

Guidelines for the conduct of transfer pricing enquiries

Introduction and scope

- a) The guidance below outlines the practices and procedures HMRC has adopted for transfer pricing enquiries in order to achieve the aims of Proposal 5 of the 2006 Review of Links with Large Business. These were:
 - greater certainty;
 - an efficient risk based approach to dealing with tax matters;
 - speedy resolution of issues; and
 - clarity through effective consultation and dialogue.
- b) Specifically for transfer pricing, HMRC have said that, in the norm, transfer pricing enquiries will be settled in 18 months with only the most complex cases taking 36 months, or else a decision taken to litigate the case to bring it to a conclusion.
- c) This document is primarily intended to provide guidance to HMRC officers on working practices that ensure that transfer pricing enquiries are worked most effectively. It also outlines the practices and behaviours HMRC will expect businesses to adopt in order to achieve a more efficient and speedy working of transfer pricing enquiries.
- d) A Transfer Pricing Group (TPG) has been formed consisting of dedicated specialist from the Large Business Service, Local Compliance, Knowledge Analysis and Intelligence, Special Civil Investigations and CT&VAT. This cross directorate group will be involved in every transfer pricing enquiry carried out by HMRC.
- e) This guidance applies primarily to enquiries involving the application of the transfer pricing rules found at Schedule 28AA ICTA 1988, but will apply also where similar principles are applied in determining the attribution of profit to a permanent establishment. This includes some thin capitalisation cases. (Further details of the application of this guidance to thin capitalisation is at paragraph i below.) The approach articulated in the guidance will also apply to enquiries that are not primarily concerned with establishing arm's length results, but where Schedule 28AA is nevertheless relevant but only the transfer pricing part of the enquiry will be governed by the new procedures.
- f) The term "enquiry" in this guidance refers to an enquiry into a tax return under the provisions of Part IV Schedule 18 FA 1998 or Section 12 AA TMA 1970.

- g) There is substantial existing guidance on the conduct of transfer pricing enquiries, found at INTM 460100 et seq and in Tax Bulletin 60. This new guidance supplements existing material by introducing additional guidance on conducting transfer pricing enquiries in an efficient and timely manner.
- h) Much of the guidance below represents best practice and will apply to existing as well as new enquiries. Other parts of the guidance represent a marked change in the way that transfer pricing enquiries are currently conducted and are introduced in conjunction with changes to the way in which transfer pricing enquiries are managed.
- i) In thin capitalisation cases, negotiations leading to agreements between HMRC and a business on the deductibility of interest payments generally take place over a shorter timescale than “mainstream” transfer pricing enquiries. HMRC has no wish to prevent the continued successful operation of this aspect of transfer pricing work and as a result, the following will not be subject to this guidance:
- discussions between HMRC and a business in relation to a thin capitalisation (or similar) agreement in conjunction with an application under a double taxation agreement (DTA) for relief from UK withholding tax on interest;
 - discussions between HMRC and a business in relation to an advance thin capitalisation agreement under the procedures resulting from the consultation, begun in May 2007 (*“Changes to Clearance Processes for Financial Transactions”*), relating to thin capitalisation agreements outside the DTA clearance process.

This guidance will thus apply to the application of Schedule 28AA to the deductibility of interest only in cases where the issue is considered for the first time in the context of a formal enquiry into a return.

Enquiry Governance and Management

1. All transfer pricing enquires will incorporate common key elements. These are:
 - Risk assessment. This is described below in paragraphs 12 to 21 below;
 - Business Case. This is described in paragraphs 22 to 28 below;
 - Timetable and action plan. Further details about this are included at paragraphs 29 to 39 below and at Appendix A (1)
 - Six monthly reviews. These are described in more detail at paragraphs 7 below;
 - Resolution decision. This is described at paragraph 8 below.

2. All cases will pass through a series of “stage gates”, each of which correspond to one of the enquiry elements described above and will each be subject to review. The key features of each of the gates are:
 - They ensure a consistent approach to all transfer pricing enquires
 - They provide a structure for the management and governance of transfer pricing enquiries and ensure that transfer pricing enquiries are actively managed from their inception
 - They indicate what needs to be achieved by the time the stage gate is reached
 - They leave flexibility for the conduct of transfer pricing enquiries between each of the stage gates.

The decision at each stage gate will be subject to review and approval. This will mean that the case team will need to prepare a recommendation on the key decision to be made at each stage gate and that the decision will be subject to approval. It will be necessary for case teams to keep a file record of these approvals at each stage gate. The approval mechanism consists of a panel process. Panels convene to consider the case at every stage gate, though in some instances to aid swift resolution of enquiries a panel member can take a decision without the full panel. Representatives of each directorate involved in transfer pricing work sit on the panels. There is one panel for Local Compliance cases and one for Large Business Service. The most important decisions in larger cases will be escalated to the Transfer Pricing Board which is accountable for all HMRC transfer pricing cases.

3. Each stage gate centres on a key decision that needs to be made and approved before the enquiry proceeds towards the next gate. These are described below.
4. *Stage Gate 1.* This is the risk assessment described in detail below. The key decision at this stage is: Do we progress to the development of a business case to justify an enquiry? This decision is made in the light of the information available, and analyses carried out, during the risk assessment. If this gate is passed, the case team will develop a business case. Further guidance on the development of a business case is provided at paragraphs 22 to 28 below.
5. *Stage Gate 2.* The key decision at this stage is whether, in the light of the business case, an enquiry should be opened. If this gate is passed, the enquiry will be opened. At this stage HMRC will commit resource to the enquiry and work with the business to develop an agreed enquiry timetable and action plan.
6. *Stage Gate 3.* The key decision at this stage is whether the enquiry timetable and action plan is acceptable. Further guidance on the development of an action plan and timetable is provided at paragraphs

29 to 39 below. This would normally be developed in collaboration with the business. Once this gate is passed, the enquiry will continue in accordance with that timetable and action plan. A particular issue to consider at this stage is whether the enquiry is “particularly complex and high risk”. If it is, then the timetable may extend beyond 18 months. In some cases, it will not be possible to take a view at this stage on whether the case is “particularly complex and high risk”. This might be the case, for example, if HMRC has not had access to detailed information regarding transfer pricing at the risk assessments and business case stages. In such cases, the timetable would normally not extend beyond 18 months, but the issue may be reconsidered at a further point in the enquiry. Further guidance on the meaning of “particularly complex and high risk” is provided at paragraphs 34 to 37 below.

7. *Stage Gates 4.* These are a series of review points, built into the timetable. The reviews should normally be held every 6 months during the enquiry. The key decision to be made at these stages is how the enquiry should continue. The main options are:
- To continue in accordance with the timetable/action plan;
 - To continue in accordance with a revised timetable/action plan;
 - To close the enquiry;
 - To progress towards resolution.

The objective of this stage is to ensure that the case is progressing in accordance with the action plan/timetable and to explore whether the enquiry strategy should be revisited. A particular point to be considered at this stage is whether, in the light of the progress to date, the case has, exceptionally, become “particularly complex and high risk”, with the effect that the timetable may extend beyond 18 months.

8. *Stage Gate 5.* This stage occurs at the point at which sufficient information is available, and sufficient analysis has been carried out, for HMRC to take a view over the acceptability of the pricing under enquiry and what adjustments, if any, are necessary. HMRC should also understand at this stage whether there is sufficient common ground with the business to reach a negotiated settlement. The key decision to be made at this stage is whether to seek a resolution of the enquiry and, if so, how to progress towards resolution. The options at this stage are:
- to close the enquiry without adjustment;
 - to seek a negotiated settlement with the business;
 - to progress to litigation.

Conduct of the Enquiry

9. The enquiry will be project managed where this is warranted and HMRC will make use of appropriate project management tools.
10. A transfer pricing team will be formed to conduct the transfer pricing enquiry. The size and make-up of this team will be dependent on the scale and complexity of the enquiry. The team will be lead by the Customer Relations Manager of the business and will consist of elements of the usual case team and at least one transfer pricing specialist from the TPG. The role of the transfer pricing specialist will be to support the team as appropriate, from providing specialist knowledge through advice to full hands on involvement. The team will have regular meetings to assess progress and decide on next steps. HMRC will ensure effective management of the team to ensure continuity where the officer conducting the enquiry, or a member of the enquiry team, leaves the case.
11. HMRC will be clear and open about the transactions that are to be subject to the enquiry. HMRC will make explicit:
 - which transaction(s) is(are) to be the subject of the enquiry;
 - what aspects of the transaction and its pricing is to be tested;
 - the criteria by which the transaction is to be tested and
 - what HMRC needs to understand in order to achieve this. (The information specified at this stage cannot be regarded as final and HMRC may need to make further or more detailed information requests as the enquiry progresses.)

An example is provided at Appendix A(2). The case team will aim to provide, and seek to agree, this analysis at the beginning of the enquiry. However, there will be cases in which additional significant transfer pricing issues emerge during the course of the enquiry and, in such cases, HMRC will provide these details as the new issue(s) emerge.

Risk assessment

HMRC recognises that transfer pricing enquiries are diverse and not all require the same input. Accordingly criteria will be applied to match resource input to the needs of the enquiry. These criteria will take account of the three risks described above. That is, quantum risk, transaction risk (e.g. nature, complexity, etc) and behaviour risks.

Profiling cases in this way will foster consistency of approach, informing key decisions such as whether an enquiry is appropriate at all; and if an enquiry is appropriate, how this will be structured, resourced and managed going forward.

12. It is essential that a full risk assessment is carried out to ensure that a) businesses are subject to enquiry only in appropriate cases and b) any enquiry is properly focused on identified high risk transactions.
13. Risk assessment in relation to transfer pricing will normally be part of a wider risk review. HMRC has set out its intentions with regards to risk review in the document “HMRC approach to compliance risk management for large business” (published March 2007). The document recognises that, for more complex and higher risk large businesses, we will gain a deeper understanding of tax risk from our direct engagement with business (supplemented by additional data where appropriate). It recognises that it is best practice to engage in open discussion about tax strategy, how tax impacts upon operations and the business approach to risk management. The practices and principles described in that document apply to transfer pricing risk in the same way that they apply to other risks.
14. There will normally be at least three elements to a risk assessment in relation to transfer pricing.
15. The first is the “quantum risk”. This is the value of tax at risk. In this context, to categorise a transaction as “high risk” does not necessarily imply that the pricing of the transaction is considered to be other than at arm’s length. Rather, a transaction will be “high risk” if the value of the transaction is such that incorrect pricing could lead to a significant understatement of taxable profit.
16. The second is behaviour risk. This is aligned with the HMRC risk framework described in paragraph 13 above. In line with the approach described in the paragraph above, the risk assessment in respect of transfer pricing should include an understanding of the system and processes the business has in place in order to manage its transfer pricing issues and ensure compliance. For more complex and higher risk businesses, we should seek to understand:
 - the business approach to, and strategy for, transfer pricing compliance and tax planning;
 - the processes the business has in place for identifying and understanding transactions that fall within the transfer pricing regime;
 - the systems in place for capturing pricing and other terms in place for such transactions and for assessing whether they meet the arm’s length principle;
 - the approach taken by the business for testing actual pricing against the arm’s length standard and for making computational adjustments in the company tax return;
 - the business systems in place with regards to transfer pricing. For example, is there a policy under which the various parts of the business are required to use demonstrably arm’s length pricing? Or are parts of the business free to set their own pricing

policy? How does the tax function capture and test pricing information and what part does it play in setting business pricing policy? What processes are in place for auditing pricing compliance policies?

17. The third is the transaction risk. This is concerned with the nature of the transaction and such issues as its complexity and whether it involves points of principle.
18. It is in the interests of business as well as HMRC that risk assessments in relation to transfer pricing are carried out thoroughly and with full information. Where there is a full understanding of the business and the transactions it undertakes, HMRC can identify those areas of highest risk and focus attention on those areas. This enables HMRC to be clear about the particular transactions to be tested in an enquiry and for information requests to be targeted. Furthermore, an early consensus between HMRC and the business on the high risk areas will also enable the business to focus its compliance efforts and analyses (including documentation) on those areas. HMRC will seek pre-return and/or pre-enquiry discussions with businesses in order to allow HMRC to work with them to understand and identify the key areas of transfer pricing risk. In many cases, such discussions already take place. HMRC will seek to expand these so that they become the norm where appropriate. However, pre-return discussions cannot go as far as agreeing a subsequent tax return unless a formal advance pricing agreement is entered into.
19. Transfer pricing enquiries frequently rely on factual information relating to periods some years before the enquiry. This can present difficulties with obtaining reliable information, as records become difficult to locate and interpret and business personnel change. It is thus often advantageous for businesses to provide HMRC with real time information. This might be by means of presentations and other meetings. HMRC will discuss with businesses whether, and in what form, information on transfer pricing might be provided to HMRC.
20. There is substantial existing guidance on risk assessment in relation to transfer pricing at INTM 461010 et seq which should be referred to when carrying out the risk assessment.
21. In order to carry out a detailed and informed risk assessment, case teams need good quality information. As part of the risk assessment, HMRC will normally invite businesses to take part in pre-return and pre-enquiry discussions and relevant information would be provided to HMRC at this stage. However, HMRC cannot require businesses to provide information until an enquiry has been formally commenced and there will be cases where businesses are unwilling or unable to take part in pre-return or pre-enquiry discussions. In such cases, HMRC may not have the full information needed in order to carry out a fully informed risk assessment and it may be necessary to open an enquiry

in order to obtain the information required to carry out a full assessment of transactions with affiliates. In these cases, decisions at stage gates one and two will be based on the information available and a view of what is not actually known but is possible and likely, including why there is a gap in knowledge. That is, at least part of the risk assessment phase will be carried out in the enquiry. In such cases, businesses will be asked, at the commencement of the enquiry, to provide their documentation¹ (in relation to transfer pricing) to support their return and self assessment.

Business case

- 22.** The outcome of the risk assessment described above would normally be a decision as to whether there are transfer pricing points that would justify further investigation. If there are such issues, the next action would be to develop a business case for opening an enquiry into one or more of those issues.
- 23.** The key question addressed in the business case is: is there enough evidence that the case is of sufficient value and importance to HMRC to open an enquiry, given the resource commitment needed to conduct the enquiry?
- 24.** The business case is the formal justification for opening an enquiry and should include:
 - a description of the issues in point, including points of principle;
 - the amount of tax potentially at stake, in both the year of enquiry and other years that will be affected by HMRC intervention, including likely tax adjustment and yield (if known);
 - other issues that impact upon the risk. This would include whether the case would create a precedent (or is a test case), the risk assessment of the business (behaviour risk) and the risk assessment of the transactions in point (the transaction risk);
 - risks involved in settling the case;
 - the resource required to conduct the enquiry, including the input that will be required from transfer pricing and other specialists;
 - an estimate of the timescale for completing the enquiry.
- 25.** The level of information and analysis contained in the business case should not be out of proportion to the size and complexity of the case.
- 26.** The amount of information available at this stage will vary between cases and, in some instances, it may be difficult to estimate the impact an enquiry is likely to have on tax yield.

¹ Paragraph 21 Sch 18 FA 1998 requires companies to maintain documentation in support of their return and self assessment. Guidance on documentation with regards to transfer pricing is contained in Tax Bulletin 37 and the International Manual at INTM433030.

- 27.** In most cases, the risk assessment will be carried out in collaboration with the business and there will be substantial information available to inform the business case. In such cases, it will be possible to include a relatively accurate assessment of the transactions in point and potential tax adjustment and yield. In cases where it is not possible to engage the business in the risk assessment, HMRC may have very limited details of the nature and value of transactions with affiliates, and of the methods used to set prices and test them against the arm's length standard. Such cases, however, may still represent a very real risk, even if it cannot be quantified. This will be the case, for example, if it is known from the nature of the business that there are likely to be high value transactions with affiliates, but there is no information available on how the pricing of those transactions is arrived at. In such cases it will still be possible to develop a business case based on the known potential risk, but acknowledging that it will not be possible to fully assess the risk until further information becomes available during the course of the enquiry.
- 28.** The business case is an internal HMRC document and will not be provided to businesses. In particular, the business case might contain industry sensitive information or confidential information not provided by that business. Even though the business case will not be provided, HMRC will still be open with the business about the risks it perceives

Enquiry Timetables and Action Plans

- 29.** An important feature of this guidance is the use of enquiry action plans and timetables, which act as "roadmaps" for the enquiry, and ensure active management of enquires. These will specify a timescale in which an enquiry will be expected to be completed. For these purposes, an enquiry will normally be treated as commenced at the time HMRC gives notice of enquiry into a company tax return. There will be cases, however, where transfer pricing issues arise within the scope of an existing enquiry at a point of time after HMRC has given notice of the enquiry. In such cases, the enquiry can be considered to have commenced when HMRC first introduces a transfer pricing issue within the scope of the enquiry.
- 30.** A transfer pricing enquiry will be treated as completed at the point at which adjustments to taxable profits are agreed in writing between HMRC and the business, or the point at which it is agreed no adjustments are due, or the time at which it is established that no agreement can be achieved and that the enquiry will be subject to formal proceedings. There will be cases in which an enquiry into transfer pricing is finalised (and treated as closed for the purpose of this guidance) but a closure notice cannot be issued. This will be the case, for example, where other issues continue to be the subject of an open enquiry or a group relief claim is awaited. The transfer pricing part

of the enquiry will be treated as closed once there is written agreement to that effect. There will also be cases where the progress of an enquiry is dependent upon the outcome of another case or issue. In such cases, the timescale will need to be extended.

31. HMRC will seek to agree with the business an enquiry timetable at an early stage in the enquiry. This timetable will provide for key stages of the enquiry, including details of the phases of the enquiry, dates for regular progress meetings or calls with the business, issue of information requests, time limits for the business to respond and for key meetings. Further guidance on the development of a timetable is included in Appendix A (1). The timetable will include agreed timescales for the submission of information by the business to HMRC.
32. As mentioned above, the enquiry timetable and action plan will specify a timescale for the completion of the enquiry. In most cases, this would be expected to be no longer than 18 months. However, a longer timescale (but no more than 36 months) may apply in exceptional cases which are both particularly complex and high risk. In those exceptional cases, HMRC will still conduct the enquiry to the same standards as cases to which an 18 month timescale applies.
33. Where the business does not wish to agree an enquiry timetable and framework, HMRC will take a view as to whether the case is particularly complex and high risk and will inform the business of its view and the timescale in which it aims to complete the enquiry. In such circumstances HMRC will use formal powers as necessary to progress the enquiry in line with the timescale. Formal powers will also be used where a previously agreed timetable is not kept to.
34. Whilst it would be virtually impossible to provide an exhaustive definition of what “particularly complex and high risk” means in the context of transfer pricing enquiries, HMRC considers that the factors described in the following paragraphs would be indicative of cases that would meet these criteria. This list of indicators is not intended to be prescriptive in limiting the definition of these terms and it should be noted that not all of these indicators will need to be present to make a case “particularly complex and high risk”. Some of the factors (such as business restructuring) will be common to both categories but no repetitions have been made in the lists below.
35. The level of *complexity* of a case will need to be gauged by reference to both procedural elements of the enquiry that will affect the ability of HMRC to meet its expected normal timescale and the nature of the transactions under consideration.

The following would be seen by HMRC as indicators of particular complexity. The list is illustrative not exhaustive.

- Cases involving business restructuring (that is, cases that involve a major change to the way that the business is conducted).
- Cases involving transactions relating to the use of intellectual property or other intangibles.
- Cases where the point at issue is whether the characterisation of entities is properly reflected in the pricing methodology applied.
- Cases where HMRC needs to use formal information powers and formal proceedings to force progress towards settlement.
- Cases where information is difficult to obtain either because of legal impediments, the relationship between the parties or the necessity of using Exchange of Information procedures under Double Taxation Conventions.

36. As regards the definition of *high risk* no attempt will be made to apply a fixed value in terms of tax or price to transactions that would automatically make a case “high risk” but the amount at stake will generally be a consideration for HMRC in both risk assessment and in “categorising” a case.

The following will be seen by HMRC as indicators of high risk.

- The behaviour of the business, measured in line with HMRC’s risk assessment framework, and consideration of culpability (if any).
- Cases involving transactions with low tax jurisdictions.
- Cases with a precedent value.

37. In terms of applying the appropriate timetable to an enquiry, in exceptional cases it may be obvious at the commencement of an enquiry that the case is particularly complex and high risk and that a longer timescale than the normal target of a maximum of 18 months should be applied. HMRC will inform the business where this is the case. There may also be cases where it becomes clear during the course of the enquiry that there are elements of the case that bring it within the scope of being particularly complex and high risk. In these circumstances it will be necessary for HMRC to review the timetable to establish whether it will be possible to still meet the normal time limits for resolution or whether a longer period should apply. The result of the review will be discussed with the business so that the appropriate timetable can then be applied.

38. The enquiry timetable should be monitored during the course of the enquiry and (in discussion with the business) updated as needed. This will occur at the review points within Stage Gate 4 described above, but the timetable should contain the flexibility to be reviewed and revisited as necessary during the course of the enquiry.

- 39.** As mentioned above, the timetable will include a target date for the completion of the enquiry. It should be made clear that an enquiry will not be closed down for the sole reason that a target date has been, or is expected to be, missed.

Obtaining relevant information

- 40.** HMRC will routinely use existing information powers if the business does not provide full and relevant information in a timely manner. This will include cases in which the business is unable to agree to an enquiry timetable or does not submit information in accordance with an existing timetable. Those powers include Paragraphs 27 Schedule 18 FA 1988 and Section 20(1) TMA 1970 (for “first party” particulars and documents) as well as third party enquiries under Section 20 (3) TMA 1970 (for documents). These powers will be used in accordance with published instructions in the Enquiry Manual (at EM 1550 and 2201 et seq). In addition, the Exchange of Information provisions of the relevant DTA will be used where necessary. Information powers will be used consistently and appropriately across all cases.
- 41.** If HMRC considers that Exchange of Information is required through its competent authority, then this should, where possible, be undertaken at an early stage of the enquiry, because of the built in time lapse involved. An exchange will be considered only where there is a significant risk to the UK tax base in connection with the business under enquiry and the information sought cannot be obtained by alternative means.

Responsibilities of the Business

- 42.** HMRC will aim to work and complete transfer pricing cases within a defined timescale. However, the speed at which HMRC is able to conduct a transfer pricing enquiry will depend in part on the co-operation of the business concerned. Where such co-operation is not forthcoming, HMRC will still apply the practices described in the paragraph above, and seek to complete the enquiry within a specified timescale, but can be expected to use the formal powers open to it in order to achieve this.
- 43.** In order to be able to complete an enquiry in the most effective and speedy manner, HMRC will expect the following from businesses.
- 44.** At an early stage in the enquiry, businesses should agree with the HMRC enquiry team a documented enquiry plan and timetable (as described in paragraphs 29 to 39 above). Once agreed, businesses (as well as HMRC) should make every effort to act fully in accordance with that timetable. If, due to unforeseen circumstances, it is not possible to

keep to the timetable, businesses and HMRC should seek to agree a revised timetable.

- 45.** Businesses are required to maintain relevant documentation (in accordance with published guidance) that can be made available to HMRC on request during an enquiry². As described above, HMRC will seek pre-return discussions with businesses in order to understand the latter's' business processes and to agree between them the most important transactions and risks. These discussions should enable the business and HMRC to agree on those transactions which warrant in-depth analysis and documentation and those transactions which, because they are agreed to be lower risk, require less extensive documentation. Such discussions should also provide an indication of the type and form of documentation that would be most useful and acceptable to HMRC. If, for whatever reason, the business and HMRC are not able to hold such discussions or reach consensus on the scope and type of documentation needed, HMRC will expect documentation, in accordance with CTSA requirements and published guidance, to be made available, on request, at the beginning of an enquiry. If such documentation is not available at that time, HMRC will seek to apply penalties for failure to maintain adequate documentation. In addition, failure to maintain documentation may be regarded by HMRC as evidence of neglect. This will affect the question of whether penalties may be applicable, and, if so, the amount of such penalties, in the event of an adjustment to taxable profit.
- 46.** Businesses are expected to fully resource the enquiry.
- 47.** Businesses should provide a response to information requests in accordance with an agreed timetable.
- 48.** As mentioned above, transfer pricing enquiries often require an in-depth understanding of the way in which a business operates and this frequently entails detailed fact-finding. This is usually best achieved through meeting with business personnel. In such cases, HMRC will expect businesses to provide access to relevant business personnel.

² Paragraph 21 Sch 18 FA 1998 requires companies to maintain documentation in support of their return and self assessment. Guidance on documentation with regards to transfer pricing is contained in Tax Bulletin 37 and the International Manual at INTM433030.

APPENDIX A (1)

Further Guidance on enquiry action plans and timetables.

49. As mentioned in paragraphs 29 to 39, above, HMRC will seek to agree an enquiry action plan with the business at the beginning of any enquiry. This would include a statement of the key features of the enquiry and a timetable for the conduct of the case.

50. Key features

The enquiry action plan should include:

- details of the transaction or transactions subject to the enquiry;
- details of the resource commitments the business and HMRC agree to be available for the working of the enquiry;
- details of the HMRC and business teams working the enquiry, together with named primary contacts. The CRM will be the lead contact;
- a statement of the objectives of the enquiry. This might include, for example, a statement that “HMRC and the business will either agree whether an adjustment is due (and, if so, its quantum) or establish that the issue will move to litigation, by [date]”;
- a broad statement of how that objective is to be achieved;
- details of the communications processes to be put in place. For example, it might be agreed to set up a shared internet workspace.

51. Timetable

An example of the timetabling of a transfer pricing enquiry is set out below. Rather than set a rigid timeline for the enquiry process, the aim of this purely illustrative example is to show the elements of the enquiry that will need to be considered in drawing up a timetable. As mentioned above, the commencement of a formal enquiry should not normally be the first steps in the enquiry process and should, under best practice, follow on from pre-enquiry discussions between the HMRC and the business.

52. After the risk assessment and business stage gates have been completed, in each appropriate case, HMRC will give notice of an enquiry into a return (which includes transfer pricing issues). Best practice will be for HMRC to give the notice of enquiry and to issue its initial clarification of which transactions are to be tested (see paragraph 11 above) and requests for information at a meeting with business to establish:

- The appropriate timetable within which the enquiry is intended to be completed, and
 - The design of that specific timetable.
- 53.** The timetable will need to include all of the elements set out below. Given variations in information systems, staff availability etc, the timetable and each element within it will need to be individually designed, taking into account the factors affecting both the business and the HMRC team involved.
- 54.** Having agreed the length of the enquiry period (which may be up to thirty-six months based on the level of risk and complexity of the issues) the first stage of the enquiry process will be the gathering of relevant information by HMRC. The amount of information to be requested, including site visits and meetings with personnel from the business, will often depend on what has been made available to HMRC during the risk assessment period. If the business held discussions with or made a presentation to HMRC during this period, the request might be restricted to information to verify the facts and further information required to understand fully the nature of the transactions and the transfer pricing applied in respect of them. Where no such discussions have taken place, the request would be expected to be more extensive and the time period allocated for gathering and providing the information would need to be set with this factor in mind. Such a request would usually include the documentation (relating to transfer pricing) maintained in accordance with the requirements of the CTSA regime, if this has not been provided during pre-enquiry discussions.
- 55.** Setting the time period for the provision of information will also need to be based on the ability of the business to access and provide the relevant information and will be the result of discussion and agreement. To ensure that the timetable is kept to throughout the process, best practice will be to timetable regular discussions of progress against the plan and allow flexing of the timetable where appropriate.
- 56.** The next element of the timetable that will need to be defined is the length of the period in which HMRC will review the information provided. The setting of the timescale for this stage will be usefully informed by discussion of both the format and volume of information that the business will provide. The timetable should include a meeting at the end of the information review period at which HMRC can set out its findings and seek any necessary clarifications of the information provided. It should be noted at this point that HMRC's findings, at the end of any information review stage, might be that further information is required. The timetable will thus need to build in a flexibility that allows for further information gathering and review, where it is appropriate to the case.

- 57.** Once the review of all relevant and appropriate information has been completed, HMRC will discuss the results of its review with the business in a meeting. The results of HMRC's review will range across a spectrum from the enquiry being settled on the grounds that all of HMRC's concerns have been addressed to a situation where HMRC's concerns have not been satisfied and the enquiry must continue. Given the range of possible outcomes, best practice is that the timetable should be drawn up based on the assumption that the enquiry will continue past the information gathering and review stages. As a result, both the business and HMRC will be prepared for the on-going enquiry to be appropriately resourced.
- 58.** The timetable will need to include a period by the end of which the business will respond to any concerns on the part of HMRC arising from its review of all of the information provided. At the end of the information review process, HMRC will clearly set out its areas of continuing concern so that the business is aware of which specific issues and areas need to be addressed. The timetable should incorporate the possibility of revision here, if appropriate, based on how best to progress the enquiry. During the period in which the business is preparing its response or seeking further information, the timetable should provide for regular update discussions to ensure that the plan for completion will be met. The timetable should include a meeting at the end of this period, at which the business will be able to make any further representations and clarifications that it wishes HMRC to consider.
- 59.** The remainder of the agreed timetable will concentrate on resolution of the enquiry. Regular discussions and meetings should be planned with a view to completing the enquiry within the agreed timescale. In this context, "completion" will include the situation where it is decided to resolve the case through litigation but not the completion of the litigation itself.
- 60.** The timetable will normally include agreed dates for regular update meetings or conference calls.

APPENDIX A(2)

Further guidance on informing the business of the points at issue

61. As described in Paragraph 11 above, HMRC will be clear and open about the transactions that are to be subject to a transfer pricing enquiry. The following example illustrates the approach described in that paragraph. That is, HMRC will specify:
- which transaction(s) is(are) to be the subject of the enquiry;
 - what aspect(s) of the transaction and its pricing is to be tested;
 - the criteria by which the transaction is to be tested, and
 - what HMRC needs to understand in order to achieve this.

Example

62. This example concerns a UK company (UK Ltd) engaged to provide research and development activities on behalf of an overseas affiliate (Non-UK Ltd). The method the group employs to set the pricing is a cost-plus method, under which Non-UK Ltd pays UK Ltd a sum consisting of UK Ltd's costs, plus a mark-up of 10%. This is characterised in UK Ltd's transfer pricing documentation as a "contract research" arrangement.

1. *The transaction(s) subject to enquiry.*

The transaction to be tested is the provision of research and development facilities by UK Ltd to Non-UK Ltd.

2. *The aspect(s) of the transaction and its pricing to be tested.*

HMRC will test whether cost-plus is an appropriate method to set the pricing between UK Ltd and Non-UK Ltd.

3. *The criteria by which the transaction is to be tested.*

HMRC will consider whether the actual functions carried out by UK Ltd and Non-UK Ltd are consistent with their respective characterisations as low-risk research provider and research contractor.

4. *What HMRC needs to understand in order to achieve this.*

HMRC will need to understand:

- i) How decisions are made concerning the identification and prioritisation of research projects, who makes these decisions and where the people making them are located.
- ii) How R&D projects are financed, the process by which funding is allocated to projects and how such funding is approved. Who is involved in making these decisions and where are they located?
- iii) The ownership of any value (including IP) arising from the R&D.
- iv) The process for reviewing and assessing R&D projects. Who is involved in this and where are they located?
- v) Whether UK Ltd subsequently uses the IPR it created in its wider trade.

In order to achieve this HMRC will issue a detailed information request and will wish to meet with key people from the business.