

Corporate Offshore Profit Shifting: Research and Policy Recommendations

Testimony of
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Chairman Whitehouse, Ranking Member Grassley, members of the Committee: Thank you for inviting me to share our research on, and experiences with corporate offshore profit shifting by U.S.-headquartered multinational enterprises (MNEs) and related enforcement issues. I am a tax practitioner with around 27 years of experience performing transfer pricing projects. I have worked from offices in New York, London, and Los Angeles mostly for Fortune 500 level corporations as an employee and Partner in the largest practices of two “Big-4” accounting firms. I founded a consultancy in 2013 to develop forensic technology and capabilities to improve enforcement of U.S. tax and transfer pricing laws, which included publishing research on corporate offshore profit shifting and indicated noncompliant tax arrangements, such as these:

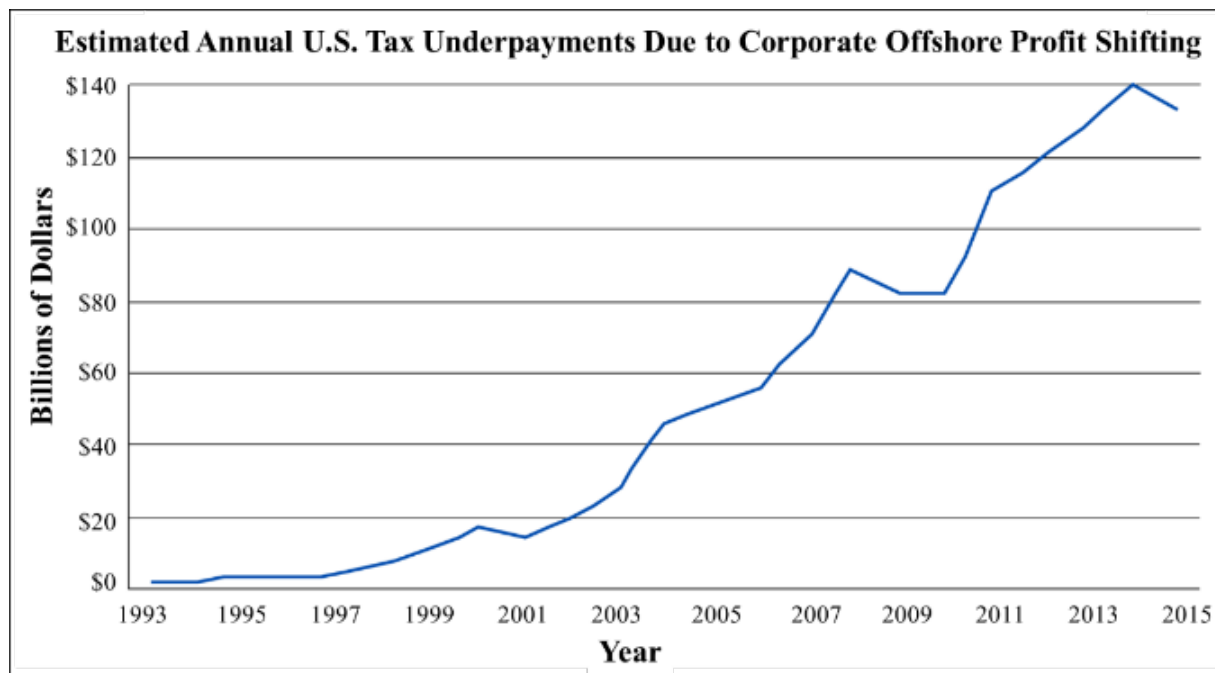
Figure 1: Indicated Cost Sharing Arrangement (CSA) Periodic Adjustment Tax Violations

(\$ million)		Tax Notes Report Publication Date	Potential Tax Adjustment	Potential Penalties	Potential Interest	TCJA Transition Taxes Paid Though 2023	Total
No.	Taxpayer						
1	Meta Platforms Inc.	21-Dec-2020	\$ 8,246	\$ 3,298	\$ 3,940	\$ (1,595)	\$ 13,889
2	Apple Inc.	23-Aug-2021	\$ 101,861	\$ 40,744	\$ 48,225	\$ (20,515)	\$ 170,315
3	Alphabet Inc.	20-Dec-2021	\$ 39,582	\$ 15,833	\$ 21,729	\$ (5,610)	\$ 71,534
4	eBay Inc.	13-Jun-2022	\$ 12,724	\$ 5,090	\$ 7,579	\$ (770)	\$ 24,623
5	Cisco Systems Inc.	18-Jul-2022	\$ 25,507	\$ 10,203	\$ 12,915	\$ (3,200)	\$ 45,425
6	Microsoft Corp.	6-Mar-2023	\$ 89,319	\$ 35,728	\$ 52,294	\$ (8,525)	\$ 168,816
7	Qualcomm Inc.	11-Sep-2023	\$ 10,109	\$ 4,044	\$ 6,736	\$ (987)	\$ 19,902
8	Oracle Corp.	11-Mar-2024	\$ 33,961	\$ 13,584	\$ 23,903	\$ (3,224)	\$ 68,224
9	Company A	TBD	\$ 5,008	\$ 2,003	\$ 2,698	\$ -	\$ 9,709
10	Company B	TBD	\$ 4,360	\$ 1,744	\$ 1,681	\$ (836)	\$ 6,949
Totals			\$ 330,677	\$ 132,271	\$ 181,700	\$ (45,262)	\$ 599,386

We estimate around \$600 billion is owed to the U.S. Treasury currently for violations of a U.S. tax law that the IRS has by all accounts never enforced. These violations are extensively described with evidence and regulatory analyses in a series of papers published in the tax journal *Tax Notes Federal*. Each paper examines a U.S. multinational that has executed aggressive

offshore profit-shifting structures that all appear to violate the aforementioned regulation,¹ that was based on a tax law enacted by Congress during the Reagan administration. Figure 2 shows the exponential growth of U.S. tax underpayments from offshore profit shifting from the high single digits in the early 2000s to around \$140 billion *per year* by 2015. My research involving tax years after 2015 suggests this trend has continued, and we’ve only scratched the surface.

Figure 2: Estimates of Annual Federal and State Tax Losses from Offshore Profit Shifting²



¹ Sources: Sources: Calculations by Stephen Curtis, and Curtis, “Facebook, the IRS, and the Commensurate With Income Standard,” *Tax Notes Federal*, Dec. 21, 2020, p. 1921; Curtis and David G. Chamberlain, “Apple’s Cost-Sharing Arrangement: Frankenstein’s Monster,” *Tax Notes Federal*, Aug. 16, 2021, p. 1049; Curtis and Chamberlain, “Apple’s Cost-Sharing Arrangement: Frankenstein’s Monster, Part 2,” *Tax Notes Federal*, Aug. 23, 2021, p. 1217; Curtis, “Google’s Cost-Sharing Arrangement: Bride of Frankenstein,” *Tax Notes Federal*, Dec. 20, 2021, p. 1623; Curtis, “eBay’s Cost-Sharing Arrangement: Frankenstein’s Progeny,” *Tax Notes Federal*, June 13, 2022, p. 1655; Curtis, “Cisco’s Cost-Sharing Arrangement: Frankenstein Poker,” *Tax Notes Federal*, July 18, 2022, p. 305; Curtis and Reuven S. Avi-Yonah, “Microsoft’s Cost-Sharing Arrangement: Frankenstein Strikes Again,” *Tax Notes Federal*, Mar. 6, 2023, p. 1443; and Curtis, “Frankenstein Calling: Qualcomm’s Unenforced Periodic Adjustment,” *Tax Notes Federal*, Sept. 11, 2023, p. 1773; Curtis, “Frankenstein’s Cloud — Is Oracle Due For a Monstrous Periodic Adjustment?” *Tax Notes Federal*, Mar. 4, 2024, p. 1747; Curtis, “Frankenstein’s Cloud — Is Oracle Due For a Monstrous Periodic Adjustment? Part 2,” *Tax Notes Federal*, Mar. 11, 2024, p. 1941; and Reuven S. Avi-Yonah, David G. Chamberlain, Stephen L. Curtis, Jeffery M. Kadet, “Commensurate With Income: IRS Nonenforcement Has Cost \$1 Trillion,” 179 *Tax Notes Federal*, (May 22, 2023), 1297–1330. All papers are publicly available on SSRN.

² Stephen Curtis and Yaron Lahav, “Forensic Approaches to Transfer Pricing Enforcement Could Restore Billions in Lost U.S. Federal and State Tax Losses: A Case Study Approach,” 12 *J. Forensic & Investigative Acct.* 285 (2020). Prepared with the assistance of Prof. Kimberly Clausung.

Recent 2023 studies by Garcia-Bernardo, Jansky and Zucman³ and the Penn-Wharton Budget Model⁴ have each failed to find any substantial impact from the 2017 Tax Cuts and Jobs Act (TCJA) on offshore profit shifting by U.S. multinationals. The former study documented how several corporations had repatriated their IP onshore (and our research includes three of these) which contributed a reduction in offshore profit shifting of around 4% since TCJA. Note however this has no impact on the funds owed to the IRS shown in Table 1, which are for tax violations for which there no applicable statute of limitations should apply, back to 2009.

Our research estimates that around \$1 trillion in revenue can be collected from initiating enforcement of this one currently unenforced tax code section, with more recoveries possible via enforcement of other tax regulations that the IRS has historically not enforced or enforced rarely. More advanced enforcement capabilities are needed to undertake this enforcement, but enhanced enforcement capabilities should also lead to increased voluntary compliance by U.S. MNEs that will be motivated to begin unwinding their aggressive tax positions.

Background on Corporate Offshore Profit Shifting

Large corporate profit-shifting projects, often planned and implemented by Big-4 accounting firms and major law firms, always involve at least three objectives: (i) a return on investment (typically but not always from the elimination of U.S. federal and state taxes); (ii) documentation to support the claim that these projects comply with U.S. tax law; and (iii) identification of non-tax business purposes to justify the arrangement. These last two objectives relate to independence and ethics rules that prohibit Big-4 accounting firms from promoting and implementing projects with a significant tax avoidance purpose or if the transaction is more likely than not to be disallowed under U.S. tax laws.

Despite this, a recent case involving Caterpillar Inc. shows that a U.S. multinational company will think nothing of paying a Big-4 accounting firm around \$55 million to eliminate \$2.4 billion of U.S. federal taxes.⁵ However, despite investigations by the Large Business and International and the Criminal Investigation divisions of the IRS and the Justice Department into Caterpillar's tax planning, the IRS assessed only a small adjustment and no penalties.⁶ It is possible however that the investigation was prematurely ended by the Executive branch for political reasons.⁷

³ Javier Garcia-Bernardo, Petr Jansky and Gabriel Zucman "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?" Working Paper, Jul 19, 2023. The study found a 3-5% reduction in offshore profit shifting related to IP repatriations by several corporations.

⁴ University of Pennsylvania, Penn Wharton Budget Model, Oct. 12, 2023. The study found that U.S. tax liability from foreign income was less in 2020 than it was in 2017 when TCJA was enacted.

⁵ United States Senate Permanent Subcommittee on Investigations, "Caterpillar's Offshore Tax Strategy" Majority Staff Report, August 28, 2014.

⁶ Caterpillar Inc. Form 10-Q, issued on November 2, 2022. The tax adjustment was \$490 million with interest of \$250 million. This was well within the taxpayer's reserves for the arrangement, allowing the taxpayer to retain most of the eliminated U.S. taxes as additional net earnings.

⁷ Jesse Drucker, "How Trump's Justice Dept. Derailed an Investigation of a Major Company," *New York Times*, March 9, 2024, at <https://www.nytimes.com/2024/03/09/business/caterpillar-tax-trump-barr.html>.

“Transfer Pricing” is a Primary Means of Corporate Offshore Profit Shifting

Transfer pricing relates to the pricing of cross-border transactions between different subsidiaries of the same multinational company. To shift profits offshore, a U.S. multinational corporation might pay “too high” a transfer price for an imported good or service, and/or a charge “too low” a price for an exported good or service. U.S. tax laws require these “intercompany” transactions reflect an “arm’s length” price, or the price the company would have paid or charged to a totally unrelated business for the same transaction. This has such a large impact on offshore tax avoidance and evasion because these “intercompany” transactions within an MNE make up about 64% of all cross-border movement of goods and services between major economies.⁸

The hallmarks of a profit-shifting structure often involve a U.S.-based multinational company that manages and conducts an integrated worldwide business that is seamless to customers, because the business (i.e. the global supply chain) is managed and controlled centrally from the U.S.⁹ A typical rule of thumb in transfer pricing is that pretax income generally follows ownership of functions, intangible and tangible assets, and financial and business risks. People and fixed assets are hard to move. So a U.S. multinational company with most of its people and fixed assets in the U.S. seeking to reduce its taxes will often move its more fungible assets such as intellectual property (IP), financial and transactional risks, and rights offshore, typically into a low taxed jurisdiction (for a “too low” price), where the (inflated) income from the arrangement will be recorded. These fungible assets, risks, and rights are often both very valuable and very difficult to value, presenting large profit shifting opportunities for taxpayers and complex and difficult enforcement issues for the IRS.

Transferring fungible assets like IP often involves transactions conducted only “on paper”. A new affiliated company is formed (typically in a tax haven or other low-tax country), contracts are executed that transfer the rights to valuable intangibles (such as IP) from the U.S. entity to the new foreign affiliate, and then those new foreign affiliates enter contracts with vendors, contract manufacturers, and customers. However, other than the name of the foreign entity on those contracts, little about the conduct of the multinational’s business actually changes. All remains under the control and direction of the U.S. management. For U.S.-parented multinationals, some portion of the shifted profits (typically no more than half and often much less) will be currently taxable under the Global Intangible Low-taxed Income or “GILTI” rule, a law enacted in the Tax Cuts and Jobs Act in 2017. All of the groups in Figure 1 fall into this U.S.-parented category.

⁸ Koen De Backer, Sébastien Miroudot and Davide Rigo, “Multinational enterprises in the global economy: Heavily discussed, hardly measured,” Sep 25, 2019 Centre for Economic Policy Research. Study measured the proportion of all exports from 60 countries and 34 industries between 2005-2016 that were made by a domestic or foreign affiliate of a multinational company, reported at Figure 1.

⁹ In her work prior to becoming Deputy Assistant Secretary, Tax Analysis, within the Treasury Department, now former Deputy Assistant Secretary Kimberly Clausing calculated that roughly *two-thirds of the real activities that earned these zero and low-taxed profits took place within the United States*. See Kimberly A. Clausing, “5 Lessons on Profit Shifting From U.S. Country-by-Country Data”, 169 *Tax Notes Federal* 925 (November 9, 2020), at 933ff, available at <https://ssrn.com/abstract=3736287>.

However, inverted multinationals¹⁰ claim on paper to be a foreign company for tax purposes while in practice being managed and controlled from a U.S. headquarters and operating a U.S. centric supply chain. These companies can shift profits from U.S. group members into foreign group members not subject to the 2017 GILTI rules so that U.S. taxation is totally evaded. The IRS should heavily scrutinize these “foreign-parented” multinationals exhibiting aggressive offshore profit-shifting structures. For instance, such a “foreign headquartered” U.S. based company may have offshored various rights and IP to a “foreign headquarters” or other foreign affiliate, along with the associated profits. While the foreign entity may possess offshore production, selling, and other supply chain operations, many or most of the key business decisions that impact foreign profits might still occur in the U.S. These can include decisions on which competitors to acquire, which products to develop, which markets to enter, how much to spend on R&D, etc. If this is the case, then some large portion of these foreign profits should be recorded and taxed in the U.S. Investigating this requires a factually intensive forensic analysis.

To illustrate the difficulties for the IRS and the need for more sophisticated forensics-based enforcement, consider a case currently before the U.S. Tax Court, in which the IRS challenged Facebook Inc.’s 2010 transfer of the economic rights to its offshore business and IP to an Irish affiliate. The transfer took place literally on the same day the Irish entity was created on paper in January 2009. Eighteen months later (when the Irish affiliate had around 150 employees and the U.S. had around 2,000) the Irish affiliate and the U.S. company then joined what is called a “cost sharing arrangement” or “CSA”. The CSA allowed the affiliated companies to share the R&D expenses in lieu of license fees in return for the rights to book all of the profits and losses from foreign customers offshore in a low-taxed jurisdiction – despite that all of these profits would be generated almost exclusively by operations occurring in the U.S. In order to join this arrangement, the Irish affiliate was required by U.S. tax laws to pay Facebook US for its U.S. owned existing IP. The Irish affiliate paid around \$6.7 billion for these rights in September 2010, as part of this CSA that was marketed, sold and implemented by Facebook’s public auditor. The IRS claimed in 2016 that the transferred economic rights should have been sold/licensed for an additional \$7 billion, and later in 2019 increased this adjustment to \$13 billion, or around 200% greater than the 2010 transfer price.¹¹ During the years the IRS challenged (2010-2013) Facebook reported only losses in Ireland, and has claimed in tax court that it complied with the U.S. Commensurate with Income or CWI statute enacted by Congress during the Reagan administration¹² (which must be the case if the company reported only foreign losses over the

¹⁰ The Congressional Budget Office reported in 2017 that 60 large U.S. companies inverted offshore between 1983 and 2015. See <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53093-inversions.pdf>.

¹¹ Petition, *Facebook Inc. v. Commissioner*, No. 21959-16 (T.C. Oct. 11, 2016).

¹² The CWI statute was enacted as part of the 1986 Tax Reform Act, and mandates that the transfer price for offshore transfers of IP and the later income from that IP transfer must be “commensurate” with each other, and gives the IRS has the authority to make ex post “periodic adjustments” to a U.S. company’s taxable income in years after the original transfer of the IP rights offshore, if the foreign income is “too high” compared to the original transfer price. As stated in the Conference Report, “The objective of these ... provisions [is] that the division of income between related parties reasonably reflect the relative

contested tax years). The IRS has never enforced the CWI statute, and did not seek to verify Facebook's compliance prior to challenging this arrangement. Our forensic models indicated that Facebook, like the companies in two similar trials involving an IRS ex ante challenge to a taxpayer's original IP transfer in a CSA transaction, was compliant at the buy-in stage with the regulation.¹³ The IRS lost the prior two cases, one of which had likewise sustained foreign losses over the period of challenge.

Developing tax planning to migrate U.S. pretax income offshore and out of the U.S. tax net in a way that circumvents enforcement efforts is part of the art and science of transfer pricing planning. *The IRS currently fails to detect most corporate tax violations, as evidenced by low audit rates and high rates of "no change" exams for those they do perform.* According to litigation outcomes and our compliance models, this also includes some failed challenges to compliant arrangements. This is substantially the equivalent of having little to no effective enforcement at all. Here are some examples of offshore profit shifting results uncovered by our research that were approved on examination by the IRS:

- a) a U.S. company's most profitable subsidiary is a tax haven shell company in Ireland, that exists only on paper with no employees or operating assets, but that earns more pretax income than the U.S. parent company with more than 50,000 employees (the expenses of generating these foreign recorded profits are deducted in the U.S.);
- b) a U.S. Internet company that hosts several billion users from around the world on the company's U.S. based and operated data centers reports an average cost of \$21 per global user, but records \$92 in expense per U.S. user in the U.S. and only \$12 per offshore user, with the apparent logic that because the U.S. users generate six times the advertising revenues of foreign users, the company can simply record eight times the cost in the U.S., inflating the otherwise low foreign pretax income to be above that of the U.S.;
- c) a U.S. company that designs, builds and then exports its products from the U.S. directly to customers overseas, who must sign an agreement to comply with U.S. export laws, and then records the majority of the revenues and income from these sales in two tax haven shell companies for their "distribution" operations that never touch the products;
- d) a U.S. company created a shell company in a foreign tax haven with five employees managed by a U.S. executive, that within months joined a cost sharing arrangement with its U.S. parent company, in which the U.S. company performed all revenue and profit generating operations from U.S. soil, but within five years the shell company was more

economic activity undertaken by each." The corollary to this that Facebook is claiming is that compliance with this statute means the IRS has no basis for any challenge to the pricing. The IRS position is that it has applied an ex ante adjustment to the original transfer price, and not an ex post adjustment to the post-transfer profits, each of which are covered by different regulations, such that compliance with the statute is irrelevant to its proposed regulatory adjustment.

¹³ *Veritas Software Corp. v. Commissioner*, 133 T.C. 297 (2009) and *Amazon.com Inc. v. Commissioner*, 148 T.C. 108 (2017).

profitable than its U.S. parent company, and this was two years after the IRS approved the arrangement with an Advance Pricing Agreement that shifted \$130 billion in pretax income offshore over 16 years – exceeding its U.S. income over the same period;

- e) a U.S. company’s senior executives that manage the global supply chain and negotiate billions in sales contracts with U.S. and foreign customers draft these contracts in the name of a Singapore affiliate with a 0% tax rate, which then records the sales and profits from the arrangement. When asked during an IRS interview what the foreign affiliate’s participation was in these contracts, the answer was that they helped make the travel arrangements for the U.S. executives that negotiate the contracts.

Resource Constraints Severely Hamper IRS Enforcement

It is clear that IRS corporate tax enforcement is vastly outgunned in resources and technology, often in the face of overwhelming information and resource asymmetries. Aside from the recent investment Congress has made, the IRS has been starved of resources to the point that effective enforcement of corporate offshore profit shifting is simply not possible. I am aware of one case in which an international examiner assigned to examine a Fortune 50 company’s transfer pricing could only spend a few hours on the exam, as it was one of 50 to which he had been assigned. This is backed up by statistics and other governmental information. The IRS has reported in the last several years an overall audit rate of around 35% or about 1/3 of the 3,873 U.S. companies with total assets above \$2.5 billion.¹⁴ Transfer pricing audits are undoubtedly much fewer than this, as the IRS has perhaps a hundred economists or so to perform these exams. In addition, IRS audit guidance for a typical transfer pricing exam is 36 months.¹⁵ Examiners are often forced to rotate off exams before the exams are completed, to be replaced by new examiners that have no prior knowledge of the taxpayer. It should therefore be no surprise that tax losses from offshore profit shifting over the past thirty years have expanded exponentially, reaching around \$140 billion in annual federal and state tax losses by around 2015, as shown earlier.

Forensic Investigation Uncovers the Causes and Sources of Offshore Profit Shifting

I have been involved in developing forensic models for tax compliance since around 2013, and first began publishing these models in two peer reviewed academic papers in 2016 and 2020.¹⁶ In 2020 I began using some of these models for detecting offshore profit shifting to identify and then investigate and publish indicated noncompliant offshore profit shifting arrangements in a tax journal called *Tax Notes Federal*. The purpose of this was to demonstrate to both taxpayers and tax enforcers the usefulness of these capabilities for improving both compliance and

¹⁴<https://www.irs.gov/pub/irs-pdf/p16.pdf>; and <https://taxfoundation.org/blog/corporations-zero-corporate-tax/#:~:text=The%20largest%20corporations%20have%20relatively%20high%20audit%20rates%E2%80%9494of,the%20overall%20corporate%20audit%20rate%20of%200.7%20percent.>

¹⁵ IRS Pub 5300, page 37.

¹⁶ Stephen Curtis, “Forensic Approaches to Transfer Pricing Compliance and Enforcement,” *J. of Forensic and Investigative Accounting*, Volume 8 Number 3 (July-December 2016): 359–405; and *supra*, note 2, Curtis and Lahav, “Forensic Approaches to Transfer Pricing Enforcement Could Restore Billions in Lost U.S. Federal and State Tax Losses: A Case Study Approach.”

enforcement of U.S. tax laws. Since 2020 I have partnered with a team of academics, attorneys and former practitioners to complete and publish eight of these investigations, documenting around \$600 billion dollars of taxes, interest, and penalties owed by these ten companies to the IRS, as shown in Figure 1.

Based on the results of Figure 1, which pertain to one regulatory violation called a “Periodic Adjustment”¹⁷, we estimated that total collections from all potential similar violations could exceed \$1 trillion.¹⁸ This is because the IRS by all accounts have never enforced this regulation, and our research has found at least 140 or so U.S. based MNEs with CSAs in recent years yet to investigate. We compared the results in Figure 1 with each MNE’s reserves for uncertain tax positions (UTP) and associated accrued reserves for penalties and interest as reported in their most recent annual SEC filing. Results show **aggregate reserves for all risky tax positions amount to only 14% of the estimated risks for just this one indicated tax violation** (CSA periodic adjustment). Figure 3 below indicates the possibility of a more systemic failure by MNEs with cost sharing arrangements and their public auditors to adequately account for these risks in their audit opinions and reserves for uncertain tax positions published in SEC filings.

Figure 3: Taxpayer Disclosed Reserves for Uncertain Tax Positions vs. Indicated Payment Risks for CSA Periodic Adjustment Tax Violations

(\$ million)		(a)	(b)	(c)=a+b	(d)	(e)=c/d
No.	Taxpayer	FY2023 Reserves for Uncertain Tax Position (UTP)	FY2023 Accrued Reserves for Penalties & Interest	Total Current Accruals for UTP, Penalties & Interest	Estimates for Periodic Adjustment Taxes, Penalties and Interest	Current Accrued Reserves % of Estimated Periodic Adjustment Risk
1	Meta Platforms Inc.	\$ 11,666	\$ 1,480	\$ 13,146	\$ 13,889	95%
2	Apple Inc.	\$ 19,454	\$ 1,296	\$ 20,750	\$ 170,315	12%
3	Alphabet Inc.	\$ 9,438	\$ 346	\$ 9,784	\$ 71,534	14%
4	eBay Inc.	\$ 613	\$ 94	\$ 707	\$ 24,623	3%
5	Cisco Systems Inc.	\$ 2,137	\$ 523	\$ 2,660	\$ 45,425	6%
6	Microsoft Corp.	\$ 17,120	\$ 5,200	\$ 22,320	\$ 168,816	13%
7	Qualcomm Inc.	\$ 2,296	\$ 199	\$ 2,495	\$ 19,902	13%
8	Oracle Corp.	\$ 7,715	\$ 1,700	\$ 9,415	\$ 68,224	14%
9	Company A	\$ 4,655	\$ 389	\$ 5,044	\$ 9,709	52%
10	Company B	\$ 371	\$ 67	\$ 438	\$ 6,949	6%
Totals		\$ 75,465	\$ 11,294	\$ 86,759	\$ 599,386	14%

¹⁷ 26 CFR section 1.482-7(i)(6), which became effective on January 5, 2009 and implements the Commensurate with Income (CWI) statute; see *supra*, note 12.

¹⁸ *Supra* note 1, Avi-Yonah, et al., “Commensurate With Income: IRS Nonenforcement Has Cost \$1 Trillion.”

Our research has also found IRS guidance that may have contributed to these results. Revenue Procedure 2015-41 allows the IRS to issue an Advance Pricing Agreement in which it will agree to waive enforcement of the CSA periodic adjustment regulation; Office of Chief Counsel Advice Memorandum 2007-007, issued two years before the current CSA regulation went into effect, directed examiners to refrain from enforcing ex post periodic adjustments.

Case Study: How One Taxpayer Evaded \$100 Billion in U.S. Taxes Despite Continuous IRS Exams and a U.S. Senate Investigation

In January 2009 new cost sharing regulations became effective that required MNEs with a preexisting CSA arrangement to prepare and record a “Restated Cost Sharing Contract” that had to comply with three rules: (i) be recorded by July 6, 2009; (ii) reflect the *actual* activities performed by the foreign CSA participants on the January 5, 2009 effective date of the regulations; and (iii) these actual activities had to comply with a 1996 CSA regulation that required they include the “use” or management of the use of the licensed IP in an active trade or business that included internal production and selling operations.¹⁹ This taxpayer executed and recorded this contract on June 25, 2009. Highlighted portions of this contract shown below claim the two Irish CSA participants were “engaged in” qualifying activities of “developing, manufacturing ... marketing and distributing” the covered products, and a table contains the words “functions performed by” these affiliates. *This contract was submitted to a U.S. Senate subcommittee in May 2013.*

Figure 4: Excerpts of Apple Inc. June 25, 2009 Restated & Recorded Cost Sharing Contract

This AMENDED AND RESTATED AGREEMENT TO SHARE COSTS AND RISKS OF INTANGIBLES DEVELOPMENT (“Agreement”) is entered into effective as of January 5, 2009 (“Effective Date”) by and between:

Apple Inc., a company organized and existing under the laws of California, U.S.A., with its principal place of business located at 1 Infinite Loop, Cupertino, California 95014, U.S.A. (“Apple”),

and

Apple Operations Europe (“AOE”), a company organized under the Irish Companies Act with a branch registered under the Singapore Companies Act, Cap. 50, to do business in Singapore and having a place of business at 7 Ang Mo Kio Street 64, Singapore 2056, and a branch doing business in Ireland at Hollyhill Industrial Estate, Hollyhill Cork, Ireland; and

Apple Sales International (“ASI”), a company organized under the Irish Companies Act doing business in Ireland at Hollyhill Industrial Estate, Hollyhill Cork, Ireland.

¹⁹ These regulations are 26 C.F.R. Section 1.482-7(m)(1) [requiring compliance with the 1996 CSA regulation by January 5, 2009]; Section 1.482-7A(c)(1) [the 1996 CSA regulation identifying the participation requirements the foreign affiliates had to meet]; and 1.482-7(k)(1)(iv)(A) [requiring the restated CSA contract to reflect the *actual* activities of the foreign participants on January 5, 2009]. These requirements are extensively explained in the various *Tax Notes Federal* papers and were designed to force taxpayers with preexisting “low substance” and “sham-like” CSAs with shell and holding companies to upgrade these affiliates to have more substance, which would then qualify them for an exemption from the CSA periodic adjustment introduced in these 2009 CSA regulations.

Apple, AOE and ASI are engaged in the business of developing, manufacturing, or having manufactured, marketing and distributing the “Products” listed in Section 1.14.

Figure 8 – Functions performed by Apple and the International Participant (ASI and AOE) under the CSA

FUNCTIONS	APPLE	INTERNATIONAL PARTICIPANT
Research and Development of the Cost Shared Intangibles	X	X
Quality Control of the Cost Shared Intangibles	X	X
Forecasting, Financial Planning and Analysis in Relation to the Intangible Development Activities	X	
R&D Facilities Management	X	X
Contracting with Related Parties or Third Parties in Relation to the Intangible Development Activities	X	X
Contract Administration in Relation to the Intangible Development Activities	X	X
Selection, hiring and supervision of employees, contractors and sub-contractors to perform any of the Intangible Development Activities	X	X
IP Registration and Defense	X	
Market Development	X	X

The only problem with this contract was that critical information was totally false. The Irish activities shown in the contract *had been attributed in Ireland to two non-existent “home office” shell company branches with no employees*, into which the pretax income from the activities was booked, while the actual activities and their expenses resided in the U.S.²⁰ The comments shown below in Figure 5 were taken from a European Commission 2016 report and a company filing to the European Court of Justice in 2016, explaining how the table above did not “purport to show the activities actually performed by the parties to the CSA” that were “performed in the U.S.” and that “[t]he profits from those activities were attributable to the United States, not Ireland.”²¹

Figure 5: Excerpts of 2016 European Commission Report and Taxpayer Submission to European Court of Justice Affirming Restated CSA Contract was False and Used to Evade U.S. Taxes

Apple indicated that the tables from the CSA of 2009 and 2013, reproduced in Figure 8 and Figure 9, do not purport to show activities actually performed by the parties to the CSA but merely summarise the activities that each party is authorised to perform under that agreement.

All the functions that drive Apple’s profits are directed by Apple Inc. executives in the US and performed largely in the US.

²⁰ European Commission, “Commission Decision of 30 August 2016 SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) implemented by Ireland to Apple,” (Aug. 30, 2016), para. 33.

²¹ Sources of statements (in order): European Commission, “Commission Decision,” para. 124, para. 126; and European Court of Justice, action brought on 19 December 2016 — *Apple Sales International and Apple Operations Europe v. Commission* (Case T-892/16).

The profits from those activities were attributable to the United States, not Ireland.

U.S. tax law and judicial precedent require that income is taxed to the person whose activities generated that income. Violating this rule meant that *Apple never qualified for an exemption from a CSA periodic adjustment* (see supra note 19). According to our analysis, the IRS can now apply periodic adjustments and recover as much as \$200 billion or more in federal taxes, interest, and penalties, with no effective statute of limitations, and more under Effectively Connected Income rules.²² There is no indication in SEC filings or elsewhere that this violation has yet been investigated or challenged by the IRS.

Recall the opening statement by the late Senator John McCain at the May 21, 2013, Senate PSI hearing involving this taxpayer (emphasis added):

As the shadow of sequestration encroaches on hard-working American families, it is unacceptable that corporations like Apple are able to exploit tax loopholes to avoid paying billions in taxes. ... It is completely outrageous that Apple has not only dodged full payment of U.S. taxes, but it has managed to *evade* paying taxes around the world through its convoluted and pernicious strategies. ... It is past time for American corporations like Apple to reorganize their tax strategies, to pay what they should, ...

Senator McCain's use of the term "*evade*," (defined as the *illegal* "affirmative act to evade or defeat a tax, or payment of tax" that is owed according to the law, *involving "deceit, subterfuge, camouflage, concealment, attempts to color or obscure events, or make things seem other than they are"*)²³ was devastatingly accurate, and confirmed in our *Tax Notes Federal* report. Senator McCain saw through the taxpayer's comments at the Senate PSI hearing:

Apple complies fully with both the laws and spirit of the laws. And Apple pays all its required taxes, both in this country and abroad. ... These foreign earnings are taxed in the jurisdiction where they are earned ("foreign, post-tax income").²⁴

Specialized and advanced capabilities are needed to detect and prosecute such brazen and well-concealed corporate tax evasion schemes, especially if on the scale that our research has found.

Policy Recommendations

1. **Congress must maintain and extend the currently planned Inflation Reduction Act funding to improve IRS enforcement of U.S. tax laws.** These funds are critical for implementing the necessary investments in new capabilities to detect and prosecute the trillion(s) in currently unaddressed corporate offshore tax evasion. President Biden's proposed budget this year included extending robust IRS funding through 2034. We

²² The calculations under Reg. section 1.482-7(i)(6) allow the IRS to apply an adjustment in a still open tax year that includes relevant income going back to 2009. As such, the calculation effectively overrides the normal three-year statute of limitations, as noted in Reg. section 1.482-7(i)(6)(i).

²³ https://www.irs.gov/irm/part25/irm_25-001-001.

²⁴ Testimony of Apple Inc. Before the Permanent Subcommittee on Investigations, U.S. Senate, May 21, 2013, pp. 1, 2.

estimate that planned expenditures could realistically target between 6,600% and 13,000% per dollar of investment in corporate enforcement.²⁵ Congress should conduct oversight to ensure the IRS is effectively using this funding to actually reduce the U.S. tax gap (whose estimates by the IRS exclude offshore profit shifting) via targeted and structural improvements and technological upgrades that are needed to ensure success.

II. The IRS Large Business and International (LB&I) division must initiate enforcement of currently unenforced corporate tax laws, consider the use of centralized advanced forensic risk detection technology, and create a dedicated forensic organization to examine the most sophisticated tax risks. Now that the IRS is fully funded, it should make these changes to better target and improve the effectiveness of its enforcement. First, initiating enforcement of Periodic Adjustments (Reg. sections 1.482-4(f)(2) and -7(i)(6)) and Effectively Connected Income (section 864(c)) and other unenforced tax laws will recover substantial revenues. Second, more sophisticated forensic risk detection technologies can be used to identify risks and assign examination resources to those known risks. And finally, dedicated specialized units with advanced forensic investigative capabilities can assist examiners on the most difficult and material cases, thereby reducing or eliminating “no change” exams, exams of compliant taxpayers, and tax court challenges to exams, while increasing recoveries and voluntary compliance.

III. The Whistleblower Program Improvement Act of 2021, sponsored by Senators Grassley and Wyden should be enacted as soon as possible, potentially with amendments. Meritorious claims continue to face substantial obstacles at every step of the process, as described in a recent series of Tax Notes papers that have documented what appear to be actions by the Office of Chief Counsel to undermine or “nullify” the whistleblower program.²⁶ The Whistleblower Office has recently enacted a multitude of anti-whistleblower policies, such as refusing to pay partial awards – as allowed by law – when stand-alone award recommendations are made *by exam cycle*. This arbitrary decision of convenience holds up a whistleblower’s award for a decade or more on a multi-cycle exam after the IRS collects the first cycle proceeds.²⁷ More deficiencies exist than can be listed here. The Whistleblower Program is in need of vast reform, and the Grassley-Wyden bill is a very good start, but more needs to be done to realize the full potential of well-placed whistleblowers on improved tax administration.

²⁵ This is based on the assumption that 1/3 of the I.R.A. \$46 billion in enforcement spending is dedicated to corporate enforcement, and between \$1 trillion and \$2 trillion can be collected, and based on our research that have already identified the likely source of the first trillion dollars.

²⁶ Michael A. Humphreys, “How the D.C. Circuit Can Save an IRS-Nullified Whistleblower Law,” *Tax Notes Federal*, April 10, 2023, p. 215; and Humphreys, “How *Shands* Can Restore the Tax Whistleblower Law,” *Tax Notes Federal*, Mar. 11, p. 1995.

²⁷ Whistleblower Office IRM 25.2.2.6.1.2 (03-13-2023) states: “*Generally, when a whistleblower submission relates to multiple actions, the Whistleblower Office will wait for a final determination of tax for all actions in the submission.*” This appears to be an arbitrary decision by the Whistleblower Office counter to the objectives of the whistleblower program.