

# IRS international enforcement efforts are increasing — what non-US companies need to know

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## In brief

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The US Internal Revenue Service (IRS), after years of employee attrition and shrinking budgets, is increasing its international tax enforcement efforts. Multinationals based outside the United States (non-US-based MNCs) should be aware of these efforts and the 'inbound' issues on which the IRS is focusing. This PwC Insight will discuss these important developments.

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## In detail

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### Background

When viewed from the United States, 'inbound' refers to non-US persons (individuals as well as entities) with US income and/or US activities. A typical inbound circumstance exists when a foreign corporation has income and/or activities in the United States. For instance, a Japanese-headquartered automotive manufacturing company (i.e., a non-US-based MNC) sells its products 'into' the United States, and generally would be considered in the inbound category.

For a transaction to be considered inbound, however, it is not necessary for products to be imported into the United States. Continuing the example, a Japanese-headquartered

automotive manufacturing company may decide it is better to manufacture products in the United States. Consequently, the Japanese-headquartered company may form a US subsidiary and have the subsidiary manufacture and sell the product in the United States. In this circumstance, no products have been imported into the United States. However, there is still an inbound transaction because the parent company is from outside the United States and its subsidiary has activities in the United States.

### IRS changes and trends

After a relatively long period with no permanent IRS commissioner in place, IRS Commissioner Charles Rettig will celebrate his first anniversary in office on October

1. Some observers expect Commissioner Rettig to oversee another IRS reorganization due to the perception that some IRS functions have become siloed as well as staff attrition in areas such as the Large Business and International Division (LB&I), which has seen its workforce decline from a high of 7000 to approximately 4500. Recently, however, the IRS has begun hiring in LB&I, with a particular focus on recruiting transfer-pricing economists and cross-border mergers and acquisitions (M&A) specialists. While the recent LB&I hiring of 500 employees represents a net gain of just 50, it does signal a reversal of years of attrition in LB&I and likely will lead to an increase in LB&I examination work.

**Observation:** With high-level IRS positions filled by people such as LB&I Commissioner Douglass O'Donnell (formerly Competent Authority) and Chief of Appeals Donna Hansberry (formerly Director of Global High Wealth), it is clear that the IRS has a 'top-down' international focus.

Enactment of tax reform legislation in late 2017 also has required the IRS to provide extensive training to many revenue agents so they can begin to examine tax years affected by the legislation.

**Observation:** This effort to ensure that IRS staff are trained on the details of the 2017 tax reform act could result in IRS willingness to close earlier years, so agents can focus on examination of the years affected by the new law.

The years of attrition noted above have forced the IRS to take a more targeted approach to audits of large taxpayers, such as limited-scope and more focused, issue-based audits. In this regard, the IRS has begun to employ new algorithmic approaches to selecting cases for examination, based on utilization of a wide range of techniques employing advanced data analytics.

**Observation:** This approach could benefit companies whose tax positions are not 'outliers.'

The attrition has also led the IRS, beginning in early 2017, to introduce dozens of strategic, issue-based 'Campaigns,' many of which address international tax issues. To date, the IRS has announced 59 Campaigns.

### IRS focus

Typical cross-border tax issues related to inbound transactions include US withholding taxes, transfer pricing, branch profits taxes, branch interest taxes, earnings stripping, and income tax treaties.

In addition, non-US-based MNCs should be aware of the IRS *Inbound Distributor Campaign*, described on the IRS website as follows:

U.S. distributors of goods sourced from foreign-related parties have incurred losses or small profits on U.S. returns, which are not commensurate with the functions performed and risks assumed. In many cases, the U.S. taxpayer would be entitled to higher returns in arms-length transactions. LB&I has developed a comprehensive training strategy for this campaign that will aid revenue agents as they examine this IRC Section 482

issue. The treatment stream for this campaign will be issue-based examinations.

The IRS has also started to issue the first wave of Information Document Requests (IDRs) to some companies with 'sandwich structures' that have repatriated earnings to the United States under Section 965 (as amended by the 2017 tax reform legislation).

**Observation:** Other tax reform provisions the IRS is expected to focus on after closing pre-tax-reform years include the base erosion anti-abuse tax (BEAT), and the new interest deduction limitations in Section 163(j).

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### The takeaway

After years of declining resources that led to a reduction in LB&I examination activity, the IRS once again is hiring revenue agents and rapidly training them on tax reform provisions. In addition, the IRS is making better use of data analytics to identify issues and target taxpayers for examination. Inbound companies should be aware of these changes and begin preparing for increased scrutiny.

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## Let's talk

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If you would like to discuss how these developments may affect your business, please contact:

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