

TIGTA Transfer Pricing Report May Put Pressure on IRS Appeals

IRS examiners' poor record in persuading the Office of Appeals to sustain transfer pricing adjustments deserves attention, but disseminating the details of every overturned adjustment may subject Appeals to undue scrutiny, according to a practitioner.

While a September 2016 Treasury Inspector General for Tax Administration report criticizing the IRS's handling of transfer pricing audits raises important questions, its recommendation on overturned adjustments may have the opposite of its intended effect, William Schmalzl of Mayer Brown LLP said during a February 9 webinar held by his firm. Based on a review of more than 200 audits involving at least one transfer pricing issue conducted between 2012 and 2014, TIGTA found that Appeals sustained only \$2 billion of the \$10.5 billion in proposed adjustments. The report also criticizes the IRS for failing to adhere to its 2014 transfer pricing audit roadmap.

"The Commissioner, LB&I Division, should implement a postmortem review of examinations with transfer pricing issues that went through the Appeals process. These results should be shared in training efforts to improve the accuracy and quality of future transfer pricing examinations," the TIGTA report says. It adds that "the IRS's corrective actions should also include dissemination of the Appeals results to the responsible revenue agents and their managers."

The report does not specify whether the low sustention rate is because examiners are too aggressive or because Appeals officers are too willing to capitulate, according to Schmalzl.

"A low sustention rate could indicate one or two things that are happening: Either [examiners are] being too aggressive in pursuing transfer pricing adjustments, or Appeals is being more permissive than they should be in rejecting those adjustments," Schmalzl said. Many practitioners in private practice believe the issue is that examiners aren't conducting transfer pricing audits wisely, he said. "However, this finding by TIGTA might make some IRS employees believe that the issue is that Appeals is giving away what [examiners] might identify, leading to more difficulties in resolving weak cases at Appeals rather than stronger ways coming out of the audits."

Schmalzl added that using examiners' proposed adjustments as the baseline for measuring outcomes on appeal could add to the perception that Appeals is to blame. "The more excessive the proposed adjustment is, the more Appeals appears to be giving up. Hence, while TIGTA has shined the spotlight on a trend that certainly warrants investigation, I'm concerned that the result will be that Appeals will be more reluctant to concede weak adjustments rather than exam limiting itself to more well supported — and most likely smaller — adjustments."

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