



Transfer Pricing Risk Assessment The UK approach

8 March 2012

Outline of presentation

What is risk assessment?

Why assess risk?

Risk assessment and transfer pricing audit

- The initial case selection
- Pre-audit analysis
- The tax at risk
- Anticipating resource

The decision to proceed to audit

Risk assessment extends to all areas of transfer pricing work

What is risk assessment?

Risk - anything which suggests that the tax return is incorrect and therefore that the taxpayer pays an incorrect amount of tax

Risk assessment is the process determining whether a risk is worth pursuit and is applied at every stage of working a case

Cost benefit analysis is key:

- what is the likely amount of tax at stake and how much tax administration resource will be required to establish the amount due?
- would time be better spent on another case?

Why assess risk?

Transfer pricing work can:

- require a lot of information to be provided
- involve research, document examination and meetings
- take many months to complete
- be complex
- be costly
- require judgement and business knowledge to establish the arm's length price

The costs fall both to the tax administration and business

HMRC concentrates its resources where tax is most at risk

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Initial selection of cases

Initial selection of cases is made through:

- A review of accounts
and/or
- Discussion with the taxpayer

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General factors affecting case selection

Worldwide effective tax rate

Approach of other countries

Results of company compared with group results

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Particular factors affecting case selection

Activities, especially very profitable activities, in or involving tax havens or shelters

Losses over a number of years

Large royalty/management fees

Charges for the use of intellectual property

Transactions that might be overlooked

Innovative business structures

Other

Risk assessment and transfer pricing audit

Detailed pre-audit work - 1

Before commencing a transfer pricing audit the following work should be undertaken:

- A detailed examination of six years' consolidated accounts and of the accounts of appropriate entities within the group.
- A review of the group's Internet site.
- A summary of the business and the important markets.
- A review of trade press and Internet for industry trends and details of where the taxpayer is placed within the sector.
- A search using a commercial database such as FAME to supply trends and comparables on the particular business sector.
- An analysis of recent developments within the group (such as new acquisitions, new markets, disposals, etc).

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Detailed pre-audit work - 2

- A review of the group structure and identification of group companies operating in tax havens or countries which offer tax shelters.
- A review of the CFC return to establish which overseas companies are claiming the benefit of the exempt activities test and motive test to avoid an apportionment of profits under the CFC legislation.
- A review of the overseas parent accounts and returns made to government bodies or available on the Internet.
- Liaison with income tax colleagues for details of highly-paid UK staff.
- Liaison (in appropriate cases) with indirect tax colleagues.
- A review of any previous transfer pricing enquiry papers

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Detailed pre-audit work - 3

Where appropriate seek advice from colleagues, such as:

- The trade sector advisor
- An economist

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Understanding the business

An important part of the risk assessment is to gain a thorough understanding the business of the group. Ideally the analysis should include:

- An overview of the business
- Location of head office and the management structure
- What type of goods or services the group is selling
- What are the principal products and/or brands
- Where the principal markets are, and what the level of sales is in each of those markets, broken down as far as possible between different products
- Where research and development is carried out
- What valuable intellectual property the group owns together with details as to which companies own what property
- etc

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Summary of reviews undertaken

Know the business

Review the file of the taxpayer

Information from other sources

- group website

- visit business

- commercial databases

- press reports

- database searches

- other – eg Customs

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Outcome of pre-audit work

The review will not provide a complete picture of the group's activities in the UK and overseas but it should answer, at least in part, the following questions:

- Is there evidence of transactions between connected businesses?
- Does there seem to be a problem (e.g. the company is making losses)?
- Can the problem be narrowed down?
- Is the case worth an audit?
- What is known for certain?
- What is known but needs confirming?
- What do I need to ask questions about?

Risk assessment and transfer pricing audit

Estimating the tax at risk - 1

A UK multinational has subsidiaries in France, Germany and Italy.

A subsidiary company in the UK provides services to the whole group.

The services consist of translation services, legal assistance on contracts and debt collection, and project management.

Approximately 50% of the services are provided to group companies in the UK, the balance to the other group companies in Europe.

The UK service company incurs costs of £250,000 in the year ended 31 December.

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Estimating the tax at risk - 2

Scenario 1

The UK service company does not charge for the services it provides to other group members.

Scenario2

The UK service company recharges all its costs, at a mark up of 8%.

Scenario 3

The UK service company recharges all its costs, but does not apply a mark-up.

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Estimating the tax at risk - 3

Exceptional cases

We recognise that we will not always be able to identify a transfer pricing risk before the start of an audit, for example details of transactions may come to light during audits into other aspects of taxation. In this situation we review the potential amount of tax at risk during the audit itself.

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Anticipated resources

As part of the pre-audit review we estimate the amount of time that we will need to complete the audit. We take into account the resources required in respect of the auditor, economist, trade sector advisor, bearing in mind the complexity of the case

Risk assessment and transfer pricing audit

The decision to proceed to audit – governance

The auditor will prepare a document setting out the Business Case:

- The case background
- The risk assessment work undertaken
- Reasons for and against an audit, supported by a scoring of transaction, behavioural and quantum risk, together with a resource forecast
- The recommendation of the Customer Relationship Manager

The Business Case is considered by the Transfer Pricing Panel (or Board in the largest cases)

The audit commences after approval is given

Risk assessment after an audit has commenced

Every case is reviewed after 3 months of the opening the audit, and thereafter at 6 months intervals.

One of the aims of the review is to consider the tax at risk and whether we should continue with the audit

We also use risk assessment when considering how to settle a case

Risk assessment is wider than transfer pricing audits

Risk assessment is used for:

- APA
- MAP

Conclusion

Effective risk identification and assessment are key steps that enable the UK tax administration to select and work the most suitable cases for transfer pricing audit.

References

HM Revenue & Customs publishes its guidance for transfer pricing auditors in its International Manual.

Risk assessment is discussed at INTM461000 to INTM461260

Governance of transfer pricing audit is at INTM453010 to INTM453090

www.hmrc.gov.uk/library/manuals/internationalmanual



Thank you

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