



Treasury Inspector General for Tax Administration

ACTIONS ARE NEEDED TO CONTROL RISKS WITH INTERNATIONAL TRANSACTIONS REPORTED ON CORPORATE INCOME TAX RETURNS

Issued on May 30, 2008

Highlights

Highlights of Report Number: 2008-30-114 to the Internal Revenue Service Commissioners for the Large and Mid-Size Business Division and the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Promoting voluntary tax compliance fairly and equitably is of paramount importance to the Internal Revenue Service (IRS). However, some in the taxpaying public could perceive inequities in the processes used to select and examine corporate tax returns because smaller corporations reporting international transactions are far less likely to be scrutinized than larger ones.

WHY TIGTA DID THE AUDIT

This audit was initiated to assess the timeliness of requesting and delivering the assistance of international specialists in corporate examinations that have international transactions. International specialists are specifically trained to evaluate the risks posed and, if necessary, examine the tax issues relating to companies operating in a multinational environment. The compliance risk associated with international transactions continues to grow and to present tax administration challenges as companies both small and large expand operations across international boundaries.

WHAT TIGTA FOUND

The IRS is not routinely making mandatory referrals of corporate tax returns containing international features. TIGTA reconciled to the Specialist Referral System 2,144 corporate tax returns that reported transfer-pricing transactions and/or foreign tax credits and were listed in the closed examination files for the Small Business/Self-Employed (SB/SE) Division and the Large and Mid-Size Business (LMSB) Division. Although all the tax returns had been assigned to examiners and each required referral to a specialist, referrals were not made in 1,212 (56.5 percent) of the 2,144 tax returns. The 1,212 returns reflected foreign tax credits and transfer-pricing transactions totaling

more than \$72 billion. However, the LMSB Division control processes provide a greater level of assurance that specialists will have an opportunity to evaluate the compliance risk associated with international transactions reported on tax returns than those in the SB/SE Division.

TIGTA also found only a limited number of corporate tax returns reporting foreign tax credits and/or transfer-pricing transactions in the SB/SE Division closed examination files, which raises questions about how well the Division identifies and selects for examination corporate tax returns with international features. The SB/SE Division annually receives almost twice as many corporate tax returns reporting international transactions as the LMSB Division, but only 1 percent of the returns received by the SB/SE Division are likely to be examined, even when significant dollars are involved.

WHAT TIGTA RECOMMENDED

The Deputy Commissioner, International, LMSB Division, should 1) re-emphasize to Examination function personnel the situations that require use of the Specialist Referral System to manually request specialist involvement and, 2) evaluate the full range of challenges the Division faces with automating the specialist referral process. The Director, Examination, SB/SE Division, should 1) develop and implement a process to provide better assurance that examiners are requesting the assistance of specialists, 2) expand the Division's quality review systems to include evaluating how well the requirements for requesting specialist assistance are met, 3) ensure that examiners are knowledgeable of and use the transfer-pricing compliance process, and 4) implement plans to use specialists in screening corporate tax returns with international features for examination.

In their response to the report, IRS officials agreed with the recommendations. The Deputy Commissioner, International, plans to provide all LMSB Division personnel with additional guidance that stresses the requirements of making international referrals and to complete an evaluation of the automated referral process. In the SB/SE Division, the Director, Examination, plans to ensure, among other things, that the Embedded Quality Review System Job Aids are updated to provide additional guidance on requesting the assistance of a specialist, publish materials and provide training to enhance awareness of international issues, and implement procedures to include international specialists in the SB/SE Division's process for screening corporate tax returns for examination.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2008reports/200830114fr.pdf>

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