Chairman Neal, Ranking Member Brady, and Members of the Ways and Means Committee, thank you for inviting me to discuss issues regarding enforcement and compliance in the international tax system. The views expressed herein are my own and should not be attributed to any other source.

Very briefly, I practiced in the international tax area for 34 years, both in the government and in private practice. I joined the IRS Office of Chief Counsel in 1981 and in 1986 began working on international tax regulations and other guidance. From 1989 to 1995 I was heavily involved in drafting guidance for taxpayers and IRS auditors addressing pricing rules for cross border transactions between related parties, typically multinational corporations and their subsidiaries. Many multinationals expend significant resources to support aggressive tax positions contrary to these rules, shifting billions of dollars of income abroad and eroding the US tax base. These activities have been well documented, both in professional journals and in national publications.

In 1995 I left the government for the private sector, where I advised large multinational corporations on international tax issues for 16 years. I returned to the IRS in 2011 to assist IRS efforts to bring taxpayer reporting more in line with economic reality. In 2016 I moved back to the Office of Chief Counsel as a deputy to the Associate Chief Counsel (International), where I was responsible for transfer pricing and international operations. I retired in August of 2018.

The business world today is exceedingly complicated, involving legal, transactional, financial and contractual complexity. In order to ensure that businesses properly report their income, the Internal Revenue Code is commensurately voluminous and complex. Moreover, the interaction of numerous code provisions exacerbates the situation. But the code is necessarily limited, and as a result lengthy regulations and other guidance are required to flesh out the statutory regime.

Over the last 30 plus years the area of transfer pricing has posed the greatest threat to the tax base. The first sentence of the relevant code provision - section 482 - is very brief, stating that:

> In the case of two or more organizations, trades or businesses . . . owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Although the regulations are much more extensive, they cannot provide much more than a framework for evaluating prices charged in related party transactions, including sales of goods, transfers of intangible property, provision of services, loans and advances, etc. The facts of each transaction are, typically, very complex, the economic analysis is difficult and not susceptible of precision, and the legal guidelines are somewhat blunt. In short, the task of auditing the pricing of trillions of dollars of transactions, within the statute of limitations, is an extraordinarily heavy lift. And as budgets shrink and senior personnel with substantial transfer pricing experience retire and cannot be replaced, transfer pricing audits become more and more challenging, and tax revenues fall. An economic analysis from 2010 estimated that inappropriate transfer pricing was draining more than $28 billion annually from the Treasury.

On the other side of the equation are large, well advised multinational corporations that control the facts but resist responding to legitimate IRS inquiries in a timely manner in the hope that they can run out the clock before the IRS has fully developed it's case. Given the tax dollars at risk, these taxpayers spend tens of millions of dollars annually on tax litigation. If you are curious, I suggest you review the financial statements of taxpayers that have recently litigated, or are litigating, a large transfer pricing case. These expenditures support not just a substantive defense of their tax position but also efforts to undermine the IRS's ability to develop it's case. It is hardball litigation by counsel zealously representing their clients, and they have far larger budgets than the IRS. Taxpayers are understandably willing to spend millions to save billions. While the IRS has excellent, very hard working litigators, the organization has far fewer resources than taxpayers to devote to these cases.

Without naming names, I'd like to share an example based on a recent Tax Court opinion that will give you an idea of what the IRS is up against. A major US multinational with a huge market share manufactures and sells high tech medical devices. It performs all the research and development, using senior scientists and engineers, and owns all the intangible property (patents, trademarks, etc.). It manufactures all the components to exacting specifications, obtains all the regulatory approvals, and writes all the embedded software. It then ships the components to a subsidiary in a low-tax jurisdiction, and the subsidiary performs a straight-forward assembly and testing operation pursuant to instructions provided by the US parent. The subsidiary then ships the assembled product back to the US parent, where a sophisticated, experienced sales team takes the product to doctors and other health professionals for sale. The product is then implanted into human bodies.

The taxpayer in this case claimed on it's income tax return that more than 60% of the total net income from all activities was attributable to the assembly and testing operations of the subsidiary. But it doesn't take a transfer pricing expert to know that most of the value of this product was derived from functions performed and assets employed by the US parent - that is, research and development, intangible property, manufacturing, software development, and sales. Interestingly, more than 90% of the costs of the entire operation were incurred by the US parent.

That the taxpayer took an aggressive position was not surprising. What was surprising was that the Tax Court concluded that the taxpayer was largely correct. While this opinion has been reversed and remanded, it illustrates the challenge the IRS faces to achieve a rational result.

There are no easy answers to resolve these challenges. But substantially increasing the IRS budget, reversing cuts made earlier in this decade, would go a long way to enhancing audit, legal guidance and litigation efforts in large, complex cases. Revisions to the Tax Court's rules and practices would also help create a more level playing field. The American people deserve at least that much.

Thanks very much for your attention.