STATEMENT OF

FRED F. MURRAY

BEFORE THE

INTERNAL REVENUE SERVICE OVERSIGHT BOARD

MAY 1, 2013

Mr. Chairman and Members of the Board:

Thank you for this opportunity to present my views[1] and to answer your questions on emerging issues in the international arena, The View from the Global Table. My name is Fred Murray.

My experience includes public law and accounting practice (I am now at Grant Thornton LLP, U.S. member of Grant Thornton International Ltd., an organization with more than 500 offices in 113 countries), and government service as Deputy Assistant Attorney General in the Tax Division at the Department of Justice and as a Special Counsel to the Chief Counsel for the Internal Revenue Service. I also served as Vice President for Tax Policy at the National Foreign Trade Council and General Counsel and Director of Tax Affairs at the Tax Executives Institute. I am presently a member of the U.S. Internal Revenue Service Advisory Council (formerly Commissioner's Advisory Group); a former Advisor to the International Tax Working Group of the United States Senate Finance Committee; and a former member, Commissioner's Advisory Council, Department of Taxation and Finance, State of New York. I am presently a Council Director, governing Council of the Section of Taxation of the American Bar Association; and, Chair of the Federal Bar Association Section of Taxation. I am a Fellow of the American College of Tax Counsel; an Elected Member of the American Law Institute; a member of the American Institute of Certified Public Accountants; and, a member of the Bureau of National Affairs U.S. International Advisory Board. I serve as an adjunct member of the faculty at Georgetown University Law Center. I have also been involved in the work of the International Fiscal Association, recently as U.S. Co-Reporter on this year's IFA Report on Exchange of Information and Cross-Border Cooperation between Tax Authorities, to be published this Fall in conjunction with its international Congress in Copenhagen, Denmark.

<u>Funding and Resources for Service Functions, Including International Compliance</u>

Before focusing on taxpayer compliance responsibilities in the global economy and the IRS enforcement responses to them, I would like to emphasize an area that is critical to them and upon which this Board has focused much previous attention, IRS funding and available resources.

This Board, on October 20, 2011, wrote the Senate Committee on Appropriations:

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[1] The views and statements expressed herein are mine alone individually, and unless otherwise so indicated do not necessarily represent the views or statements of any firm, association, institution, or agency by which I may be employed or with whom I am presently or have been in the past associated.

> The Internal Revenue Service (IRS) Oversight Board urges Congress to fund the IRS adequately in FY2012 to provide support and service to taxpayers and address tax non-compliance. The IRS Oversight Board recommended a budget of $13 .342 billion for FY2012. The gap between the Board's recommendation and the budgets passed by the House and Senate Appropriations Committees, $11.516 billion and $11.663 billion, respectively, is disturbingly large.

In a nearly contemporaneous October 17, 2011, letter[2] to the Senate Finance Committee, IRS Commissioner Shulman noted:

> However, cuts of the magnitude contemplated in the current appropriations bills (approximately $525 million from core IRS accounts in the Senate bill and $650 million in the House bill) would lead to noticeable degradation of both service and enforcement and would have a serious detrimental impact on voluntary compliance for years to come.

These statements indicate that the ability of the Service to achieve its mission would be severely compromised by the then proposed cuts in the Service's budget.

Unfortunately, the Service's fiscal situation has not improved since that time, and in fact, has in my view deteriorated.

Budget Data and Trends: Dollars by Appropriation Account, Fiscal Years 2010 through 2014

Appropriation account	Fiscal year 2010 enacted	Fiscal year 2011 enacted	Fiscal year 2012 enacted	Fiscal year 2013 annualized continuing resolution[a]	Fiscal year 2014 requested	Dollar change fiscal year 2012 enacted compared to fiscal year 2014 requested	Percent change fiscal year 2012 enacted compared to fiscal year 2014 requested
Enforcement	$5,504	$5,493	$5,299	$5,331	$5,667	$367	7%
Operations support	4,084	4,057	3,947	3,971	4,481	533	14
Taxpayer services	2,279	2,293	2,240	2,254	2,413	173	8
Business Systems Modernization (BSM)	264	263	330	332	301	-29	-9
Health Insurance Tax Credit Administration (HITCA)[b]	16	15	-- [b]	-- [b]	-- [b]	n/a	n/a
Subtotal	**12,146**	**12,122**	**11,817**	**11,888**	**12,861**	**1,044**	**9**
Other resources, such as user fees	539	655	695	905	497	-198	-29
Total funding available for obligation	**$12,686**	**$12,777**	**$12,512**	**$12,793**	**$13,358**	**$846**	**7%**

Legend: n/a = not applicable.
Source: Fiscal Year 2012, 2013, and 2014 Congressional budget justifications for IRS.
Note: Dollars are nominal and not adjusted for inflation, and numbers may not add due to rounding.
[a] A full-year 2013 appropriation for this account was not enacted at the time the budget was prepared; therefore, the budget assumes this account is operating under the Continuing Appropriations Resolution, 2013 (P.L. 112–175). The amounts included for 2013 reflect the annualized level provided by the continuing resolution and do not include reductions due to sequestration.
[b] In fiscal year 2012, administrative resources for HITCA were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act, 2012 (Pub. L. No. 112-74).

[2] Letter of Commissioner Douglas H. Shulman to Senator Max Baucus, Chairman, Committee on Finance, United States Senate, dated October 17, 2011.

IRS Funding Subject to Sequestration and Subsequent Reductions to Discretionary IRS Appropriation Accounts for Fiscal Year 2013[a]

Discretionary appropriation accounts	Total sequestrable budget authority amount (in millions)	Sequester percentage	Total sequester amount (in millions)
Enforcement	$5,348	5%	$267
Operations support	3,983	5	199
Taxpayer services	2,271	5	114
BSM	332	5	17
Total discretionary	**$11,934**	**--**	**$597**

Source: Office of Management and Budget, “OMB Report to the Congress on the Joint Committee Sequestration for Fiscal Year 2013.”
[a] Discretionary appropriations are budgetary resources that are provided in appropriations acts, and do not fund mandatory programs. Sequestration also requires reductions of 5.1 percent to other nonexempt nondefense mandatory programs. IRS has eight appropriation accounts, such as the IRS Miscellaneous Retained Fees account, that fall into this category. The total sequester amount for those appropriation accounts is $232 million.

Source: GAO-13-541R, IRS’s 2013 Filing Season and 2014 Budget Request, April 15, 2013 (“GAO Budget Report”).

Funding levels are now significantly below levels that many of us, including Members of Congress, believe necessary for the Service to fully and successfully achieve its traditional mission, and new ones like the critical role it has been mandated to play in the implementation of the Affordable Care Act.

The IRS budget for Fiscal Year 2012 was a significant reduction from the previous year, so the agency has been very focused on cost savings and efficiencies. The Continuing Resolution passed last fall has kept the IRS at the 2012 budget level since the beginning of the 2013 Fiscal Year. That CR ran out March 27, and with the new Continuing Resolution that replaced it, the overall operating level through the end of September will I understand be about $100 million less than what had been previously anticipated, in addition to the more than $597 million due to the sequestration.

I recognize the intense challenges that the Congress faces in trying to reduce federal spending on government programs in order to balance the federal budget. In light of those challenges, however, it is even more important that the Service has the resources it needs to perform its central function. I believe that adequate funding of the Service is critical to allowing the Service to achieve its core mission of collecting the taxes mandated by Congress as necessary to fund the Government. This importantly includes both assisting taxpayers in complying with their legal obligations and enforcing those legal obligations when necessary. Any decline in the Service’s ability to achieve its core mission will only further deepen the Nation’s fiscal and budget woes.

Practitioners are already observing adverse impacts on important Service programs as the Service adjusts to the Continuing Resolutions and future funding reductions. These include not only restrictions on hiring and retaining personnel, but also the less obvious and visible effects resulting from cuts in expenditures for items like travel and training for IRS examinations, Appeals and litigation functions.

Further, statements made by Acting IRS Commissioner Miller indicate that as a result of the sequestration adjustments totaling more than one-half billion dollars, IRS may plan to continue to operate under a hiring freeze; reduce funding for grants and other expenditures; cut costs in areas such as travel, training, facilities, and supplies; review contract spending to ensure only the most critical and mandatory requirements are fully funded; and furlough all staff for a total of 5 to 7 days after the filing season ends.[3] We expect that these additional reductions in Service programs will soon be felt by American taxpayers of all types.

I urge you to continue your efforts to seek adequate levels of funding for critical programs at IRS so that it may perform its mission of providing much needed support to taxpayers who are attempting to meet their tax obligations and to address the non-compliance of those who are not so inclined.

International Cooperation and Exchange of Information between Tax Administrations

In recent years, the global economy has grown beyond any imagining only a few decades ago, not the least features of which are the way in which capital and information are created, used, and transferred. These significant changes affect the tax system of every country, and tax administrations like IRS have had to leverage their available resources to keep up with these changes.

As is the case with other developed countries, the United States has endeavoured to protect its tax revenue base from erosion by taxpayers' inappropriate use of foreign (non-United States) entities, arrangements, and structures. The United States is at the forefront in the development of the exchange of tax information and cross-border cooperation in the administration of taxes.

The United States participates in all of the significant international organizations which promote and support cooperation of tax authorities and the exchange of tax information. For example, The United States participates in the Joint International Tax Shelter Information Centre (JITSIC). JITSIC was established in 2004 by IRS, the United Kingdom's Her Majesty's Revenue and Customs,[4] the Australian Tax Office, and Revenue Canada. Japan began participating in 2007, and China and Korea have also joined the organization. France and Germany participate as official observers. The significance of information shared through JITSIC is illustrated by the fact the U.S. foreign tax credit generator schemes were first discovered by HMRC and provided to IRS.

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[3] GAO Budget Report, at 20.

[4] See http://www.businessifc.com/articles/Dave-Hartnett-Interview-JITSIC-six-years-on.htm.

The United States is a founding member of the Organisation for Economic Co-operation and Development ("OECD").[5] The United States actively participates in and supports The Global Forum on Transparency and Exchange of Information for Tax Purposes, a program of the OECD.[6] The Global Forum is a multilateral framework within which work in the area of tax transparency and exchange of information is carried out by over 100 jurisdictions. The Global Forum is charged with in-depth monitoring and peer review of the implementation of the international standards of transparency and exchange of information for tax purposes.

The United States is a party to the Convention on Mutual Administrative Assistance in Tax Matters, a convention established under the authority of the OECD and the Council of Europe.[7] That multi-lateral treaty provides, in principle, for exchange of information on request, spontaneous exchange of information, and automatic exchange of information as well as joint audits and assistance in collection. The automatic exchange of information provision requires a separate, additional agreement between the two exchanging party countries to become effective.[8] This Convention also provides for joint examinations, providing tax information spontaneously, and to conduct examinations in the other country.[9]

The Financial Action Task Force ("FATF") is an inter-governmental group composed of 34 countries and 2 regional councils. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system.

The United States has cooperated in examination procedures with other jurisdictions for some time[10] but there has never been any large number of such cases. There are two types of procedures currently in place.

The first of these is the Simultaneous Examination Program as authorized by IRS procedures[11] and working arrangements with other participating countries, including Australia, Canada, France, Germany, Italy, Japan, Korea, Mexico, Norway, Philippines, Sweden, and the United Kingdom. The U.S. Simultaneous Examination Program operates pursuant to the exchange of information provisions of tax treaties and TIEAs; they are coordinated through the Competent Authority and carried out according to written "working arrangements" entered into by the Deputy Commissioner

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[5] Convention on the Organisation for Economic Co-operation and Development, Paris, Dec. 14, 1960, ratified by United States March 16, 1961.

[6] *See* OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, at http://www.oecd.org/tax/transparency/.

[7] Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters, Strasbourg, January 25, 1988, United States entry into force - April 1, 1995. *See fn.* 39 for a description of significant reservations entered by the United States in regard to its accession to the treaty. The United States has not yet ratified the 2010 Protocol.

[8] *Id*., Art. 6.

[9] *Id*., Arts. 7, 8, and 9.

[10] International Fiscal Association, *Cahiers*, vol. 75b, International Mutual Assistance Through Exchange of Information, pp. 311, 315 (1990).

[11] Internal Revenue Manual, §4.60.1.3 – Simultaneous Examination Program (SEP) (Jan. 1, 2002).

(International), Large Business & International Division (the US Competent Authority) and the competent authority of tax treaty or TIEA partners. [12] Simultaneous Examinations involve the US and its foreign partners conducting separate, <u>independent</u> examinations of the taxpayer or a related taxpayer within their jurisdiction. [13]

The second and more recent form of cooperative examination procedure is the joint audit. A joint audit is not a simultaneous examination. Rather, it is a process where two or more countries join together to carry out a single audit of a company with cross-border business activities.[14] The OECD has suggested guidelines,[15] and the U.S. is still working through the initial stages of its program.[16]

Domestic laws require extensive reporting of both domestic and foreign transactions and assets by United States persons, ranging from reporting of payment of withholding taxes on payments to a number of other collections of information of various types.[17]

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[12] Internal Revenue Manual, §4.60.1.3.1.1 (Jan. 1, 2002). *See fn*. 148.

[13] The compliance benefits which may result from a simultaneous examination include: assessment of tax based on a more complete factual development of the circumstances pertaining to the tax liability; exchange of information on apparent tax avoidance techniques or patterns; exchange of information on tax haven transactions; exchange of information on cost sharing arrangements; exchange of information on profit allocation methods in special fields such as global trading and new financial instruments; more thorough understanding of multinational business practices, complex transactions, and examination issues that may be particular to an industry or group of industries; and identification of noncompliance trends in a market segment. A simultaneous examination may also enable examiners to build more complete factual evidence for tax adjustments for which the Mutual Agreement Procedure might be requested. A simultaneous examination may also enable taxpayers to make a request for Competent Authority consideration at an earlier stage than might otherwise have been the case. Internal Revenue Manual, § 4.60.1.3.1 (Jan. 1, 2002).

[14] *See* http://www.irs.gov/uac/Prepared-Remarks-of-Commissioner-of-Internal-Revenue-Douglas-H.-Shulman-before-the-OECD-BIAC.

[15] *See*, Sixth meeting of the OECD Forum on Tax Administration, Joint Audit Report, Istanbul, 15-16 September 2010, at http://www.oecd.org/tax/taxadministration/45988932.pdf. The report "reflects the wealth of experiences" of Australia, Canada, Denmark, France, Japan, Korea, Mexico, the Netherlands, South Africa, Spain, Turkey, the U.K., and the U.S.

[16] For example, officials from the US IRS and Australian Taxation Office have made statements indicating progress on concluding such an examination. *See* Kristen A. Parillo, U.S., Australian Officials Hope Joint Audit Process Will Improve Tax Administration, 2011 TNT 16-18 (January 25, 2011).

[17] In addition to numerous questions on and additional schedules attached to forms that report a tax liability (e.g., Schedule M-3, in the series of corporation and partnership tax returns, Forms 1120 and 1065), Notice 2008-13, _ C.B. _, and Notice 2008-46, 2008-18 I.R.B., May 5, 2008, list the following information returns and reports that are not tax returns reporting a liability: Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding; Form 1065, U.S. Return of Partnership Income (including Schedules K-1); Form 1120S, U.S. Income Tax Return for an S Corporation (including Schedules K-1); Form 5500, Annual Return/Report of Employee Benefit Plan; Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues; Form 8038-G, Information Return for Government Purpose Tax-Exempt Bond Issues; Form 8038-GC, Consolidated Information Return for Small Tax-Exempt Government Bond Issues; Form 1099 series of returns; Form W-2 series of returns; Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding; Form SS-8, Determination of Worker Status; Form 990, Return of Organization Exempt from Income Tax; Form 990-EZ, Short Form Return of Organization Exempt From Income Tax; Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ; Form 1040-ES, Estimated Tax for Individuals; Form 1120-W, Estimated Tax for Corporations; Form 2350, Application for Extension of Time to File U.S. Income Tax Return; Form 2350 (SP), Application for Extension of Time to File U.S. Income tax Return (Spanish Version); Form 4137, Social Security and Medicare Tax

The United States has an extensive network of income tax treaties and other exchange of information agreements that meet broadly accepted international standards.[18] The United States utilizes its extensive network of tax treaties and other international agreements to obtain information about United States taxpayers.

According to IRS Office of Exchange of Information and Overseas Operations ("EOI/OO") officials, the United States is currently engaged in the automatic exchange of information[19] with 25 countries, transmitting approximately 2.5 million records annually to other countries and receiving approximately 2.1 million records from its treaty partners.[20] Through automatic exchange of information, the United States provides some treaty partners with information on taxable income and federal tax withholding related to certain types of income received by U.S. nonresidents.[21] IRS officials told GAO that the information that the United States receives through automatic exchange of information varies by treaty partner and includes data on wages, interest, dividends, and other forms of income.[22]

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on Unreported Tip Income; Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes; Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return; Form 4868 (SP), Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (Spanish Version); Form 5558, Application for Extension of Time to File Certain Employee Plan Returns; Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns; Form 8109, Federal Tax Deposit Coupon; Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips; Form 8809, Application for Extension of Time to File Information Returns; Form 8868, Application for Extension of Time To File an Exempt Organization Return; Form 8892, Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax; and Form 8919, Uncollected Social Security and Medicare Tax on Wages; Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner (Under section 6048(b)); Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations; Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code); Form 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax; Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities; Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships; Form 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests; and Form 8288-B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests. Other information reports that are also required include the Form 90-22.1, Report of Foreign Bank and Financial Accounts.

[18] As of September 30, 2012, the United States had the following bilateral agreements authorizing exchange of tax information: 68 income tax treaties, 27 TIEAs, 49 MLATs, and two MLAAs in force between the United States and foreign jurisdictions. Other instruments, all incorporating tax information exchange provisions, have been signed but are not in force as of that date. Current Status of U.S. Tax Treaties and International Agreements, 41 *Tax Management International Journal* 574 (Oct. 12, 2012). The United States is also party to 15 treaties involving the taxation of inheritances and gifts, although information exchange under these treaties is rare. Similarly, social security totalization agreements and transportation income treaties contain information exchange provisions.

[19] Other forms of exchange of information include spontaneous exchanges of information and specific exchanges of information.

[20] *See*, Report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate, TAX ADMINISTRATION: IRS's Information Exchanges with Other Countries Could Be Improved through Better Performance Information, September, 2011, Report No. GAO-11-730, available at http://www.gao.gov/products/GAO-11-730 [hereinafter cited as "GAO Information Exchange Report"], p. 23.

[21] Information automatically provided by the United States is from IRS Form 1042-S, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.*

[22] GAO Information Exchange Report, p. 24.

All exchanges of information under an agreement involving the United States must occur through formal channels established between the United States and treaty partner competent or central authorities. Exchanges that occur within these formal channels restrict the disclosure of tax information both as a matter of the terms of the international agreement and as a matter of statutory law and internal procedure by the U.S. agency.[23] The information exchange provisions of TIEAs and bilateral tax treaties concluded by the United States require that a request for information satisfy a standard of relevance in order to be considered a valid request under the agreement. One of the requirements of the relevance standard is that requests contain "the identity of the person(s) under examination or investigation." Nevertheless, increased recognition by tax authorities worldwide of the importance of full exchange of information for tax purposes has led countries to refine information exchange practices to ensure that exchange will occur to the widest appropriate extent.[24]

The US will not provide information received from one Tax Treaty partner to another, either in the framework of a bilateral simultaneous examination or in a multilateral simultaneous examination. This would violate the secrecy provisions of the tax treaty or TIEA with the country providing the information.[25]

The United States has a robust statutory structure to protect taxpayer information. [26] Tax information shared through exchange of information and information about such exchanges is confidential and protected by domestic laws and provisions contained in tax treaties and other such agreements. The I.R.C. protects information exchanged under tax treaties and other relevant agreements from disclosure in the same manner as information obtained under domestic laws, and disclosure is not made except in specific circumstances such as to courts and administrative bodies. The identity of taxpayers, information about those taxpayers, and the identity of the countries involved in the exchange of information are protected from public disclosure.[27]

Regardless of the language in the relevant agreements, the United States has a policy of not carrying out administrative measures at variance with the laws and administrative practice of either contracting state, not supplying information that contracting states would not be able to obtain under their own laws, and not providing information that would disclose trade, business, industrial, commercial, or professional secret or trade process, or information that would be contrary to the public policy of either contracting state.[28]

In 2010, by far the most far reaching of tax information reporting statutes, the Foreign Account Tax Compliance Act[29] ("FATCA"), became law. This new regime begins to become partially

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[23] I.R.C. §6103, and I.R.M. §4.60.2.2 (Jan. 1, 2002), discussed *infra*. References herein to the I.R.C. are to the U.S. Internal Revenue Code of 1986, as amended as of the relevant point in time.

[24] GAO Information Exchange Report, p. 17.

[25] I.R.M. §4.60.1.3.2.4 (01-01-2002).

[26] I.R.C. §6103.

[27] 26 U.S.C. § 6105. *See also*, *Tax Analysts v. Internal Revenue Service*, 217 F. Supp. 2d 23, 28 (D.D.C. 2002) (citing *Tax Analysts v. Internal Revenue Service*, 152 F. Supp. 2d 1, 11 (D.D.C. 2001)).

[28] GAO Information Exchange Report, p. 19.

[29] Pub. L. 111-147 (Hiring Incentives to Restore Employment Act), §501(a) (March 18, 2010), adding I.R.C. §1471—1474.

effective in 2013. It is essentially an information collection regime with the sanction of withholding at 30% for failures to comply with its requirements.

New I.R.C. sections 1471 through 1474 operate to impose a 30% withholding tax on "withholdable payments" made to Foreign Financial Institutions ("FFIs") and Non-Financial Foreign Entities ("NFFEs") after December 31, 2012. In order to avoid this 30% withholding tax on all withholdable payments, a foreign entity must comply with an extensive information reporting regime. The information reporting requirements differ depending on whether a foreign entity is an FFI or an NFFE.

As part of the new FATCA system, in 2012, the U.S. Treasury Department published two "Model I" Intergovernmental Agreements ("IGAs")[30], which affect and apparently significantly modify the implementation of the new FATCA regime.[31] The U.S. Treasury Department announced September 14, 2012, that it had signed the first of these new agreements with the United Kingdom.

Earlier in 2012, the U.S. Treasury Department had issued joint statements with Japan and Switzerland which announced their intention to enter into another, second form of IGA ("Model II" IGA), a draft of which has not as yet been published. The statements indicated that the Model II IGA would reflect a mixture of direct reporting by the relevant country's financial institutions to the IRS of both certain specific account-specific information about non-recalcitrant accounts and aggregate information about certain recalcitrant account holders, as well as possible exchange of information upon request between the U.S. and foreign government with respect to recalcitrant account holders of U.S. accounts.

The primary inducement for foreign governments to enter into such agreements is their ability to obtain information under them with respect to their own taxpayers.

One concern of U.S. and other countries' taxpayers is that they are generally not entitled to participate in the transmission of information about their U.S. tax information to non-U.S. entities or governments as such is governed by treaties or U.S. statutes, and in many cases they are not even aware of such activities. Foreign persons are sometimes concerned about the sharing of

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[30] The two types of Model I IGA published on July 26 are reciprocal and nonreciprocal. In the reciprocal version, the United States commits to require its financial institutions to report certain information on the accounts of FATCA Partner taxpayers to the IRS and to transmit that information to the FATCA Partner through automatic EOI in order to reciprocate for the FATCA Partner's transmission of information about U.S. accounts. In the nonreciprocal version, the United States does not make that commitment.

[31] The Treasury and IRS published proposed FATCA regulations on February 8, 2012. On the same day, Treasury and five European countries (France, Germany, Italy, Spain, and the United Kingdom (sometimes referred to as "the G5") released a joint statement ("Joint Statement") in which they announced their intention to enter into bilateral agreements to implement FATCA through a cooperative approach. Under that approach, the relevant foreign government (FATCA Partner) would enact legislation requiring FFIs in its jurisdiction to collect and report FATCA-required information to the tax authority of the FATCA Partner, allow those FFIs to apply the necessary due diligence procedures to identify U.S. accounts, and transmit the collected information to the IRS through automatic EOI procedures. The Joint Statement further indicated that under these agreements the United States would agree to modify the application of FATCA to FATCA Partner FFIs. For example, the agreement would eliminate the need of the FFI to enter into PFFI agreements, to apply withholding on passthru payments, or to close the accounts of recalcitrant account holders. The agreement would also identify certain categories of FATCA Partner FFIs as "deemed compliant," eliminating some of the other required procedures. The United States would further agree to commit to reciprocity of automatic EOI for information of FATCA Partner taxpayers' accounts in the United States.

information with their home country governments due to fear of political reprisals or persecution, and unlike the U.S. immigration laws recognizing principles of political asylum, the standards enabling the U.S. to withhold information in such cases are vague at best.

The principle concern that taxpayers and the institutions with which they do their business have about the operation of this extensive information gathering system is its cost of compliance. There are substantial costs involved in the gathering and assimilation of all required information into all the various information reporting forms, many of which, while having a valid and supportable purpose in aid of law enforcement, have no relation to the actual computation of their tax liability.

Transfer Pricing and the Advance Pricing Agreement Program

An important exception to taxpayer involvement in these processes just described is the competent authority process in the context of civil tax disputes.[32] It is possible for taxpayers to have some involvement in this process depending on the situation. Many cross-border transfer pricing disputes involve the taxpayer. The IRS operates the Mutual Agreement Program for the resolution of transfer pricing disputes with tax treaty partners. This program is based on the procedure contemplated by the mutual agreement procedure articles of the several tax treaties.[33]

Nevertheless, reaching an agreement between the taxpayer and the affected tax administrations with respect to its transfer pricing and allocation of income between jurisdictions has long been one of the most difficult areas of tax administration for government and taxpayer alike, with many situations resulting in costly litigation lasting as long as twenty years. Transfer pricing has long been critical to the maintenance of the United States tax base, and is becoming more so with consideration of tax reforms like the adoption of a territorial or exemption system of taxation.

The Advance Pricing Agreement ("APA") Program has been subject to intense public scrutiny since its inception in 1991. Many of us at the IRS at the time were uncertain of its future, but there was a sense that something had to be done to address the inability of both taxpayers and the government to deal efficiently with the existing situation. That decision has in my view been justified over time.

An APA is an agreement between the IRS and a taxpayer under which the IRS agrees not to seek a transfer pricing adjustment under I.R.C. section 482 for one or more specific covered transaction(s) if the taxpayer files its tax return for a covered year based on the agreed Transfer Pricing Method(s). The APA process is a voluntary program designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional examination (and often litigation) process.

The Revenue Procedure (Rev. Proc.) covering APAs has seen many updates and revisions since 1991 when Rev. Proc. 91-22 was issued. The current Rev. Proc. 2006-09[34] was released in

[32] *See, e.g.*, U.S. Model Treaty, Art. 25 – Mutual Agreement Procedure.

[33] *See, e.g.*, United States-Germany, Income and Capital Tax Treaty, Art. 25.

[34] Rev. Proc. 2006-9, 2006-2 I.R.B. 278.

December, 2005, and was amended by Rev. Proc. 2008-31 in May, 2008. The IRS is reworking Rev. Proc. 2006-09 and US Competent Authority (USCA) Rev. Proc. 2006-54. Pending the updates, the IRS released Announcement 2012-38 on March 27, 2012 advising taxpayers to continue to follow the Revenue Procedures currently in effect with minimal exceptions.

When competent authority procedures are available in the other countries involved (under an effective tax treaty), the IRS encourages bilateral or even multilateral APAs. These agreements are also binding on the foreign tax authority for the same period of time and help avoid instances of double taxation.

Public scrutiny of the APA program has come in the form of Congressional inquiries and lawsuits.[35] The General Accounting Office, now the General Accountability Office, has reviewed the program on several occasions.[36] In GAO's August 14, 2000 report, Tax Administration: IRS' Advance Pricing Agreement Program (GAO/GGD-00-168), the GAO mostly focused on the APA Program's backlog of cases and timeliness, criticism which persists to the current day. Commissioner Charles Rossotti responded to the Report (the response is included in the Report):

> The main reason APA cases take longer than the ideal to process is resource constraints. In this way, the APA program has been a victim of its own success. As the Program's reputation for reaching principled, even-handed, practical solutions to some of the most difficult cases facing the IRS and taxpayers has grown, demand for APAs has also grown. Even though we are processing APAs at a record pace, this demand has outstripped the Program's resources.

The IRS issued the fourteenth annual Advance Pricing Agreement (APA) Report (the "APA Report") on March 25, 2013, in Announcement 2013-17. During early 2012, the APA Program merged with the portion of the USCA that resolves transfer pricing cases under the mutual agreement procedures of the U.S. bilateral income tax conventions noted above. As the successor to the APA program, the new Advance Pricing and Mutual Agreement (APMA) Program issued this year's APA Report.

In conjunction with the reorganization, staffing of the newly-created APMA program has expanded, with a focus on hiring experienced transfer pricing economists.[37]

Since the APA program's inception in 1991 through December 31, 2012, the IRS has received a total of 1,745 APA applications, and executed 1,155 APAs.

During 2012, 126 APA applications were filed and 140 APAs were completed. This represents a single-year record high number of closures and is more than three times the 2011 results. This is also the first time that the number of case closures exceeded the number of applications received,

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[35] *See, e.g., Bureau of National Affairs v Internal Revenue Service*, D.D.C., Nos. 96-376, 96-2820 and 98-1473.

[36] *See*, Tax Administration: Information on the IRS' International compliance Activities (GAO/GGD-94-96); Tax Administration: IRS Initiatives to Resolve Disputes Over Tax Liabilities (GAO/GGD-97-71); Tax Administration: Foreign and U.S.-Controlled Corporations That Did Not Pay U.S. Income Taxes, 1989-95 (GAO/GGD-99-39); and, Tax Administration: IRS' Advance Pricing Agreement Program (GAO/GGD-00-168).

[37] Overall headcount increased from approximately 77 professionals in 2011 to 104 at the end of 2012

leading to progress in reducing the program's inventory of pending cases. At year end, 391 APA requests were pending, down from 445 pending requests in 2011.

For the first time, the report provides detail on the treaty partners to the bilateral APAs concluded during the year. APAs with Japan (53%), Canada (16%) and the UK (10%) combined comprised 79% of all US bilateral APAs executed in 2012. Approximately 75% of the APAs executed in 2012 were completed with companies having a foreign parent while 25% were completed with U.S. parent companies.

The APMA Program favors agreements with terms of at least five years, which can be extended through renewal procedures. In 2012, 41% of the completed agreements were for terms of five years. Approximately 90% of all cases had terms of nine years or less, with the average term being six years. Also noteworthy is the significant increase in renewals executed during the year. More renewals were executed during 2012 than three prior years combined.

One of the aspects of the new combined organization is an elimination of the "handoffs" that existed prior to APMA's formation. Under the legacy program, an APA team leader would develop the relevant facts and a recommended negotiating position before handing the case off to a USCA analyst for discussion with the treaty partner. Once an agreement was reached, the USCA analyst would hand the case back to the team leader to draft the domestic APA. As a result of the merger of the APA and USCA programs, the team that develops the IRS position on the case is also responsible for negotiating with the treaty partner and finalizing the agreement with the taxpayer. It is to be hoped that the practical implications of competent authority negotiations are now a consideration from the outset.

Perhaps significantly however, the average time required to complete an APA increased slightly, from 40.7 months in 2011 to 41.7 months in 2012.

This particular statistic is troubling because it reflects concerns that have been voiced by a number of practitioners for many years now – that the process takes a long time to complete, that the taxpayers lacks the desired and necessary certainty for which it entered the program during the process, and that because so much of the process is performed outside the view of the taxpayer and without its interaction, the process lacks transparency.

One of the reasons for combining and reorganizing the functions involved was a desire to increase the amount and efficiency of personnel resources that could be devoted to these agreements and to reduce the time required to complete them. While it is clear that the Large Business & International Division is working hard to revamp and further improve this critical process, much remains to be done. The Service should consider the suggestions of affected taxpayers and practitioners[38] as it continues the process, and should not be criticized by those in oversight positions for taking new approaches to solve some of the persistent problems that remain. In particular:

[38] *See, e.g.*, Comments by the American Bar Association Section of Taxation on the Advance Pricing and Mutual Agreement Program, in a letter dated January 5, 2012, to Commissioner Douglas Shulman, at http://www.americanbar.org/content/dam/aba/administrative/taxation/010512comments.authcheckdam.pdf.

- It appears that a significant amount of time in past application processes was devoted to resolving technical issues in conformity with technical guidance being developed by the Treasury and the Office of Chief Counsel, strict adherence to other informal practices in the program, achieving complete consistency among various taxpayers who may have facts involving some of the same issues, preparing lengthy internal briefing memoranda, and so on.

    - Some amount of "rough justice" would seem appropriate, meaning that some flexibility in the process is desirable.

    - Although the Service has been criticized in other contexts for allowing taxpayers to draft documents for Service use, it is far less resource consuming for the Service to thoroughly review and edit drafts of documents, including the supporting memoranda and other exhibits to the standard agreement forms, than it is for the APMA team to perform the entire process. That would also allow for greater interaction with the taxpayer, and hopefully greater transparency to both the government and the taxpayer.

- The Service could establish checklists or other forms that would allow a faster and more efficient classification of issues, or the absence of them, in an application, particularly a renewal application.

    - This would allow simpler or at least less complex situations to follow a track different from those involving more complex issues or an increased risk.

    - It would also improve the efficiency of taxpayer conferences at the beginning of the application process.

- The Service could establish and publish "safe harbors" of comparables or acceptable ranges for certain "routine" services or other more common transactions. This would also help meet criticisms that the results of the agreements themselves should be published.

- By following these approaches, it would also be possible to make the process less burdensome for small taxpayers, a desirable end in itself.

<u>IRS Offshore Voluntary Disclosure Programs In Some Cases Discourage Voluntary Compliance</u>

The Bank Secrecy Act (BSA) requires U.S. citizens and residents to report foreign accounts on Treasury Form TD F 90–22 .1, *Report of Foreign Bank and Financial Accounts* ("FBAR"). The original purpose of the form was related to detection of money laundering and other related activities, but active enforcement of the requirements that have been in Title 31 of the United States Code since the 1970's was eventually transferred to IRS from FINCEN. IRS saw potential in the requirements to detect tax evasion under Title 26. Compliance with the requirements, however, despite the severity of the related Title 31 penalty provisions was relatively low.

Beginning in 2009, the IRS initiated a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and to file related information returns such as the FBAR. These programs applied a resource-intensive, burdensome, punitive, one-size-fits-all approach designed for "bad actors"[39] to "benign actors" that also had inadvertently violated the rules. The view held by many of us is that it is possible to differentiate between situations in the degree of noncompliance and the reasons for it. As each of the successive programs evolved and were completed, the Service adjusted the penalties to successively make them more severe (on the theory that those who had not yet come into compliance should not be rewarded for waiting), and attempted to fine tune the available options for the less egregious cases. These adjustments in options for the benign actors do not seem to be reaching all appropriate cases, and an allowance of more discretion to address the circumstances that are presented in these cases would seem appropriate. Further, the severity of the penalties is having the perverse effect of driving some back into hiding.

As stated by the Taxpayer Advocate:

> Benign actors were required to "opt out" to get a fair result — at the risk of facing draconian penalties. Afraid to opt out, some paid more than they should — extortion in their view. Others declined to address the problem. While an estimated five to seven million U.S. citizens reside abroad, and many more U.S. residents have FBAR filing requirements, the IRS received only 741,249 FBAR filings in 2011, and as of September 29, 2012, it had received fewer than 28,000 OVD submissions. Thus, OVD programs have both infringed taxpayer rights and failed to address significant FBAR compliance problems.
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> The IRS discouraged taxpayers from voluntarily correcting FBAR violations outside of the OVD programs. Those who opted out could be subject to an examination and FBAR penal- ties of up to 300 percent of the unreported account balance. The IRS also provided inconsistent guidance about how Canadians with certain retirement plans could participate. In addition, the IRS will soon require duplicative reporting on an FBAR and Form 8938, *Statement of Specified Foreign Financial Assets.*
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> The IRS recently identified a few situations in which a taxpayer could opt out without penalty. In addition, on September 1, 2012, it established a Streamlined Nonresident Filing Initiative that allows certain nonresidents to correct errors outside of the OVD programs. However, as the IRS identifies more FBAR noncompliance, it will face the choice of whether to devote more enforcement resources to address it, expand its outreach and self-correction options, or ignore the noncompliance altogether.
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> The IRS should expand the self-correction options available to all benign actors (including U.S. residents); send "soft" notices to educate persons with foreign accounts about the reporting requirements; consolidate and simplify conflicting

[39] This description is coined by the Taxpayer Advocate in her National Taxpayer Advocate 2012 Annual Report to Congress, found at www.TaxpayerAdvocate.irs.gov/2012AnnualReport, pg. 12.

guidance; and revise Forms 8938 and TD F 90–22 .1 to reduce duplicative reporting .

Thank you for your consideration of my comments, and thank you for making an evaluation of international enforcement priorities and activities an important part of your review. I would be pleased to answer your questions.