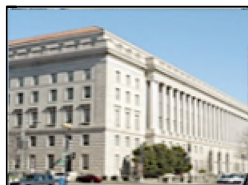


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29 DTR G-3
Tax Compliance
Tax Practitioners Fear Lack of Goals in IRS Audit Campaigns


By Alex M. Parker

A lack of clear goals and measurements for success could lead to aggressive or inconsistent enforcement of newly announced IRS audit campaigns, several tax professionals said.

"If the IRS lacks a central plan as to how to pursue transfer pricing cases, it's not surprising that the individual agents are going off in a variety of directions," William Schmalzl, a partner at Mayer Brown in Chicago, said during a Feb. 9 webcast.

The Internal Revenue Service Jan. 31 announced 13 campaigns for audits, including international taxation issues such as transfer pricing for inbound distributors, repatriation strategies and non-filing of tax returns by foreign companies doing business in the U.S.

While the IRS has emphasized that the campaigns are primarily guidance intended to focus the resource-strapped agency on the most pertinent issues, tax practitioners said they are puzzled about how these specific topics were chosen—and how agents will be pursuing their enforcement.

Issue Selection

Schmalzl noted that in the international front, the outbound transfer of intellectual property—recently highlighted with controversial new regulations (T.D. 9803) under tax code Section 367(d)—would likely be a more lucrative focus for revenue than inbound distribution.

"In my own experience, a lot more cases are being pursued by agents focusing on outbound transfers than focusing on inbound distributors," Schmalzl said. "Further, I would expect the potential for a large adjustment is much greater when dealing with an outbound transfer of technology, rather than trying to adjust the profit of an inbound distributor."

As practitioners sought to wrap their heads around the campaigns announcement, many wondered whether the approach would lead to defter enforcement or an assumption of guilt.

"The IRS talks about these campaigns being the product, at least in part, of data analysis. And if you look at some of the issues, you wonder what data is the IRS looking at to determine that this should be a campaign," said Daniel Rosen, a partner at Baker McKenzie LLP in New York.

In the case of inbound distribution, or networks used by foreign companies to distribute goods in the U.S., the issue seems to be driven less by data than by a prior IRS project to look into the issue.

"The concern I have is that the way this campaign is phrased, it does suggest that if you're tagged as a taxpayer who's going to be part of this campaign, you're going in with the presumption that there are problems with your transfer pricing, as opposed to it being an issue that has just been identified for purposes of audit and seeing where the issue goes," said Rosen. "It seems to suggest the conclusion."

"They identified issues that they're focusing on as part of these campaigns, and given a little bit of background, but not the kind of specifics that you would like to see," said Joseph Caliano, a partner at BDO USA LLP in Washington. "Like what specifically are the transactions you disagree with, or you think taxpayers are taking an incorrect or overly aggressive position on?"

The Trouble With Measurements
Snapshot

- Difficulty of setting goals, measuring success in the international area could hinder enforcement of new IRS campaigns
- Some practitioners question how IRS selected its issues

The announcement of the campaigns follows a November report from the Treasury Inspector General for Tax Administration, which identified issues of concern in the agency's transfer pricing enforcement. The report highlighted a low rate of sustaining transfer pricing adjustments through the IRS appeals process, and also claimed a transfer pricing road map for auditors isn't always being followed.

May Chow, an associate with Mayer Brown in Chicago, also speaking during the Feb. 9 webcast, said TIGTA itself ran into problems measuring IRS's success. The report looked at exam length as a benchmark, but Chow said a few lengthy cases may have given a misleading result.

"It doesn't appear that the length of exam is the ideal metric to measure the success of the IRS's transfer pricing efforts," Chow said. "The IRS management will have to decide what measure to rely on. TIGTA has opened up a really important question for LB&I"—the Large Business and International Division of the IRS.

During the announcement of the campaigns, LB&I Commissioner Douglas O'Donnell said the agency is aiming to remain flexible as it implements its campaigns focus.

"We are very interested in recalibrating to the extent that anything that we're doing either doesn't make sense or doesn't achieve what we wanted to achieve," O'Donnell said during a teleconference with reporters Jan. 31. "A lot of this is being flexible, paying attention to an ongoing communications feedback loop."

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