applied
- Conclusion

### 4.4. Follow-up Phase

Outcomes of the audit should be linked with other tools and procedures. It may be useful to evaluate:

- The implications of audit conclusions on subsequent years: A transfer pricing audit for recurring transactions may be extended to cover more financial years if the taxpayer signals that there is no intention to rectify intercompany transactions in line with the audit conclusions.
- The relations with dispute prevention (unilateral and bilateral) and resolution mechanisms: A taxpayer may seek to enter into an APA, where such a

programme is available, to secure tax certainty for future years. In evaluating the application for the APA, the conclusion of the audit should be carefully considered. Another consideration is whether an APA was only filed to impede an audit to commence or continue. A transfer pricing audit is likely to result in double taxation. The resolution of double taxation is typically dealt with in a MAP between competent authorities. Especially in cases with substantial transfer pricing adjustments, a preventive dialogue between the audit team and the competent authority may be beneficial.

- Evaluation of the risk assessment phase with audit results: At the end of the audit, it is important to cross-check if the risks identified in the risk assessment materialized, and whether they led to an actual transfer pricing adjustment. Equally, it is crucial to understand whether audit activities identified other facts and circumstances that may pose transfer pricing risks that were not previously identified.
- Update of transfer pricing database: To improve the risk assessment procedure, the database with information on taxpayers should be constantly fed with audit results. This helps to regularly update the risk profile of a taxpayer and enhance the effectiveness of the risk assessment.

#### Box 6: Joint audits

Tax administrations may use joint audits to tackle transfer pricing issues more effectively while improving dispute prevention.

In an environment where businesses operate on a global basis and sell goods and services in multiple jurisdictions, tax administrations need to cooperate more closely to tackle profit shifting and minimize costly and time-consuming disputes.

A joint audit involves two or more tax administrations that come together and form a single audit team to examine an issue/set of transactions that pertain to one or more related taxpayers with cross-border economic activities. This exercise aims to agree on a single audit report at the end and assess taxes on this basis. Through this process, tax authorities are expected to form a more comprehensive understanding of the audited taxpayer's affairs and conclude with an assessment that does not result in double taxation or non-taxation, and with no need for a dispute resolution mechanism such as a MAP.

In 2019, the OECD Forum on Tax Administration published a report<sup>26</sup> that provides best practices for performing joint audits and identifies possible areas of improvement.

The European Union Joint Transfer Pricing Forum in 2018 published a report<sup>27</sup> to encourage European tax administrations to cooperate more closely. It provides best practices for a coordinated approach to transfer pricing controls.

<sup>26</sup> OECD (Organisation for Economic Co-operation and Development) (2019). Forum on Tax Administration: Joint Audit—Enhancing Tax Co-operation and Improving Tax Certainty. Paris: OECD Publishing.

<sup>27</sup> EU Joint Transfer Pricing Forum (2018). A Coordinated Approach to Transfer Pricing Controls Within the EU.



# UN Tax Committee

This publication is a product of the  
United Nations Committee of Experts on  
International Cooperation in Tax Matters.