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## United States

### **Budget Woes, Mounting Demands Force IRS to Think Strategically, Focus on Training**

**T**he Internal Revenue Service's focus on developing a strategic approach to international tax issues in part reflects a pressing need to do more with restrained resources, an IRS official said March 18.

Budget constraints limit the agency's ability to hire new examiners, but one means of coping is to train agents to break out of traditional specialties, said Michael Danilack, deputy commissioner (International) with the IRS's Large Business & International Division. Danilack spoke at an international tax enforcement conference sponsored by the American Bar Association Section of Taxation.

Danilack noted that LB&I has about 3,000 examiners, 500 of whom work in International Business Compliance and 50 to 60 of whom work in the Transfer Pricing Practice. The largest segment are considered domestic agents, he said.

"But once International's training is fully fleshed out, there is no reason you couldn't see domestic agents coming in to look at international issues," he said.

**Increasing Demands.** The ability to achieve greater flexibility in deployment of resources will be increasingly important as demands on LB&I increase, he noted. The Advance Pricing and Mutual Agreement (APMA) Program's staff is down about 15 percent compared to when it started two years ago, he said, even as the output of the APA program has increased significantly.

The budget constraints on the IRS are serious concerns, according to Peter Barnes, of Caplin & Drysdale in Washington, D.C., who spoke on a later panel.

Barnes, who also is a senior fellow at the Duke Center for International Development, warned that even as the IRS has lost international examiners, other nations "have doubled and doubled again" the number of international examiners.

"That is the environment in which multinational corporations are facing international audits," he said, and it does not bode well for U.S. multinationals or for the IRS.

Danilack noted that resource constraints have contributed, in part, to a thorny issue in the execution of the Compliance Assurance Process (CAP) for large taxpayers.

**Transfer Pricing Cases in CAP.** "We have a number of CAP cases where transfer pricing is sort of a hangover issue," he said. "Post-filing, the transfer pricing issue is still being worked with the taxpayer. It's something we're very focused on," Danilack said.

"It's understandable that transfer pricing, which tends to be very facts and circumstances oriented, is sometimes difficult to be worked out in the relatively compressed time-frame that CAP calls for," he added.

While the agency has been able to work with taxpayers in CAP on non-transfer pricing issues, "there's also perhaps a question as to whether a taxpayer who's got myriad transfer pricing issues should be in CAP at all," Danilack said.

"That's something we're wondering about at a fairly preliminary and high level," he said.

The IRS might consider urging taxpayers who want to be in CAP to combine with the advance pricing agreement process "as a way to make sure that we're not doing CAP and an audit at the same time," he said.

But Danilack also suggested that more intensive training in transfer pricing issues would lead to improved performance in the CAP arena.

"We recently released the transfer pricing road map—which is really directed towards agents—that lays out a disciplined approach to transfer pricing work," he said, and "explains how to move through a transfer pricing analysis" (22 *Transfer Pricing Report* 1251, 2/20/14).

"I like to think that as we do more and more of that—a lot of things come down to training—we may be able to work through transfer pricing issues in a more compressed time frame," he said. "Then maybe it [would] work a little better in the CAP context than it does at the moment."

**IPNs Focus on Key Issues.** A key component of that training are the recently launched international practice networks (IPNs), composed of IRS employees that gather together resources on strategic issues in international compliance. Those issues are organized around segments of the agency's international matrix and are "the engine" for international strategy, training, and data management, according to Danilack.

He noted that international compliance is organized around issues that are divided into four key components—business outbound, business inbound, individual outbound, and individual inbound (see the table below).

"We like to think we are thinking the way a planner might think," he said.

For example, an outbound U.S. tax planner will reduce a company's effective tax rate through shifting income to low-tax jurisdictions, conducting deferral planning to avoid Subpart F exposure, managing the company's foreign tax credits, and if successful, seeking to repatriate the cash.

Thus, the outbound business component is divided into income shifting, deferral planning, foreign tax credit management, and repatriation issues, and strategic priorities are established within those sub-areas.

The IPNs reflect those divisions, bringing experts together to communicate with each other on these topics, he said, and allowing the individuals responsible for strategy to communicate with agents in the field.

"Our thinking is you don't just take a strategy from on high, think it up in Washington and push it out to the agents and say 'Do this,'" he said. "You need a dynamic process because there are instances where agents stumble on things and they need a way to communicate" with their colleagues and managers.

Danilack noted that the IPNs are now up and running, developing practice units, which are intended to illustrate a particular type of transaction and how agents should think about that transaction. Those units are part of staff training and will eventually be made available to the public.

**Greater Transparency.** "One of the major initiatives we have underway is to bring more transparency to government thinking," Danilack said.

"The real question is whether what the IRS is doing out there can be considered strategic enough—thoughtful enough—to get us to a place where taxpayers are willing to lay their cards on the table," he said. "We think if we are better trained, more strategic, more focused on what we think needs to be looked at, that will facilitate that more open discussion."

He noted that foreign governments—such as the Netherlands, the United Kingdom, Australia, and Canada—already have adopted more cooperative compliance regimes, and that the United States trails them in that respect.

"The idea is if the corporate taxpayer has rigorous controls in place, good quality controls, and are compliant year to year, you can acknowledge they are low-risk from a government perspective," he said.

While the United States is interested in these concepts, he said, the size and complexity of its tax base makes it difficult to adopt such an approach, particularly given the agency's limited resources.

"Conceptually it is where we'd like to go," he said.

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### International Practice Networks (IPNs)

Business Outbound	Business Inbound	Individual Outbound	Individual Inbound	Crossover Areas
Income Shifting Outbound	Jurisdiction to Tax	Jurisdiction to Tax	U.S. Business Activities	Treaties
Deferral Planning	Income Shifting Inbound	Offshore Arrangements	Withholding	Foreign Currency
FTC Management	Inbound Financing	Foreign Tax Credits		Information Gathering
Repatriation	Repatriation/ Withholding	Foreign Entities		Organization/ Restructuring

Source: IRS