TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Barriers Exist to Properly Evaluating Transfer Pricing Issues

September 28, 2016

Reference Number: 2016-30-090

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BARRIERS EXIST TO PROPERLY EVALUATING TRANSFER PRICING ISSUES

Highlights

Final Report issued on September 28, 2016

Highlights of Reference Number: 2016-30-090 to the Internal Revenue Service Commissioners for the Large Business and International and the Small Business/Self-Employed Divisions.

IMPACT ON TAXPAYERS

Transfer pricing refers to the setting of a price for goods or services sold between one member of a multinational entity and another member of the same entity. The principal tax policy concern regarding aggressive transfer pricing is that it does not reflect an arm's-length result from a related party transaction, causing multinational corporation profits to be intentionally inflated in low-tax countries and reduced in high-tax countries. The IRS's priority is to improve voluntary taxpayer compliance attributable to these types of transactions.

WHY TIGTA DID THE AUDIT

Cross-border trade in goods and services has increased substantially over the past several decades. The IRS has designated transfer pricing as a key focus of its international compliance initiatives. Transfer pricing issues account for approximately 46 percent of the Large Business and International Division's international issues inventory and 71 percent of the potential total dollar adjustment amounts of all international issues. This audit was initiated to identify and assess the barriers to the IRS efficiently evaluating transfer pricing issues.

WHAT TIGTA FOUND

The IRS provided external stakeholders adequate education and outreach related to the transfer pricing examination process; however, some IRS employees may not be consistently following the Transfer Pricing Audit Roadmap. The IRS also does not have a process to ensure that all transfer pricing issues are identified for specialized review because 20 percent of the transfer pricing inventory is received from the Specialist Referral System. Further, Transfer Pricing Practice (TPP) employees do not have access to the Specialist Referral System and are reliant on International Business Compliance (IBC) function management to share any transfer pricing referrals with them. In addition, the Rules of Engagement between the TPP and the IBC function are not always being followed for working transfer pricing-related examinations.

Also, there are no separate performance measures related to quantifiable results to determine the success of the IRS's transfer pricing efforts, including Appeals determination information that could be used to better refine the approach for identifying and working cases.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS ensure that employees follow the Transfer Pricing Audit Roadmap, and include this as an attribute of the quality review process; ensure that TPP employees have full access to the Specialist Referral System; ensure that TPP and IBC function employees follow the Rules of Engagement, and include this as an attribute of the quality review process; develop a formal transfer pricing strategy; and implement a postmortem review of examinations with transfer pricing issues that went through the Appeals process.

The IRS agreed or partially agreed with five recommendations, and disagreed with two recommendations. While IRS management stated that they specifically track and monitor transfer pricing examinations and adjustments, identifying the assessment results of compliance efforts by issue would require modifications to several existing systems and necessitate a substantial expenditure of funds. However, in a response to a prior TIGTA report, Large Business and International Division management agreed to provide "compliance results by issue from the Issue Based Management Information System for use by the practice areas in the development of campaigns."

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 28, 2016

MEMORANDUM FOR COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL DIVISION
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Barriers Exist to Properly Evaluating Transfer Pricing Issues (Audit # 201530025)

This report presents the results of our review to identify and assess the barriers to the Internal Revenue Service efficiently evaluating transfer pricing issues. This audit is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Globalization.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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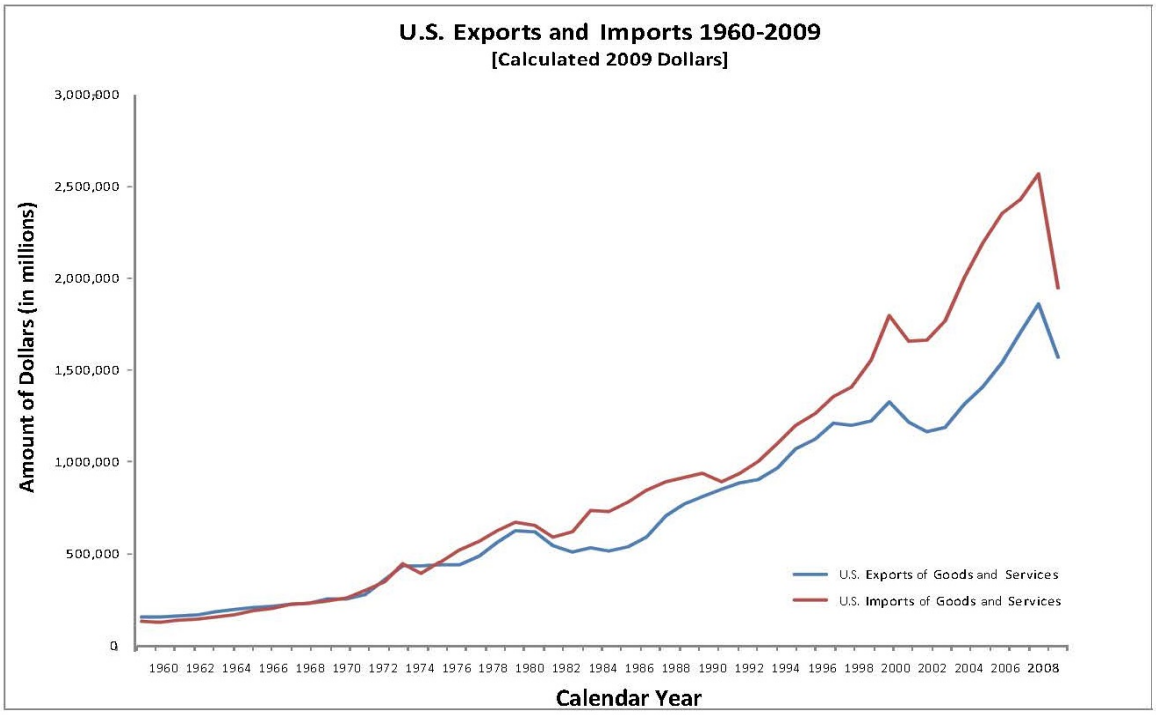
Abbreviations

ACDS	Appeals Centralized Database System
AIMS	Audit Information Management System
ERCS	Examination Returns Control System
GAO	Government Accountability Office
IBC	International Business Compliance
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
LB&I	Large Business and International
SB/SE	Small Business/Self-Employed
SRS	Specialist Referral System
TIGTA	Treasury Inspector General for Tax Administration
TPIAR	Transfer Pricing Issue Assessment Report
TPO	Transfer Pricing Operations
TPP	Transfer Pricing Practice

Background

Cross-border trade in goods and services has increased substantially over the past several decades. Many people in the United States owe their present employment to businesses that import goods for final sale or import component parts for further manufacturing in the United States. Likewise, many U.S. employers produce goods and services for direct final sale abroad or for sale as a component for further manufacturing abroad. Figure 1 compares U.S. imports and exports over a nearly 50-year period ending in Calendar Year 2009.

Figure 1: U.S. Imports and Exports for Calendar Years 1960 Through 2009



Source: Present Law and Background Related to Possible Income Shifting and Transfer Pricing, Joint Committee on Taxation, JCX-37-10 (July 20, 2010).

At the same time, foreign direct investment by U.S. persons, that is the direct ownership of a greater than 10 percent interest in assets located abroad, has grown steadily over the past 50 years. "Outbound" foreign direct investment occurs when a U.S. person acquires an existing foreign business or when a U.S. person invests in business operations abroad. Multinational

corporations engage in outbound foreign direct investment as they acquire or create assets abroad to manufacture or sell their goods and services in both the United States and abroad.[1]

There are many reasons that may motivate a U.S. multinational corporation to make an outbound foreign direct investment; however, there are extensive rules designed to preserve the U.S. tax base by ensuring that income properly attributable to the United States is not shifted to a foreign controlled party through inappropriate pricing of related party transactions. The statutory authority for those rules is found in Internal Revenue Code (I.R.C.) Section (§) 482, and the principal measure by which that authority is exercised is the arm's-length standard.[2]

Transfer pricing refers to the setting of a price for goods or services sold between one member of a multinational entity and another member of the same entity. The principal tax policy concern regarding aggressive transfer pricing is that it does not reflect an arm's-length result from a related party transaction, causing multinational corporation profits to be intentionally inflated in low-tax countries and reduced in high-tax countries. The Internal Revenue Service's (IRS) priority is to improve voluntary taxpayer compliance attributable to these types of transactions.

I.R.C. § 482 gives the IRS broad authority to make adjustments on filed tax returns and to allocate the income, deductions, and credits of commonly owned or controlled organizations, entities, or businesses. These adjustments are made when necessary to prevent evasion of taxes or to clearly reflect income. I.R.C. § 482 cases involve determining whether controlled transactions achieve results consistent with the arm's-length standard. This is typically referred to as a transfer pricing analysis.

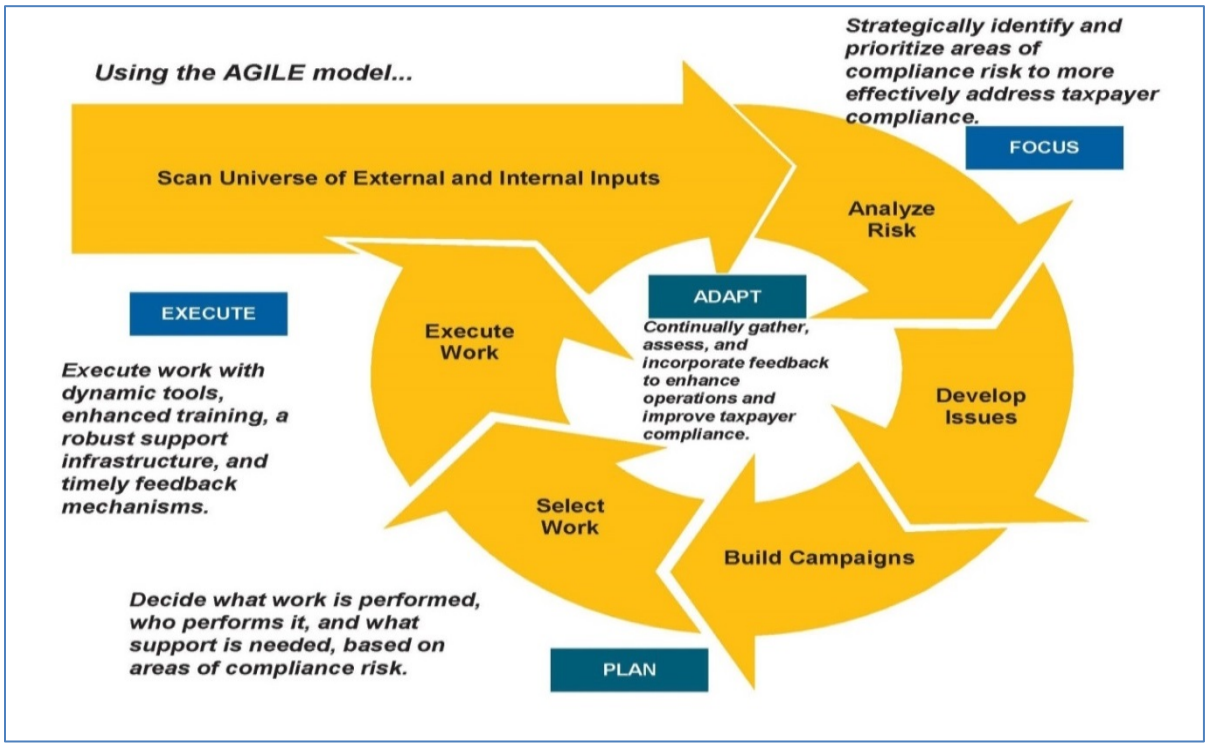
International examiners in both the Transfer Pricing Practice (TPP) and the International Business Compliance (IBC) function operate within the IRS's Large Business and International (LB&I) Division to develop transfer pricing analyses. The TPP was under the direction of the Transfer Pricing Operations (TPO) during most of our review. TPP resources are limited, and they are not available to assist in every transfer pricing case. While the IBC function develops many transfer pricing cases without direct TPP involvement, cases with significant transfer pricing issues and potentially broad impact should be referred to the TPP. The TPP also identifies emerging issues and trends in transfer pricing, ensures that appropriate technical expertise is available, assists in the development of new risk assessment techniques to identify taxpayers and issues with the greatest potential risk, and develops best practices for examination of transfer pricing cases.

The LB&I Division reorganized in February 2016, and the TPP is now under the Director, Treaty and Transfer Pricing Operations Practice Area, and the IBC function has been moved to the

[1] See Appendix IV for a glossary of terms.
[2] According to Treas. Reg. § 1.482-1(b), the arm's-length standard is met when the result of a transaction between controlled taxpayers is consistent with the result that would have been realized if an uncontrolled taxpayer had engaged in the same transaction under the same circumstances.

Cross Border Activities Practice Area.[3] Examination inventory in the LB&I Division will now be selected based on the focus of issues (campaigns). Figure 2 shows the Agile Development Model that will be used by the LB&I Division as a method to build its structure for inventory selection. This model will include a guiding principle of utilizing data analytics and examiner feedback to select better work with intended compliance outcomes.

Figure 2: The AGILE Development Model



Source: LB&I Division future structure and operation.

This review was performed at the LB&I Division's TPP and IBC function offices in San Jose, California, Downers Grove, Illinois, and New York, New York; the IBC function office in Bethpage, New York; and the Small Business/Self-Employed (SB/SE) Division's Examination function office in Downers Grove, Illinois, during the period May 2015 through April 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[3] A practice area is a group of employees organized together to focus on a particular area of expertise.

Results of Review

Education and Outreach Have Been Provided to Taxpayers With Transfer Pricing Issues, but Some Employees May Not Be Consistently Following the Transfer Pricing Audit Roadmap

International noncompliance is an area of strategic focus for the IRS. In Calendar Year 2010, the IRS consolidated most of its international tax administration responsibilities into the LB&I Division to better focus its resources on complex tax areas like transfer pricing. In recognition of the strategic importance of transfer pricing, LB&I Division management established a dedicated team of transfer pricing specialists in the TPO. This team developed the Transfer Pricing Audit Roadmap (commonly referred to as the "Roadmap") to provide IRS examiners with audit techniques and tools to assist with the planning, execution, and resolution of transfer pricing examinations. The Roadmap aligns key transfer pricing activities to these three phases of the Quality Examination Process.[4] It also describes key elements of a generic transfer pricing examination, provides advice, links to useful reference material, provides a timeline for the examination process, and lays out what taxpayers can expect from the IRS during a transfer pricing examination. For example, the three phases of a generic transfer pricing examination in the Roadmap consists of the following key elements and timelines.

- The Planning Phase which can be up to a six-month process. This phase includes the pre-examination analysis, opening conference, taxpayer orientations, and preparation of initial risk.
- The Execution Phase which can be up to a 14-month process. This phase includes fact finding, information gathering, and issue development.
- The Resolution Phase which can be up to a six-month process. This phase includes issue presentation, issue resolution, and case closing.

In each of these phases, the Roadmap provides more detailed information to assist the examiner on what steps need to be taken to complete these phases, such as what tax research needs to be done and what they should request from the taxpayer. In February 2014, the Director, TPO, introduced the Roadmap to the public. According to the IRS, the purpose of disclosing the Roadmap was to provide taxpayers "insight into what to expect during a transfer pricing examination. This transparency is intended to help improve communications and efficiency, for

[4] The Quality Examination Process was designed to promote better, more consistent communication and engagement with taxpayers throughout the entire examination cycle, from early planning activities through the resolution of all the issues. The Quality Examination Process was changed to the LB&I Division Examination Process as of May 2016.

benefit of both the IRS and taxpayers." The Roadmap was announced in several tax publications and according to PricewaterhouseCoopers, "This roadmap represents another step by the IRS in its on-going restructuring of the way it interacts with multinational entities, especially those undergoing transfer pricing examinations."

The IRS has indicated that the Roadmap is a "work in process" and plans to update it as necessary based on taxpayer input and comments. According to the IRS, the Roadmap is currently being updated to reflect the IRS's new "Future State" efforts that began in February 2016.

We interviewed TPO, TPP, and IBC function management, as well as reviewed transfer pricing education and outreach materials provided by the IRS to external stakeholders.[5] Overall, we found that the IRS provided external stakeholders adequate education and outreach related to the transfer pricing examination process, and it appears that the information would be useful to help them comply with the transfer pricing procedures. For example, with the release of the Roadmap, the TPO provided taxpayers important information to help facilitate a smooth examination process.

As part of our review, we attempted to survey a statistically valid sample of 400 corporations that, according to IRS records, had examinations concerning a transfer pricing issue and/or a case that was reviewed by the TPP or the IBC function at some point during Calendar Years 2012 through 2014.[6] However, only 46 corporations responded to our survey, which did not meet our minimum sampling requirements. Therefore, we are unable to extrapolate the survey results to the total popluation of transfer pricing-related examination cases worked by the IRS during Calendar Years 2012 through 2014.

Of the 46 corporations that responded to our survey, 63 percent of them said that they did not have any knowledge of the Roadmap. While it appears that the Roadmap provides corporations involved in transfer pricing insight into the key issues of a transfer pricing examination, and that considerable outreach has been provided to these external stakeholders, based on the responses to our survey, not all corporations may be fully aware of the potential benefits of gaining an understanding of the Roadmap. In addition, they may not be taking advantage of the opportunity to share their perspectives on the Roadmap and help shape its future use.

We also surveyed 5,991 supervisory revenue agents, revenue agents, economists, and tax law specialists in the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions to obtain feedback on their various experiences with transfer pricing issues; the training they had received to work transfer pricing cases; and their opinions on the procedures that are used to

[5] External stakeholders include taxpayers and foreign governments.
[6] Of the 46 corporations that responded, 63 percent were under examination for less than a year and 77 percent had no examination adjustments.

work transfer pricing issues.[7] The TPP and IBC survey respondents were asked if IRS management had requested their feedback on the Roadmap, and 62 percent replied "no." When the same respondents were asked if the Roadmap was used as a tool to assist them when working an examination with a transfer pricing issue, 40 percent responded that they "sometimes" use the Roadmap and 19 percent said that they "never" use it. In addition, when working with taxpayers with potential transfer pricing issues, only 62 percent of the same respondents believed that their responsibilities included referring the auditee to the Roadmap. The Roadmap was intended to provide a structured process to aid LB&I Division employees in the early identification and efficient and effective pursuit of transfer pricing issues that warrant further scrutiny. We believe that if the structured process laid out in the Roadmap is better followed by IRS employees involved in transfer pricing examinations, it could ensure consistency in their interactions with taxpayers, as well as help answer taxpayer questions about the examination process.

Recommendations

The Commissioner, LB&I Division, should ensure that:

Recommendation 1: Employees follow the Roadmap and include this as an attribute of the quality review process.

> **Management's Response:** The IRS disagreed with this recommendation. IRS management agrees that the Roadmap is a useful guide for the transfer pricing professional and provides valuable tools and techniques for the transfer pricing professional's consideration; however, the Roadmap is neither a checklist nor a "one-size fits all tool." They stated it would not be possible to monitor the "use" of the Roadmap and document it as an attribute of the quality review process.
>
> Alternatively, the IRS proposed that it will complete the current revision to the Roadmap to reflect the LB&I Division's restructuring and new examination processes, and then develop and deliver mandatory Roadmap training for all employees engaged in the examination of transfer pricing issues on the proper use of the Roadmap as a tool.
>
> **Office of Audit Comment:** The Roadmap provides detailed information to assist the examiners on what steps need to be taken to complete each phase of the transfer pricing examination, such as what tax research needs to be done and what they should request from the taxpayer. The Roadmap is intended for use by LB&I Division teams in performing a risk assessment of transfer pricing issues and in carrying out a transfer pricing examination. This Roadmap was presented to the tax practitioner community as

[7] A total of 734 surveys were sent to TPP and IBC function employees. In addition, 2,591 surveys were sent to LB&I (Domestic) Division employees and 2,666 surveys were sent to SB/SE Division employees. A total of 255 employees responded to the TPP/IBC function survey, and 455 LB&I (Domestic) Division and 303 SB/SE Division employees responded to the LB&I (Domestic) and SB/SE Divisions' survey. A total of 11 employees did not report their business unit.

the way the IRS would work with multinational corporations during a transfer pricing examination. The IRS should at a minimum make this an element of employees' workload case reviews performed by managers.

Recommendation 2: Taxpayers undergoing examinations with a transfer pricing issue have a clear understanding of the Roadmap. This should include providing them a copy of the Roadmap prior to the beginning of the examination engagement and requiring employees to be consistent in its use.

Management's Response: The IRS partially agreed with this recommendation and will provide taxpayers with information to gain access to the Roadmap at the beginning of an examination engagement for cases with a transfer pricing issue. The IRS disagreed that they can ensure that taxpayers undergoing examinations with a transfer pricing issue have a clear understanding of the Roadmap.

The LB&I Division will ensure that at the beginning of an examination engagement, taxpayers are given appropriate information that allows them to access the most current version of the Roadmap on IRS.gov. IRS transfer pricing professionals will be instructed to discuss the Roadmap with taxpayers to facilitate their understanding during the planning phase of the LB&I Division Examination Process. As previously noted, the Roadmap is not a checklist or a "one-size fits all tool" and as such, the LB&I Division cannot require its consistent use. However, LB&I Division employees working transfer pricing issues will be encouraged to use the Roadmap as a guide.

Office of Audit Comment: We agree that providing taxpayers with information to gain access to the Roadmap at the beginning of an examination engagement for cases with a transfer pricing issue is a positive step. We also believe that IRS transfer pricing professionals discussing the Roadmap with taxpayers to facilitate their understanding is essential. However, it is not clear how the IRS will confirm employees are consistently providing and discussing this information without some type of verification that this requirement has been fulfilled.

There Is No Process to Ensure That All Transfer Pricing Issues Are Identified for Specialized Review

During our review, TPP management stated that approximately 80 percent of the transfer pricing issues were identified from Coordinated Industry Cases, and 20 percent came from referrals through the Specialist Referral System (SRS).[8] The SRS is an electronic, web-enabled referral routing system used to request international assistance on original filed returns with international features meeting the mandatory international referral criteria.

International specialists are used on LB&I Division cases to examine events or high-risk transactions that require specialized skills and abilities to determine whether a significant international issue needs to be examined, including cases with transfer pricing issues. The SRS communicates the status of the acceptance or rejection of referrals and facilitates management issue tracking. A key benefit of the SRS is that it eliminates redundancy by preventing the generation of multiple referrals typically required on a Coordinated Industry Case.

Currently, TPP employees do not have access to the SRS and do not have any knowledge of or input as to whether a referred issue should be worked unless further assistance is requested by an international examiner. Because TPP employees cannot access the SRS, they are reliant upon IBC function management to share any transfer pricing referrals with them. As a result, TPP management is concerned that they may not be aware of the number or status of referrals with transfer pricing issues on the SRS.

In addition, on September 30, 2013, the IRS issued the *IBC and TPP Rules of Engagement for Transfer Pricing Issues* memorandum, which prescribed general guidelines and the Rules of Engagement, sometimes referred to as the "rules of the road," for the cooperation between the TPP and the IBC function. Specifically, the guidelines call for the TPP and the IBC function to work as a "unified team," with neither in full control but sharing responsibility for issue identification, selection, development, and resolution of the transfer pricing issues. According to the memorandum, TPP and IBC function management teams have joint responsibility of the national transfer pricing inventory, but because of limited resources, often the TPP will not be involved in the day-to-day management of the transfer pricing issues. The memorandum also clarifies the roles of the TPP and IBC function in establishing an estimated examination completion date, managing the transfer pricing issue, and managing requests for information from the taxpayer for cases in which the TPP is moderately or extensively involved. Further, it provides the sequencing of risk assessments, staffing, and establishing timelines when transfer pricing issues are identified at the beginning of an examination. The memorandum also establishes guidelines for involving the TPP when the need for its assistance is identified during an ongoing examination.

[8] The SRS automates the referral request process for personnel in the LB&I, SB/SE, Tax Exempt and Government Entities, and Wage and Investment Divisions. The LB&I Division is responsible for this system.

The language of the memorandum suggests that control issues between the two groups may have affected the management of transfer pricing issues under examination in the past. For example, it states that disagreements will be elevated to management and will be resolved internally, "never in front of the taxpayer." Interviews with TPP and IBC function management and staff suggested there is still tension between the TPP and IBC functions, primarily concerning staffing and the timing of the audit resolution.

In addition, some IBC function examiners are hesitant to refer a transfer pricing-related examination to the TPP because they believe that they have the expertise to work the issue and do not want the resolution of the case to be further delayed. Further, TPP examiners do not trust they are receiving all of the transfer pricing-related examinations because of this hesitancy of some IBC function examiners to refer their cases, as well as their inability to access the SRS to identify any potential transfer pricing cases not currently being worked as a Corporate Industry Case.

The Rules of Engagement were established to provide guidelines that facilitate management expectations and coordination between the TPP and the IBC function, thereby enabling them to successfully work together to develop transfer pricing issues. However, interviews with TPP management and IBC function employees, along with our survey results, indicate that the Rules of Engagement may not have always been followed.

One of our survey questions to TPP and IBC function employees asked if they were familiar with the Rules of Engagement between the TPP and the IBC function. We found that:

- 44 percent responded that they were "very familiar" with the Rules of Engagement.
- 41 percent responded that they were "somewhat familiar" with the Rules of Engagement.
- 14 percent responded that they were "not familiar at all" with the Rules of Engagement.[9]

In addition, the responses to our survey question inquiring if TPP and IBC function employees believe that the Rules of Engagement are followed and effective, showed that:

- 46 percent of the respondents said "They were not sure."
- 38 percent of the respondents said "No."
- 16 percent of the respondents said "Yes."

It would be unreasonable to expect that the TPP could assume joint responsibility with the IBC function for issue identification, selection, development, and resolution of transfer pricing issues when it may be unaware of the potential transfer pricing inventory received through the SRS. We believe that the Rules of Engagement should be an important part of the LB&I Division's quality review process for transfer pricing-related issues and, as such, should be a monitored

[9] Percentages do not total 100 percent due to rounding.

attribute. LB&I Division management must ensure that the Rules of Engagement are followed for all cases with transfer pricing issues. Without adherence to the Rules of Engagement, there is a greater chance of examinations with questionable transfer pricing issues not being adequately pursued.

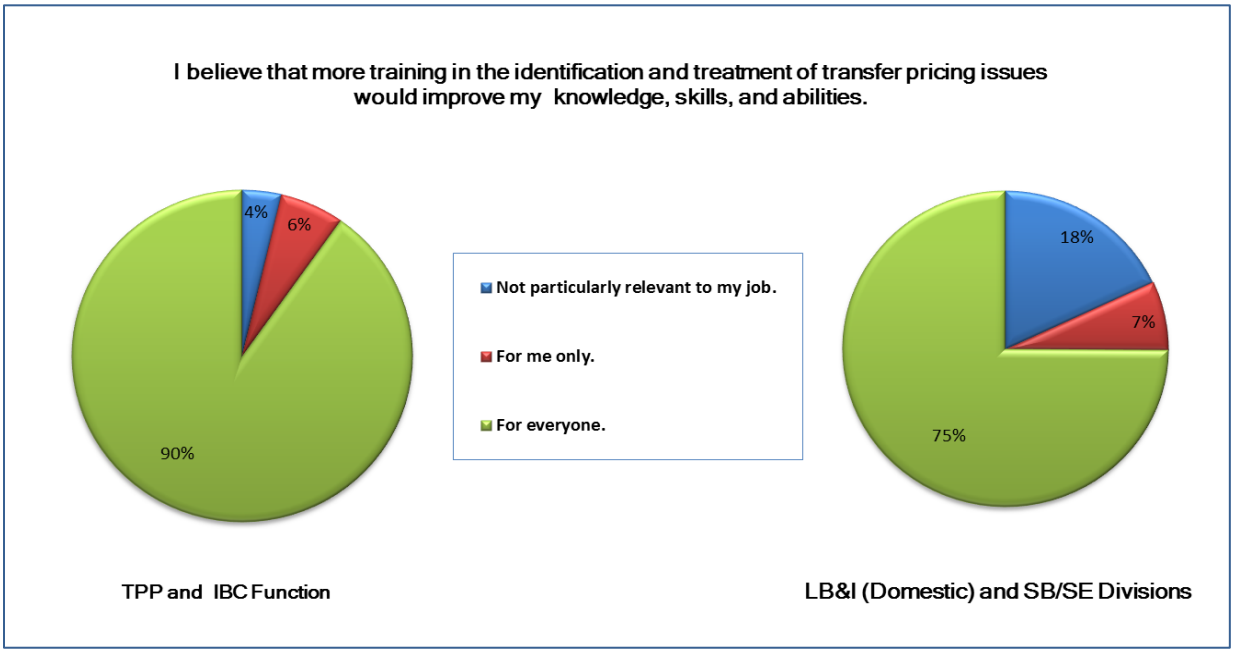
A training plan could assist employees in developing the skills needed to identify transfer pricing issues

Productive inventory may also not be recognized and referred if employees are not adequately trained to identify transfer pricing issues and refer them to an international specialist. We identified and reviewed transfer pricing-related training available to employees and management staff in the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions.[10] While the amount of transfer pricing-related training available appears to be substantial, there is no mandatory requirement that employees and management staff in these areas take it.[11] This is concerning because 62 percent of LB&I (Domestic) Division and SB/SE Division employees and 34 percent of TPP and IBC function employees responded to our survey that they did not know or were unsure where to go for the most up-to-date procedural guidance to help them accurately identify, refer, or work transfer pricing issues.

"Training includes providing for and making available to an employee, planned, prepared, and coordinated programs, courses, or routine of instruction in professional, technical, clerical, administrative, or other fields which will improve individual and organizational performance, and assist in achieving the agency's mission and performance goals."[12] Of the 1,024 respondents to our survey, Figure 3 shows an overwhelming majority of them (96 percent of TPP and IBC function employees and 82 percent of LB&I (Domestic) Division and SB/SE Division employees) believe that more training in the identification and treatment of transfer pricing issues would improve the knowledge, skills, and abilities of themselves and others.

[10] At the time of our survey, personnel in the LB&I (Domestic) and SB/SE Divisions generally performed examinations of domestic corporations. However, during an examination of a domestic corporation, there is a possibility that a transfer pricing issue could be identified.
[11] According to the TPO's Summary Listing of Income Shifting Training, there were 29 transfer pricing-related courses or International Practice Network presentations delivered in Fiscal Years 2013 and 2014.
[12] 5 U.S. Code § 4101(4).

Figure 3: Percentages of Survey Respondents Who Believe That More Training in Transfer Pricing Would Be/Would Not Be Beneficial



Source: Results of the Treasury Inspector General for Tax Administration's (TIGTA) survey of TPP, IBC function, and LB&I (Domestic) and SB/SE Divisions' management and employees.

From our survey results, we also found that:

- 76 percent of LB&I (Domestic) and SB/SE Divisions' respondents and 26 percent of TPP and IBC function respondents were not confident or not sure that they had received sufficient training to identify transfer pricing issues in their examination inventory.
- 54 percent of LB&I (Domestic) and SB/SE Divisions' respondents and 48 percent of TPP and IBC function respondents believe that unclear guidance contributes to lengthy or untimely resolution of transfer pricing examinations.

We also determined through our interview with the TPO Training Coordinator that the TPP and IBC function are not coordinating with the LB&I (Domestic) and SB/SE Divisions to ensure that training to properly identify and refer transfer pricing cases is mandatory and provided to all. Further, training personnel could not provide attendance lists for certain International Practice Network presentations that were given related to transfer pricing.

The Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* suggests that without personnel receiving the right training, operational success is not possible.[13] In addition, these standards state that management should ensure that skill needs

[13] GAO-14-704G, September 10, 2014.

are continually assessed and that the organization is able to obtain a workforce that has the required skills that match those necessary to achieve organizational goals. Training should be aimed at developing and retaining employee skill levels to meet changing organizational needs. We do not believe that the IRS can ensure the adequacy of its training program without requiring mandatory training on transfer pricing issues. Training coordinators in the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions should be responsible for making sure that personnel have completed this essential training.

Recommendations

The Commissioner, LB&I Division, should:

Recommendation 3: Ensure that TPP employees have full access to the SRS and that they work collaboratively with the IBC function to ensure that transfer pricing issues are consistently identified and directed for specialized review.

> **Management's Response:** The IRS disagreed with this recommendation stating that revenue agents in the geographic practice areas are responsible for making a referral for specialized review on cases with international aspects. The IRS also said the SRS is currently under review to ensure that it aligns with the LB&I Division's Future State objectives. As part of this review, and assuming the SRS continues to be a tool within the Future State organization, the LB&I Division will recommend that TPP managers are granted similar access as Cross Border Activities managers and International Referral Recipients in order to review a return with potential transfer pricing issues for assignment.
>
> **Office of Audit Comment:** During our review, we found that one of the primary concerns of TPP management was that not all cases with transfer pricing issues were made known to them. The Rules of Engagement provides that the TPP has joint responsibility for the IRS's entire transfer pricing inventory. This is not possible without access to the SRS.

Recommendation 4: Ensure that TPP and IBC function employees follow the Rules of Engagement and include this as an attribute of the quality review process.

> **Management's Response:** The IRS agreed with this recommendation. The *Rules of Engagement* were incorporated into the *Principals of Collaboration* under the new LB&I Division Examination Process. In addition, the LB&I Division Quality Review adjusted the quality standards to include the new examination process.

Recommendation 5: Coordinate with the Commissioner, SB/SE Division, to ensure that adequate transfer pricing training is provided. The LB&I Division should require mandatory transfer pricing specific training for TPP and IBC function employees and managers. The LB&I and SB/SE Divisions should ensure that LB&I (Domestic) and SB/SE Divisions' Examination function employees and managers with potential exposure to transfer pricing issues be adequately trained to identify, refer (as necessary), and work transfer pricing issues appropriately. Detailed training plans should be implemented and include documentation and tracking of all employees' successful completion of the mandatory training.

Management's Response: The IRS partially agreed with this recommendation and stated that TPP and IBC function employees take mandatory transfer pricing specific training. The LB&I Division already requires IBC function and TPP employees to take extensive, mandatory transfer pricing training during their International Taxation Phase 2 and Phase 3 training, and will continue to require such training during the LB&I Division's transition to the Future State campaign driven inventory selection model. The LB&I Division asserts that it has already established detailed training plans and already documents and tracks all employees' successful completion of the mandatory training.

The LB&I (Domestic) and SB/SE Divisions agree that Examination function employees and managers with potential exposure to transfer pricing issues will be adequately trained to identify and refer (as necessary) transfer pricing issues. The LB&I and SB/SE Divisions will collaborate to develop and deliver a mandatory Continuing Professional Education module for all SB/SE Division employees about proper identification and referral of transfer pricing issues. Additionally, the LB&I and SB/SE Divisions will collaborate to develop and issue communication to the field clarifying the correct procedures to follow to refer transfer pricing cases to the TPP in accordance with current guidance. The LB&I Division will implement detailed training plans and include documentation and tracking of all employees' successful completion of the mandatory training. However, the LB&I and SB/SE Divisions disagree that LB&I (Domestic) and SB/SE Division employees work transfer pricing issues outside of the Future State Campaign model.

Office of Audit Comment: Our recommendation did not include the suggestion to work transfer pricing issues outside of the Future State Campaign model, but to ensure that employees working transfer pricing issues under the new Future State Campaign model are appropriately trained. Management's initial response to implement detailed training plans and include documentation and tracking of all employees' successful completion of the mandatory training appears to contradict the IRS's assertion that they have already established this process. We did not identify any detailed training plans, and only International Taxation Phase 2 and Phase 3 training along with any training performed in the IRS's electronic learning environment was provided to us during this review. However, there were other transfer pricing-related training sessions that were not tracked.

Separate Performance Measures Related to Quantifiable Results Are Needed to Determine the Success of Transfer Pricing Efforts

The IRS's Balanced Measures was created to ensure that the components of customer satisfaction, employee satisfaction, and business results are each given due consideration. Accordingly, the Internal Revenue Manual requires the IRS to consider each of the three components when setting organizational objectives, establishing goals, assessing progress and results, and evaluating individual performance. This measurement system requires the IRS to measure performance at three levels: strategic, operational, and individual.

- At the strategic level, measures should assess overall performance in delivering the IRS's mission. Strategic measures should apply to the organization as a whole and to each of the major operating and functional divisions in the modernized IRS.
- At the operational level, measures should assess the effectiveness of specific programs, such as the TPO, the TPP, and the IBC function.
- At the individual level, measures should assess employee performance by using critical elements and critical performance expectations that support and align with the IRS's mission and Balanced Measures approach.

The TPP and the IBC function are subject to these performance requirements under the LB&I Division's business results criteria. The LB&I Division measures its business results focusing on return closures, quality, cycle time/months-in-process, customer satisfaction, and employee satisfaction. While there are no performance measures specific to the transfer pricing areas, the TPP, while under direction of the TPO, established the following priorities:

- Issue identification and selection.
- Issue development.
- Reach appropriate resolutions on cases.
- Identify, pursue, and win strategically important cases in the transfer pricing areas.

However, TPP management does not have any specific measures or tracking methods to monitor and assess their performance to ensure that these priorities are met. According to TPO management, their goal with regard to transfer pricing examinations was to improve their credibility with the transfer pricing taxpayers. They stated that these four priorities would be needed in order to accomplish their goal; however, they acknowledged that the idea was very qualitative in nature and that ultimately, the right cases would need to be worked appropriately to the correct resolution. However, with none of these priorities being quantitative in nature and no specific measures related to them in place, the TPP could not provide us any information on how successful it was in achieving them.

The TPP did create the Transfer Pricing Issue Assessment Report (TPIAR) as a summary report of the statuses of all transfer pricing issues. This assists IRS management by giving them inventory data on what specific issues are being worked. The information in the TPIAR is derived from the IBC Briefing Book, a SharePoint site developed in Calendar Year 2012 to address the lack of issue-specific information in the Issue Management System and the Issue Based Management Information System.[14] The IBC Briefing Book and the TPIAR are additional tools for management to monitor transfer pricing issues. While the TPIAR is generated on a quarterly basis, its focus is on technical issues rather than the status of transfer pricing cases. LB&I Division management has stated that the IBC Briefing Book is used to:

- Ensure that IBC function managers and executives are aware of significant issues.
- Ensure that resources are deployed in accordance with the LB&I Division's strategy.
- Identify training opportunities.

The TPIAR is synched with the IBC Briefing Book to collect select TPP-related information and results, and consolidates it into a TPP specific report. For example, the TPIAR contains TPP-related information including:

- Open and closed issues.
- Cycle type.
- Statute date.
- Estimated completion date.
- TPP Territory.
- TPP level of involvement.

When we requested a copy of the most recent quarterly IBC Briefing Book and the TPIAR from the IRS, we found that they were not available. We were told that effective the quarter ending September 30, 2015, the IBC Briefing Book SharePoint site underwent an overhaul intended to link it to the Issue Management System, but technical problems arose that were not resolved before the next scheduled reporting update of December 31, 2015. Additional reporting delays are due to the recent LB&I Division reorganization and the shift of the TPP to the Treaty and Transfer Pricing Operations Practice Area, and the IBC function to the Cross Border Activities Practice Area. Accordingly, the June 2015 issuance of the IBC Briefing Book and related TPIAR were the only copies that the IRS could provide, despite current Issue Based Management Information System data being available.[15] The lack of a current IBC Briefing

[14] The Issue Based Management Information System is the LB&I Division's primary system for monitoring all issues including transfer pricing issues.
[15] Subsequently, the IRS provided us with the most current copy of the TPIAR dated March 25, 2016, but stated that this was created without a current copy of the IBC Briefing Book.

Book to update the TPIAR inhibits the reporting of specific TPP monitoring information to IRS management.

In addition, the GAO's *Standards for Internal Control in the Federal Government* states that monitoring should assess the quality of performance over time and ensures that the findings of audits and other reviews are promptly resolved. Through interviews with TPP and IBC function management, we determined that there are few quality reviews related specifically to the TPP at the operational level. Although the LB&I Division may select cases that include some attributes of transfer pricing examinations in its quality review process, we found no support that these findings are used to improve the transfer pricing program or assess the performance quality at the operational and individual levels. Without quality reviews at the operational and individual levels, the IRS cannot ensure that transfer pricing examinations are timely and accurately resolved, and that employees and managers are accountable for the work that is performed.

Further, the Office of Management and Budget and the Government Performance and Results Act of 1993 recommend that performance measures:

- Consistently report on the same programs.
- Regularly report performance data.
- Include targets or goals.
- Hold employees and managers accountable.
- Provide information to make business decisions.[16]

Performance measures provide a way to determine what has been accomplished and whether or not an organization is meeting its stated goals and objectives. Without any outcome-focused performance metrics for transfer pricing examinations, the IRS cannot establish effective performance goals or measure its success in achieving them.

Unexpected changes in critical leadership positions have hindered the development and implementation of a strategic plan related to transfer pricing

Since their creation, both the TPO and the TPP have had several changes in critical leadership positions, including departures of the LB&I Division Commissioner, the Deputy Commissioner (International), the first TPP Director, the first Director of International Strategy, *etc*. Many of these leaders were instrumental in the initial development of the TPO and the TPP. On February 7, 2016, the LB&I Division began implementing its portion of the IRS's "Future State" efforts and with it came additional changes in key leadership roles.

[16] Office of Management and Budget, Circular No. A-11, *Preparation, Submission, and Execution of the Budget* (Aug. 2012), and Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C. (2013)).

The GAO's *Standards for Internal Control in the Federal Government* states that people are what make internal controls work, and that the responsibility for good internal control rests with all managers. Management sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates them. Additionally, a U.S. Office of Personnel Management standard states that "agency leaders and managers effectively manage people, ensure continuity of leadership, and sustain a learning environment that drives continuous improvement in performance, and provide a means to share critical knowledge across the organization." We believe that a significant factor affecting the successful development and implementation of a strategic plan related to transfer pricing is the many managerial changes at the executive level in the LB&I Division, the TPO, and the TPP. During interviews with management and employees in the TPP, the IBC function, and the LB&I (Domestic) Division, many expressed their frustration with the turnover and stated that the perceived lack of consistent leadership had morale at an all-time low. Results from the most recent Federal Employee Viewpoint Survey corroborate our interviews by showing that LB&I Division Employee Engagement is currently at 68 percent, and that only 30 percent of LB&I Division respondents believe that leaders in their organization generate high levels of motivation and commitment in the workforce.[17]

It is difficult to develop and implement a long-term improvement strategy without consistent executive leadership. LB&I Division management developed and approved transfer pricing-related strategies each fiscal year, yet there were no formal action plans or proposed timelines in place for their implementation, and any accomplishments were not documented. The strategy documents were general in nature and provided no specificity regarding TPO plans to enact a comprehensive transfer pricing strategy. In addition, these strategies did not contain any of the requirements of a strategic plan. For example, there were no descriptions of how the goals and objectives were to be achieved (including the operational processes, skills, technology, and resources required); no external factors were identified that could significantly affect the achievement of the goals and objectives; and there were no descriptions of program evaluations that could be used to establish or revise the goals and objectives.

[17] Employee Engagement includes whether employees feel leaders listen to and lead employees, help them develop, provide them with the tools and the support they need to do their jobs, involve them in decision making, and implement their solutions where practical. This survey includes all LB&I Division employees and not all responses would specifically relate to employees working transfer pricing issues.

The IRS has designated transfer pricing as a key focus of its international compliance initiatives. Management in the TPP reported that transfer pricing issues account for approximately 46 percent of the entire LB&I Division's international issues inventory and 71 percent of the potential total dollar adjustment amounts of all international issues.[18] By issue as well as dollar materiality, it is clear that income shifting is the most prevalent international tax issue representing the greatest tax compliance risk facing the LB&I Division. In addition, TPP and IBC function management expressed concern that staffing in their functions may not be sufficient to support this type of workload, resulting in a reduction of successful transfer pricing examinations. Individually written survey responses from TPP and IBC function management and staff showed that 92 (42 percent) of 217 responses specified that a lack of resources, or economists specifically, was the biggest challenge they faced working a transfer pricing issue and may reduce the IRS's ability to provide timely resolution to transfer pricing examinations.

Transfer pricing issues account for approximately 46 percent of international issues and 71 percent of the potential total dollar adjustment amounts.

Accomplishments of the TPP cannot be determined without sufficient tracking and monitoring of examinations with transfer pricing issues

LB&I Division management does not specifically track or monitor transfer pricing examination results or outcomes. LB&I Division management stated that there is insufficient, imperfect data collected to provide certain results. In a related audit being performed by TIGTA, we determined that the LB&I Division does not generally know the results of its compliance efforts by issue. The lack of compliance information by issue is due in part to an overly broad Uniform Issue List and a lack of emphasis on the part of management to ensure that issues are logged appropriately into the Issue Management System, which is the LB&I Division's case management system.[19] LB&I Division management has tried to fill this gap with the data analysis of the TPIAR, but it still does not provide sufficient statistics to measure their transfer pricing accomplishments, *e.g.*, examination adjustments and taxes ultimately assessed.

The GAO's *Standards for Internal Control in the Federal Government* requires management to track major agency achievements and compare these to established plans, goals, and objectives. Managers also need to compare actual performance to planned or expected results throughout the organization and analyze significant differences. Internal controls should generally be designed to ensure that ongoing monitoring occurs in the course of normal operations; is performed continually and is ingrained in the agency's operations; and includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties. In the IRS's "Future State" plan, a core set of guiding principles was established as the foundation for where the LB&I Division wants to be in the future. These include:

[18] For example, international issues include inbound financing, deferral planning, and other cross-border issues.
[19] TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 2016).

- Utilizing data analytics and examiner feedback to select better work with intended compliance outcomes.
- Driving continual collection and analysis of data and feedback to enhance ability to focus, plan, and execute work, and promote innovation and feedback-based improvement.

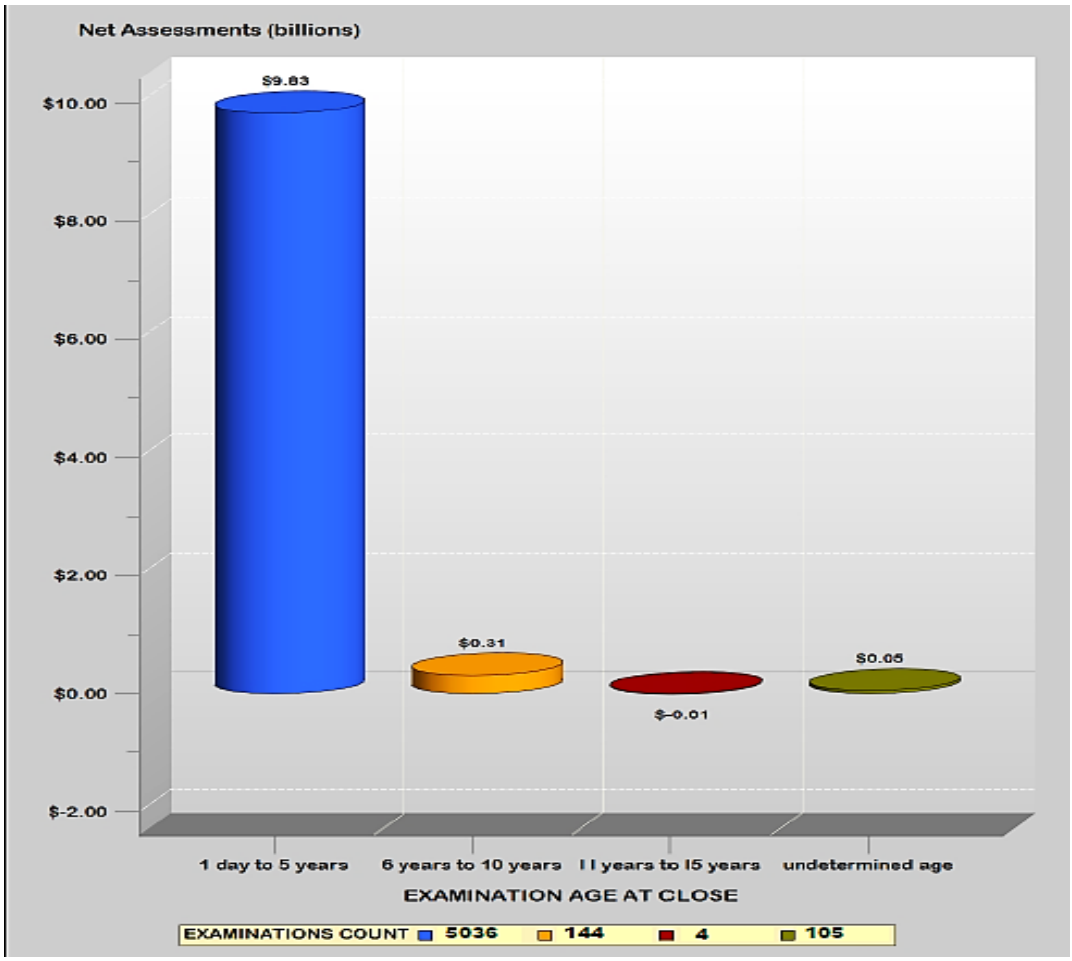
The LB&I Division intends to use data and analysis, combined with input from its experienced examiners and their leaders, to determine the selection of better work (building campaigns). Without tracking and monitoring the transfer pricing work they are currently engaged in, the potential to do this in the future may be greatly diminished.

To measure the efficiency of the transfer pricing examination process, we used inventory aging as the standard. Our aging analysis on closed cases with transfer pricing issues (determined by the number of days between the opening and closing of the transfer pricing portion of each examination) found that examinations that included at least one transfer pricing issue taking more than five years to close tend to result in fewer positive net total assessments than shorter examinations.[20] Figure 4 compares the net total assessments for closed examinations that included at least one transfer pricing issue by age range.[21]

[20] While most transfer pricing examinations are closed within five years or less, some transfer pricing issues take longer to resolve. For example, tax complexity and issues involving foreign governments and the Competent Authority may cause delays in the examination closure.

[21] Net Total Assessments could include both transfer pricing and other assessments related to non-transfer pricing adjustments (Net Operating Loss carryforwards/carrybacks, freeing up of tax credits as a result of audit adjustments, *etc*.). Due to limitations on how the IRS only captures the net assessment on each case, we were unable to differentiate the specific dollar amounts related to transfer pricing from the other adjustments in the Net Total Assessments calculations.

Figure 4: Net Total Assessments by Age for Examinations That Included at Least One Transfer Pricing Issue Closed in Calendar Years 2012 Through 2014



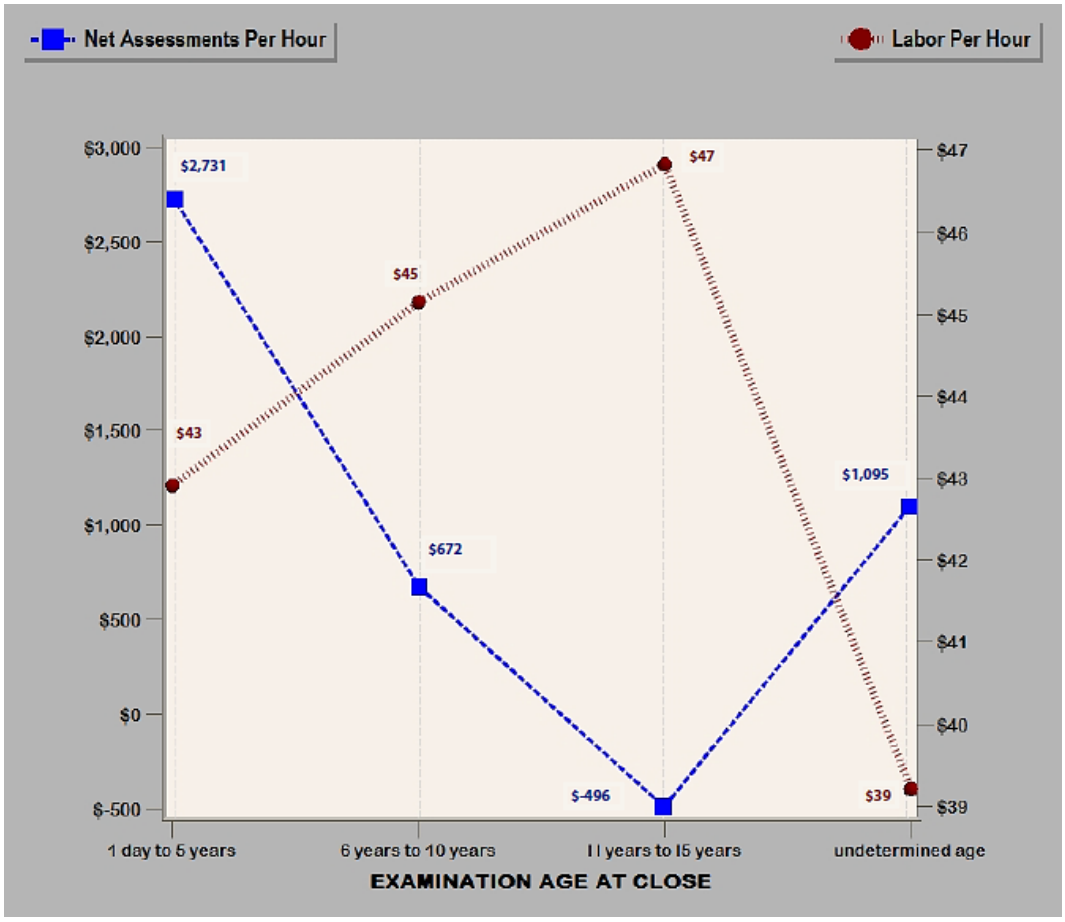
Source: TIGTA analysis of the Issue Based Management Information System information provided by the IRS and matched to the Audit Information Management System (AIMS) and the Examination Returns Control System (ERCS) for examinations that included at least one transfer pricing issue closed during Calendar Years 2012 through 2014.

Figure 5 compares the examination assessment amounts to their related labor costs.[22] The Return on Investment computation did not include capital expenditures or any of the usual expense allocations normally associated with business operations, *e.g.*, rent, utilities, maintenance, training, travel and transportation, employee benefit programs, postage, supplies,

[22] Labor costs were calculated based on direct time in hours logged by the examiner and did not include any indirect labor costs, for example, program administration or consultations with specialized staff or with IRS Office of Chief Counsel.

etc. Therefore, our determination is a limited estimate of program labor expenses relative to program assessment results.

Figure 5: Net Assessments Per Hour Versus Labor Costs Per Hour[23]



Source: TIGTA analysis of the Issue Based Management Information System information provided by the IRS and matched to the AIMS and the ERCS for examinations that included at least one transfer pricing issue closed during Calendar Years 2012 through 2014.

[23] Net Assessments Per Hour could include both transfer pricing and other assessments related to non-transfer pricing adjustments (Net Operating Loss carryforwards/carrybacks, freeing up of tax credits as a result of audit adjustments, *etc.*). Due to limitations on how the IRS only captures the net assessment on each case, we were not able to differentiate the specific dollar amounts related to transfer pricing from the other adjustments in the Net Assessments Per Hour calculations. The Net Assessments Per Hour was calculated based on the total number of labor hours charged to the examination, not hours charged to only the transfer pricing adjustment, which could be one of many adjustments in an examination assessment.

Recommendation

Recommendation 6: The Commissioner, LB&I Division, should develop a comprehensive transfer pricing strategy that includes outcome-related strategic goals, a description of how the LB&I Division intends to achieve those goals, and an action plan with a timeline for implementation. This strategy should measure the success and productivity of the examinations of transfer pricing issues. This should include, but is not limited to, the amount of the examination adjustments and the taxes ultimately assessed.

> **Management's Response:** The IRS partially agreed with this recommendation and stated that a comprehensive examination strategy that includes outcome-related strategic goals, a description of how the LB&I Division intends to achieve those goals along with an action plan and timeline for implementation is appropriate. However, the IRS disagreed that this strategic plan must exist at the transfer pricing operations level or any other practice-area level. The LB&I Division is implementing a campaign approach to address its highest compliance risk issues, including transfer pricing. Campaigns will ensure that its future compliance activities consider all potential approaches, not only examinations, to ensure that the LB&I Division is using its resources as efficiently and effectively as possible to improve taxpayer compliance. The campaign process will include robust feedback mechanisms for capturing input on the effectiveness of data analysis, issue identification filters, soft letter processes, training, on-the-job tools, outreach efforts, and other matters.
>
> Because of the complexity of the LB&I Division examinations and the net operating loss position of many taxpayers, the LB&I Division disagrees with implementing a system of records that can link examination adjustments and the taxes ultimately assessed.
>
> **Office of Audit Comment:** The IRS has stated that it is implementing a campaign approach to address its highest compliance risk issues, *including* transfer pricing. In response to a prior TIGTA report, LB&I Division management agreed to provide "compliance results by issue from the Issue Based Management Information System for use by the practice areas in the development of campaigns."[24] Therefore, it is imperative that the IRS measure the success and productivity of the examinations of transfer pricing issues, including the amount of the examination adjustments and the taxes ultimately assessed regardless of the approach that is used. In addition, the IRS's Balanced Measures system requires the IRS to measure performance at the operational level. At the operational level, measures should assess the effectiveness of transfer pricing specific programs.

[24] TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 2016).

Appeals Determination Information Could Be Used to Better Refine the Approach for Identifying and Working Cases

According to the IRS, its Appeals function's mission "is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the taxpayer and the Federal Government." It is independent of any other IRS office and provides a venue in which disagreements concerning the application of tax law can be equitably resolved. Taxpayers who disagree with the IRS may generally appeal or litigate the proposed adjustments prior to or after the assessment of the tax either administratively within the IRS or through the Tax Court, District Court, or the Court of Federal Claims. Settlement authority, with a few limited exceptions, rests solely with the Appeals function as described in the Treasury Regulations.[25]

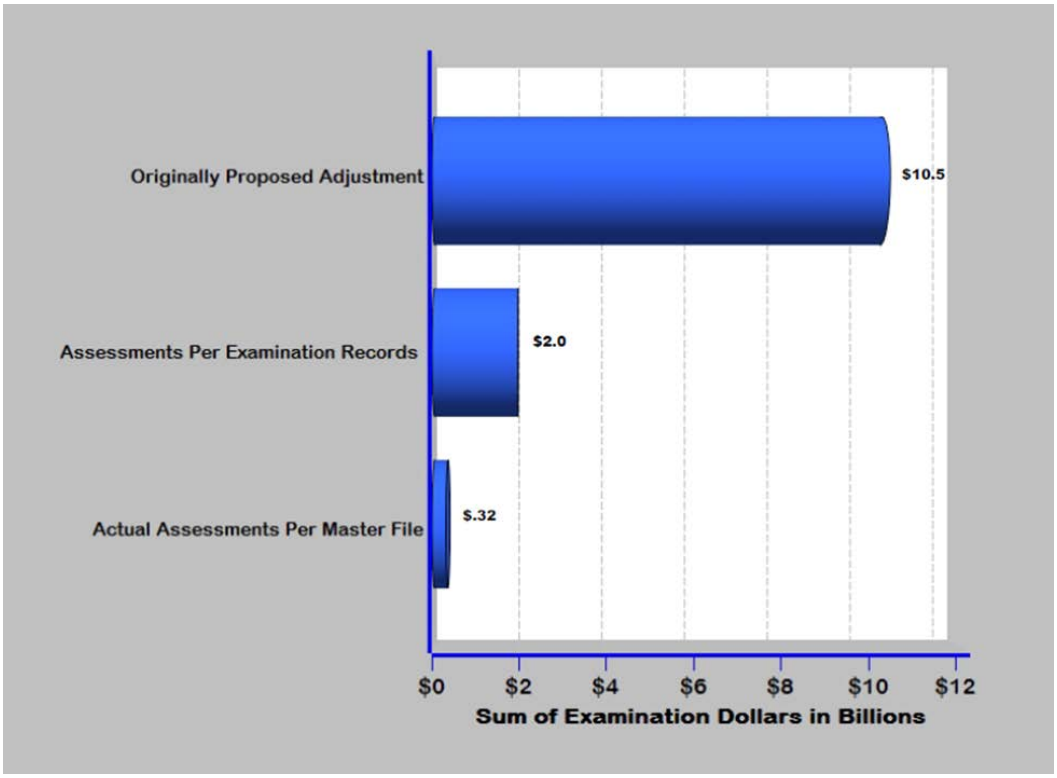
Settlements are reached by using the authorities found in the I.R.C. to determine applicable law and hazards of litigation. A "hazards" settlement is a resolution that is based on the uncertainty as to how the courts would interpret and apply the law or as to what facts the courts would find. Litigating hazards generally fall into three categories: factual, evidentiary, and legal. An example of a factual hazard is missing records. Evidentiary hazards include a lack of evidence to support the allegations. A legal hazard exists when there is an absence of legal precedent.

Figure 6 shows our analysis of 213 examinations that included at least one transfer pricing issue with appealed adjustments closed during Calendar Years 2012 through 2014.[26] We determined that appealed cases were settled for amounts much less than what was proposed by the LB&I Division's Examination function.

[25] 26 C.F.R. § 601.106.

[26] At the conclusion of an examination, an account adjustment is proposed. The adjustment is composed of all assessments and abatements (net assessments) for all issues examined.

Figure 6: Proposed Examination Adjustments With at Least One Transfer Pricing Issue Before and After Appeal



Source: TIGTA analysis of the Issue Based Management Information System information provided by the IRS and matched to AIMS, ERCS, and Appeals Centralized Database System (ACDS) data for examinations that included at least one transfer pricing issue closed during Calendar Years 2012 through 2014.

For all 213 examinations that included at least one transfer pricing issue with appealed adjustments, proposed adjustment amounts totaled approximately $10.5 billion.[27] Amounts recorded in the AIMS/ERCS as final examination assessments totaled approximately $2.0 billion.[28] The Appeals process resulted in reductions in excess of $8.5 billion to the originally proposed adjustment amounts. Actual assessment amounts identified on the Integrated Data Retrieval System as the post-Appeals examination adjustments showed that only $321 million of the original proposed $10.5 billion in adjustments were ever posted to taxpayer

[27] Due to limitations on how the IRS only captures the net assessment on each case, we were unable to differentiate whether the appealed adjustments were related to transfer pricing or from the other adjustments in the examination assessment.

[28] AIMS/ERCS data are records of actions taken by Examination function employees and will reflect only those account changes occurring under examination control. Reversals and reductions of appealed examination adjustments may not be reflected in AIMS/ERCS records and may be determined only through actual taxpayer account review.

accounts. The reasons for the decrease in adjustment amounts after the Appeals process may show that transfer pricing-related examinations require a different approach for the IRS in identifying and working these cases.

In addition, examiners were not always aware that their proposed transfer pricing-related adjustments had been reduced by the Appeals function. One of our survey questions to TPP and IBC function employees asked if they were informed when their proposed transfer pricing adjustments were reduced by the Appeals function. Approximately 54 percent of the respondents said that they were not informed, while another 14 percent said they were informed, but were unaware of the reason for the change. If examiners are not aware that their proposed adjustments are changed by the Appeals function or the reason for the change, they are not being provided the necessary information to effectively work cases to mitigate the potential hazards of litigation.

Recommendation

Recommendation 7: 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.

> ***Management's Response:*** The IRS agreed with this recommendation. The LB&I Division already conducts a review of Appeals Case Memoranda, including transfer pricing issues, and agrees that lessons can be learned from this review. For example, the TPP developed a training course to improve the Notice of Proposed Adjustment writing skills to be delivered to managers and employees responsible for working transfer pricing examinations partially due to feedback from results of the Appeals Case Memoranda review. The IRS will continue to evaluate the Appeals Case Memoranda to strengthen the LB&I Division's selection, development, and resolution of transfer pricing issues. The LB&I Division will disseminate the results of these reviews to Cross Border Activities and TPP Territory managers.
>
> ***Office of Audit Comment:*** The IRS has stated that it will be disseminating the results of the Appeals Case Memoranda reviews to TPP Territory managers; however, our review found that most revenue agents who are responsible for working transfer pricing cases do not receive any feedback after the Appeals process. The IRS's corrective actions should also include dissemination of the Appeals results to the responsible revenue agents and their managers.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to identify and assess the barriers to the IRS efficiently evaluating transfer pricing issues.[1] To accomplish this objective, we:

I. Assessed the controls and procedures that the IRS has for processing and evaluating transfer pricing issues.

   A. Interviewed IRS management in the TPO, the TPP, and the IBC function to determine whether their procedures and guidance are designed to address the appropriate actions that need to be taken on the transfer pricing cases and performed a walkthrough of the transfer pricing process.

   B. Interviewed LB&I (Domestic) Division and SB/SE Division management to determine what procedures and guidance have been provided to their employees related to referring cases for transfer pricing issues.

   C. Reviewed transfer pricing strategic/annual plans, directives, program letters, and policies the IRS uses for processing transfer pricing cases.

   D. Assessed the IRS's plans to determine whether the Transfer Pricing Audit Roadmap (commonly referred to as the "Roadmap") is beneficial in increasing the efficiency of processing transfer pricing cases by evaluating if the IRS ensures that the Roadmap is being used by examiners in the TPP and IBC function and whether examination procedures reflect the Roadmap.

      1. Interviewed IRS management in the TPO, the TPP, and the IBC function to identify if transfer pricing examiners in the TPP and the IBC function provided feedback on the Roadmap.

      2. Assessed whether the Roadmap addresses any recent program developments.

II. Assessed the IRS's education/outreach and IRS employee training efforts related to transfer pricing.

   A. Interviewed IRS management in the TPO, the TPP, and the IBC function to identify what types of education/outreach have been provided to external stakeholders (taxpayers, taxpayer representatives, foreign governments) related to transfer pricing.

[1] See Appendix IV for a glossary of terms.

B. Assessed any education/outreach provided to external stakeholders to ensure that the information provided is useful to help external stakeholders comply with the transfer pricing procedures.

1. Selected a statistically valid sample of transfer pricing auditees to survey. We determined that the population of unique business entities with examinations that included at least one transfer pricing issue closed between Calendar Years 2012 and 2014 totaled 2,949. We limited our survey criteria to those entities having either total examination hours equal to or greater than 2,600 or total examination days equal to or greater than 365, which reduced our sample population to 2,157. To meet a confidence level of 95 percent, an expected error rate not exceeding 5 percent, and ±3 percent precision, we determined that our sample needed to have 187 responses. We oversampled by 114 percent. We identified 400 multinational corporations with transfer pricing issues and cases closed by the TPP and/or IBC function in Calendar Year 2014, and prepared and sent a survey to these corporations for their views on their transfer pricing examination experience and any specific obstacles encountered.

2. Evaluated the returned surveys to determine if the Roadmap adequately addresses their concerns.

C. Interviewed IRS management in the TPO, the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions to identify any training that has been provided to their employees and management staff related to transfer pricing, and evaluated the sufficiency of the content and timeliness of the delivery of the training program.

D. Developed and sent a survey to all transfer pricing examiners and their managers in the TPP and IBC function, and to all LB&I (Domestic) Division and SB/SE Division revenue agents and their managers who work cases with potential transfer pricing issues to get their perspectives on the efficiency of the transfer pricing examination process and what impediments they face to timely resolve their cases.[2]

III. Evaluated how transfer pricing cases are identified and directed for specialized review.

A. Interviewed IRS management in the TPO, the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions to determine how the IRS identifies transfer pricing issues.

[2] A total of 734 surveys were sent to TPP and IBC function employees. In addition, 2,591 surveys were sent to LB&I (Domestic) Division employees and 2,666 surveys were sent to SB/SE Division employees. A total of 255 employees responded to the TPP/IBC function survey, and 455 LB&I (Domestic) Division and 303 SB/SE Division employees responded to the LB&I (Domestic) and SB/SE Divisions' survey. A total of 11 employees did not report their business unit.

1. Assessed the IRS's procedures used to route transfer pricing cases to the appropriate examiner, and identified the specialized units in the TPP and IBC function assigned to transfer pricing cases.
2. Determined how the TPP and IBC function coordinate with the LB&I (Domestic) and SB/SE Divisions to ensure that they are properly identifying and routing transfer pricing cases.

IV. Assessed the IRS efforts to accurately and timely resolving transfer pricing cases.

A. Interviewed IRS management in the TPO, the TPP, and the IBC function to determine how the IRS ensures that transfer pricing cases are accurately and timely resolved, and to ascertain if staffing levels are consistent with the workload.

B. Evaluated whether there is a specific process for the quality review of cases with transfer pricing-related examinations. We also determined the extent of transfer pricing manager involvement in case development, and identified any requirements for supervisory review and/or approvals prior to case closure.

C. Obtained a spreadsheet from the TPP with 3,308 unique Taxpayer Identification Numbers of all examinations that included at least one transfer pricing issue closed during Calendar Years 2012 through 2014 taken from the Issue Based Management Information System.

1. Obtained and analyzed extracts from TIGTA's Data Center Warehouse AIMS and ERCS files and matched the data to the spreadsheet provided by the TPP, and identified a population of 5,289 examination records matching tax returns listed on the spreadsheet provided by the TPP.
2. Using the data matched in Step IV.C.1., identified all the examinations having examination hours greater than zero, computed the number of days from the examination start to the examination disposal date, and converted them to age ranges to perform an aging analysis. We also calculated the total net adjustments for all examinations closed during each age range and graphed the results.

V. Assessed IRS efforts to monitor, measure, and evaluate the transfer pricing program.

A. Interviewed IRS management in the TPO, the TPP, and the IBC function to determine how the IRS monitors, measures, and evaluates the transfer pricing program.

B. Determined the extent to which Quality Review reports obtained in Step IV.B. are used to improve the transfer pricing program.

C. Reviewed any management reports related to measuring and monitoring transfer pricing statistics, such as numbers of cases, amount of time expended on the cases, and resolution of the cases.

D. Using the data obtained in Step IV.C.1., calculated the examination cost, the examination profit, and the return on investment.

VI. Assessed the effects of the Appeals process on transfer pricing-related examinations.

A. Interviewed IRS management in the TPO, the TPP, and the IBC function to determine the Appeals process for transfer pricing-related examinations.

B. Matched the data obtained in Step IV.C.1. to TIGTA's Data Center Warehouse ACDS files through October 2015.

C. Compared all examinations that included at least one transfer pricing issue to the ACDS data and identified the proposed adjustments made in the Examination function versus the adjustments to the taxpayers' accounts after the Appeals process.

Data validation methodology

During this review, we relied on a spreadsheet from the Issue Based Management Information System provided by the TPP for all examinations that included at least one transfer pricing issue closed during Calendar Years 2012 through 2014. Additionally, an auditor extracted AIMS, ERCS, and ACDS files from TIGTA's Data Center Warehouse and matched the data to the spreadsheet provided by the TPP. To assess the reliability of the computer-processed data, TIGTA auditors and programmers within our Strategic Data Services function validated the data extract files. We ensured that each data extract contained the specific data elements we requested and that the data elements were accurate. For example, we reviewed a judgmental sample of 38 cases and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System and on the AIMS and the ERCS.[3] We also reviewed a judgmental sample of 87 cases from the ACDS and verified the data were the same as the data captured on the Integrated Data Retrieval System. As a result of our testing, we determined the data used in our review were reliable.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices for identifying, processing, and evaluating transfer pricing issues in the TPP, the IBC function, and the LB&I (Domestic) and SB/SE Divisions. We evaluated these controls and procedures by interviewing IRS management and field employees, as well as evaluating training and performance measures.

[3] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Bryce Kisler, Director
Tina M. Parmer, Audit Manager
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Kim I. McMenamin, Senior Audit Evaluator
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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Large Business and International Division
Deputy Commissioner, Small Business/Self-Employed Division
Director, International Business Compliance, Large Business and International Division
Director, Office of Audit Coordination

Appendix IV

Glossary of Terms

Term	Definition
Appeals Centralized Database System	An application used by Appeals officers, settlement officers, managers, and technical analysts to track case receipts, record case time, document case actions, and monitor the progress of the Appeals workload.
Appeals Function	The Appeals function's mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the taxpayer and the Federal Government. The Appeals function considers cases that involve examination, collection, and penalty issues. Taxpayers who disagree with the IRS findings in their cases may request an Appeals hearing. The local Appeals office is separate and independent of the IRS office that proposed the tax adjustment, collection action, or penalty.
Audit Information Management System	A computer system used by Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
Balanced Measures	Balanced Measures is used by the IRS to measure performance at all levels of the organization. The three components of Balanced Measures are: 1) customer satisfaction, 2) employee satisfaction, and 3) business results. Each component is equally important in carrying out the IRS's programs and functions. Each component must be considered when dealing with any activity that includes Balanced Measures, such as setting targets, assessing progress, and evaluating results.
Business Results	Business results is one of the three Balanced Measures. It measures both quality and quantity. **Quality** – To do quality work by identifying the needs and characteristics of the customer, and utilizing programs, products, and processes to carry out the IRS's mission. **Quantity** – To use numeric measures focusing on identifying and taking appropriate actions to improve performance and diagnosing the underlying factors that have influenced organizational outcomes.
Calendar Year	A 12-consecutive-month period ending on the last day of December.

Term	Definition
Coordinated Industry Case	Any case assigned to the LB&I Division in which the taxpayer and its effectively controlled entities warrant the application of team examination procedures. Cases normally have 12 or more points as defined by the criteria found in Internal Revenue Manual 4.46.2.
Cross Border Activities Practice Area	The Cross Border Activities Practice Area provides complex tax administration services primarily related to inbound and outbound international issues while providing ad hoc services related to other international issues, such as transfer pricing, advance pricing mutual agreements, and treaty related activities, to meet the needs of large and mid-sized businesses with international activity.
Customer Satisfaction	Customer satisfaction is one of the three Balanced Measures. The primary measurement data comes from customer surveys.
Economist	An economist is an LB&I Division audit specialist with expertise in economics and finance issues. A referral for Economic Assistance is required for all Coordinated Industry Cases including issues involving I.R.C. Section 482 pricing and/or valuation.
Employee Satisfaction	Employee satisfaction is one of the three Balanced Measures. The primary measurement comes from employee surveys conducted by outside consultants.
Examination Returns Control System	An automated inventory management system used to requisition tax returns, assign returns to examiners, change codes such as status and project codes, and charge examiner time. The ERCS can be used to control work that is not controlled on the AIMS, such as preparer penalties. The ERCS also provides real-time information in the form of screens and reports for the LB&I and SB/SE Division Examination groups; the Planning and Special Programs function; the Centralized Case Processing function; the Technical Services function; the SB/SE Division Examination and LB&I Division Quality Measurement Staffs; and the National Quality Specialty Review.
Future State Plan	A core set of guiding principles establishing the foundation for where the IRS wants to be in the future.
Hazards of Litigation	The hazards of litigation are the uncertainties of the outcome of the court's decision in the event of a trial. A hazards settlement is an intermediate resolution of an issue based upon the fact that there is uncertainty in the event of litigation as to how the courts would interpret and apply the law or as to what facts the court would find.

Term	Definition
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Code	The Federal Statutory Law enacted as Title 26 of the U.S. Code is organized according to topic and covers all relevant rules pertaining to income, gift, estate, payroll, and excise taxes. The IRS is its implementing agency.
Internal Revenue Manual	The primary official source of instructions to staff related to the organization, administration, and operation of the IRS.
International Examiner	An international examiner provides expertise in the area of global taxation. International examiners collaborate with revenue agents and other international specialists to plan and conduct international aspects of tax examinations.
International Specialist	International specialists are used on cases to examine events or transactions that require specialized skills and abilities.
Issue Management System	A computer application for agents, specialists, international examiners, managers, and others. It supports existing and new examination processes, including the Compliance Assurance Process. The Issue Management System consists of a laptop application and a centralized data repository. The laptop application provides the tools to support planning, selection, and examination. The centralized data repository feature allows the LB&I Division to better capture issue information.
Multinational Corporation	A business that has its facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they coordinate global management.
Return on Investment	The net profit or loss in an accounting period divided by the capital investment used during the period, usually expressed as an annual percentage return.
Revenue Agent	An employee in the Examination function who conducts face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes, *e.g.*, excise tax returns.
Specialist Referral System	The SRS automates the referral request process and must be used for referrals, questions, and requests for assistance from specialist groups.

Term	Definition
Strategic Plan	Outlines objectives and strategies to achieve LB&I Division goals.
Tax Law Specialist	The TPP's tax law specialists assist examination teams in planning, directing, and coordinating the examination of international transfer pricing issues. Tax law specialists in the TPP serve as consultants and/or team members with other examination specialists, international revenue agents, counsel, appeals officers, and revenue agents assigned to an examination regarding transfer pricing issues.
Taxpayer Identification Number	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the Taxpayer Identification Number is an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.
Transfer Pricing	The system of laws and practices used by countries to ensure that goods and services transferred between related companies are appropriately priced and based on market conditions, such that profits are correctly reflected in each tax jurisdiction.
Treaty and Transfer Pricing Operations Practice Area	The Treaty and Transfer Pricing Operations Practice Area provides complex tax administration services related to inbound and outbound and other international issues including transfer pricing, advance pricing mutual agreements, and treaty-related activities.
Uniform Issue List	A list of codes used to track examination issues for various reports.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

LARGE BUSINESS AND
INTERNATIONAL DIVISION

September 15, 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell,
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report # 2015-30-025- Barriers Exist to Properly Evaluating Transfer Pricing Issues

Thank you for the opportunity to review the above subject draft report. Transfer pricing is a significant compliance issue facing the IRS. Indeed, as noted in your report, transfer pricing issues account for a significant percentage of international issues being worked and a substantial portion of potential total dollar adjustments. And, while cross-border trading between related parties and foreign investments by U.S. persons continue to increase over the last several years, our enforcement resources for dealing with any inappropriate or aggressive transfer pricing issues resulting from these transactions continues to decrease; effectively limiting the amount of United States revenue that the IRS can ultimately protect.

In recognition of the significance and scope of transfer pricing issues, IRS implemented a strategic approach to transfer pricing enforcement, establishing the Transfer Pricing Operations (TPO) unit in 2011 and the Transfer Pricing Practice (TPP) in 2012, which was LB&I's first practice area and a precursor to the current LB&I restructuring around 9 compliance practice areas. LB&I is implementing a campaign approach to address our highest compliance risk issues, including transfer pricing. Campaigns will ensure that our future compliance activities consider all potential approaches, not only examinations, to ensure we are using our resources as efficiently and effectively as possible to improve taxpayer compliance. The campaign process will include robust feedback mechanisms for capturing input on the effectiveness of data analysis, issue identification filters, soft letter processes, training, on-the-job tools, outreach efforts, and other matters. As we deploy this new model, we are evaluating the role of the Specialist Referral System (SRS).

We appreciate your recognition of the achievements and progress IRS has made in its transfer pricing administration. Your review recognized that LB&I established the TPO and TPP as a strategic approach to transfer pricing administration. We also appreciate

you highlighted our education, outreach and engagement of external stakeholders; especially through our publication of the Transfer Pricing Audit Roadmap (Roadmap). In addition, the IRS external website contains numerous International Practice Units on transfer pricing topics that provide internal and external training.

We have also provided substantial training to our employees on the Roadmap. We appreciate that your survey of TPP and IBC employees shows that 81% use the Roadmap sometimes if not always. Under the Future State Campaign model, employees will receive campaign issue specific training on a just-in-time basis when assigned specific issues. Transfer pricing issues will be included in this model. LB&I is currently utilizing this just in time training in our inbound distributor project. This project provides both basic background international training and specific issue training to revenue agents new to the transfer pricing area.

LB&I Division management does specifically track and monitor transfer pricing examinations and adjustments. As noted in the report, LB&I utilizes Issue Based Management System (IBMIS) as our primary reporting system. IRS has determined that identifying the assessment results of compliance efforts by issue would have Service-wide implications, requiring modifications to several existing systems and necessitating a substantial expenditure of funds. With limited budgetary resources and other competing initiatives that have higher priority, the IRS cannot deploy resources to track the data at the detail level TIGTA references at this time.

We have attached a detailed response to the specific recommendations and proposed corrective actions are more fully described.

If you have any questions, please contact me, or a member of your staff may contact Sharon Porter, Director, Treaty and Transfer Pricing Operations at (630) 493-5931.

Attachment

Attachment

RECOMMENDATION 1:

The Commissioner, LB&I, should ensure that employees follow the Roadmap, and include this as an attribute of the quality review process.

CORRECTIVE ACTIONS:

LB&I disagrees with TIGTA's recommendation to require employees to follow the Roadmap and include this as an attribute of the quality review process. LB&I agrees that the Roadmap is a useful guide for the transfer pricing professional. The Roadmap provides valuable tools and techniques for the transfer pricing professional's consideration; however, the Roadmap is neither a checklist nor a "one-size fits all tool". It would not be possible to monitor the "use" of the Roadmap and document it as an attribute of the quality review process.

Alternatively, LB&I proposes to complete the current revision to the Roadmap to reflect LB&I's restructuring and new examination processes and then develop and deliver mandatory Roadmap training for all employees engaged in the examination of transfer pricing issues on the proper use of the Roadmap as a tool.

IMPLEMENTATION DATE:

October 15, 2017

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operations

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Commissioner, LB&I, should ensure that taxpayers undergoing examinations with a transfer pricing issue have a clear understanding of the Roadmap. This should include providing them a copy of the Roadmap prior to the beginning of the examination engagement and requiring employees to be consistent in its use.

CORRECTIVE ACTIONS:

LB&I agrees in part. LB&I disagrees that it can ensure that taxpayers undergoing examinations with a transfer pricing issue have a clear understanding of the Roadmap.

LB&I agrees to provide taxpayers with information to gain access to the Roadmap at the beginning of an examination engagement of a case with a transfer pricing issue. In its current state, the Roadmap is approximately 27 pages long. LB&I will ensure that at the beginning of an examination engagement, taxpayers are given appropriate information that allows them to access the most current Roadmap on IRS.gov. IRS transfer pricing professionals will be instructed to discuss the Roadmap with taxpayers to facilitate their understanding, during the planning phase of the LB&I Examination Process (LEP).

As previously noted, the Roadmap is not a checklist or a "one-size fits all tool" and as such LB&I cannot require its consistent use. We will encourage employees working transfer pricing issues to use the Roadmap as a guide.

IMPLEMENTATION DATE:

October 15, 2017

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operations

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:

The Commissioner, LB&I, should ensure that TPP employees have full access to the Specialist Referral System (SRS) and that they work collaboratively with the IBC function to ensure transfer pricing issues are consistently identified and directed for specialized review.

CORRECTIVE ACTIONS:

LB&I disagrees that granting Transfer Pricing Practice (TPP) employees access to SRS will ensure transfer pricing issues are consistently identified and directed for specialized review. Revenue Agents in the geographic practice areas are responsible for making a referral for specialized review on cases with international aspects.

The SRS system is currently under review to ensure it aligns with the LB&I Future State Objectives. As part of this review, and assuming the SRS continues to be a tool within the Future State organization, LB&I will recommend that TPP managers are granted similar access as Cross Border Activities managers and International Referral Recipients in order to review a return with potential transfer pricing issues for

assignment. Additionally, TPP employees should have similar access to the SRS as Cross Border Activities employees in order to receive issue assignments.

IMPLEMENTATION DATE:

September 15, 2018

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operations

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:

The Commissioner, LB&I Division, should ensure that TPP and IBC function employees follow the Rules of Engagement, and include this as an attribute of the quality review process.

CORRECTIVE ACTIONS:

The new LB&I Examination Process (LEP) was approved by the LB&I Commissioner in February 2016 and published in IRM 4.46 on March 9, 2016. The LEP has been incorporated into LB&I's quality review process. Under the LEP, *Principles of Collaboration* (IRM 4.46.1.4) replaces *Rules of Engagement* (formerly IRM 4.51.1). The *Principles of Collaboration* section emphasizes collaboration among all parties and timely elevation of concerns. It also provides guidelines for when internal elevation may be appropriate.

On October 1, 2015, LB&I Quality Review adjusted the quality standards to more closely mirror and support the new LEP in anticipation of changes to the LEP published in the IRM. The changes were implemented on October 1, 2015 because quality measurements may only be changed at the beginning of a fiscal year.

The transition Rules of Engagement specifically written to address the new Transfer Pricing Operation (TPO) organization are incorporated in IRM 4.46.1.4.

IMPLEMENTATION DATE:

October 1, 2015 (completed)

RESPONSIBLE OFFICIAL(S):

Director, Technology and Program Solutions

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 5:

The Commissioner, LB&I Division, should coordinate with the Commissioner, Small Business and Self-Employed (SB/SE) Division, to ensure that adequate transfer pricing training is provided. The LB&I Division should require mandatory transfer pricing specific training for TPP and IBC function employees and managers. The LB&I and SB/SE Divisions should ensure that LB&I (Domestic) and SB/SE Divisions' Examination function employees and managers with potential exposure to transfer pricing issues be adequately trained to identify, refer (as necessary), and work transfer pricing issues appropriately. Detailed training plans should be implemented and include documentation and tracking of all employees' successful completion of the mandatory training.

CORRECTIVE ACTIONS:

Recommendation #5 is a multipart recommendation to which LB&I agrees in part and disagrees in part. LB&I agrees that TPP and International Business Compliance (IBC) function employees take mandatory transfer pricing specific training. LB&I already requires IBC and TPP employees to take extensive, mandatory transfer pricing training during their International Taxation Phase 2 and Phase 3 training and will continue to require such training during LB&I's transition to the Future State campaign driven inventory selection model.

LB&I (Domestic) and SBSE Divisions agree that examination function employees and managers with potential exposure to transfer pricing issues be adequately trained to identify and refer (as necessary) transfer pricing issues. LB&I and SBSE Divisions will collaborate to develop and deliver a mandatory continuing professional education (CPE) module for all SB/SE employees about proper identification and referral of transfer pricing issues. Additionally, LB&I and SB/SE will collaborate to develop and issue communication to the field clarifying the correct procedures to follow to refer transfer pricing cases to the TPP in accordance with current guidance.

LB&I and SBSE Divisions disagree that LB&I (Domestic) and SBSE Division employees work transfer pricing issues outside of the Future State Campaign model.

LB&I agrees that detailed training plans should be implemented and include documentation and tracking of all employees' successful completion of the mandatory training. LB&I asserts that we have already established detailed training plans,

implemented mandatory training, and track and document all employees' successful completion of the mandatory training.

IMPLEMENTATION DATE:

Implement mandatory training for TPP and IBC employees: Implemented FY 2010 (stand-up of LB&I) (completed)
Develop and deliver CPE module on proper identification and referral: August 15, 2017
Develop and issue communication clarifying correct procedures: August 15, 2017
Complete mandatory CPE module: October 15, 2017
Implementation of training plans and documentation: Implemented FY 2010 (completed)

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operation

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 6:

The Commissioner, LB&I Division, should develop a comprehensive transfer pricing strategy that includes outcome-related strategic goals, a description of how the LB&I Division intends to achieve those goals, and an action plan with a timeline for implementation. This strategy should measure the success and productivity of the examinations of transfer pricing issues. This should include, but is not limited to the amount of the examination adjustments and the taxes ultimately assessed.

CORRECTIVE ACTIONS:

LB&I agrees that a comprehensive examination strategy that includes outcome-related strategic goals, a description of how LB&I intends to achieve those goals along with an action plan and timeline for implementation is appropriate. However, LB&I disagrees that this strategic plan must exist at the transfer pricing operations level or any other practice area level. LB&I is implementing a campaign approach to address our highest compliance risk issues, including transfer pricing. Campaigns will ensure that our future compliance activities consider all potential approaches, not only examinations, to ensure we are using our resources as efficiently and effectively as possible to improve taxpayer compliance. The campaign process will include robust feedback mechanisms for capturing input on the effectiveness of data analysis, issue identification filters, soft letter processes, training, on-the-job tools, outreach efforts, and other matters. Because of the complexity of LB&I examinations and the net operating loss position of many taxpayers, LB&I disagrees with implementing a system of records that can link examination adjustments and the taxes ultimately assessed.

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IMPLEMENTATION DATE:

September 15, 2018

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operations

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 7:

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.

CORRECTIVE ACTIONS:

LB&I already conducts a review of Appeals Case Memoranda (ACM), including transfer pricing issues. LB&I agrees lessons can be learned from ACM review. For example, the TPP Practice Network developed a training course to improve Notice of Proposed Adjustment (NOPA) writing skills to be delivered to managers and employees responsible for working transfer pricing examinations partially due to feedback from ACM results. We will continue to evaluate ACMs to strengthen LB&I's selection, development and resolution of transfer pricing issues. LB&I will disseminate the results of these reviews to Cross Border Activities (CBA) and TPP territory managers.

IMPLEMENTATION DATE:

Conduct Reviews of Transfer Pricing ACMs: FY 2013 (completed)
Dissemination of Reviews to Territory Managers: October 15, 2016

RESPONSIBLE OFFICIAL(S):

Director, Treaty and Transfer Pricing Operations

CORRECTIVE ACTION(S) MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.