Treasury Inspector General for Tax Administration
Office of Audit

ADDITIONAL ACTIONS ARE NEEDED TO HELP ENSURE TAXPAYER COMPLIANCE WITH THE FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT

Issued on September 3, 2014

Highlights

Highlights of Reference Number: 2014-30-051 to the Internal Revenue Service Commissioners for the Large Business and International Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

Congress passed the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) to provide Federal tax rules for the sale of U.S. real property by foreign persons. The Deficit Reduction Act of 1984 imposed a withholding tax on the anticipated taxes due on any capital gain from the sale of a U.S. real property interest by a foreign seller. This is generally the only method that the IRS has to ensure the collection of any taxes on the capital gains resulting from these sales. Once the foreign seller and the sale proceeds leave the United States, it is difficult for the IRS to collect any delinquent taxes due. When this happens, the foreign sellers may be able to evade payment of taxes.

WHY TIGTA DID THE AUDIT

This audit was initiated as part of our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenges of *Globalization* and *Fraudulent Claims and Improper Payments*. The overall objective of this audit was to determine the effectiveness of the IRS's efforts in ensuring taxpayer compliance related to the disposition of foreign investments in U.S. real property.

WHAT TIGTA FOUND

There are some barriers for the IRS in ensuring the tax compliance of real estate sales transactions subject to the FIRPTA. As such, the IRS cannot provide assurance that all foreign seller real estate transactions comply with the FIRPTA.

TIGTA's review of Form 1099-S, *Proceeds From Real Estate Transactions*, real estate transaction data reported to the IRS revealed that there may be noncompliance with the FIRPTA filing requirements. TIGTA also found that the IRS did not always ensure compliance with FIRPTA filing requirements when a request for reduced withholding was filed and the FIRPTA withholding tax was still owed.

In addition, TIGTA also identified various internal control weaknesses in the processing of 1) FIRPTA withholding payments and 2) FIRPTA withholding credits claimed by foreign sellers on their income tax returns. These internal control weaknesses resulted in the issuance of erroneous refunds and balance due notices.

WHAT TIGTA RECOMMENDED

TIGTA made recommendations that will help improve compliance with the FIRPTA, including revising the Form 1099-S to more easily identify real estate transactions subject to this law and considering legislative/regulation changes to reduce barriers to effective administration of the FIRPTA. TIGTA also made several recommendations to improve controls over the processing of FIRPTA transactions.

The IRS agreed with four recommendations and indicated it had already addressed a fifth recommendation, which TIGTA was not able to verify. It will apprise the Department of the Treasury of the recommendation pertaining to overcoming barriers to ensuring taxpayers comply with the FIRPTA. It did not agree to one recommendation intended to help it validate affidavits of non-foreign status. TIGTA continues to believe that the IRS should follow through on this recommendation.

READ THE FULL REPORT

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

http://www.treas.gov/tigta/auditreports/2014reports/201430051fr.pdf.