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TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



*The Internal Revenue Service Has  
Made Progress in Implementing the  
Foreign Account Tax Compliance Act*

**September 23, 2015**

**Reference Number: 2015-30-085**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

2 = Risk Circumvention of Agency Regulation or Statute

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## HIGHLIGHTS

### THE INTERNAL REVENUE SERVICE HAS MADE PROGRESS IN IMPLEMENTING THE FOREIGN ACCOUNT TAX COMPLIANCE ACT

## Highlights

Final Report issued on  
September 23, 2015

Highlights of Reference Number: 2015-30-085 to the Internal Revenue Service Commissioners for the Large Business and International and the Wage and Investment Divisions.

### IMPACT ON TAXPAYERS

To improve U.S. taxpayer compliance with reporting foreign financial assets and offshore accounts, Congress passed the Foreign Account Tax Compliance Act (FATCA) in March 2010 as part of the Hiring Incentives to Restore Employment Act of 2010.

Under the FATCA, beginning with Tax Year 2011, individual taxpayers with specified foreign financial assets that meet a certain dollar threshold were to report this information to the IRS by attaching Form 8938, *Statement of Specified Foreign Financial Assets*, to their annual Form 1040, *U.S. Individual Income Tax Return*, or for nonresident alien taxpayers, to their Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*. The FATCA also requires foreign financial institutions to report to the IRS information about financial accounts held by U.S. taxpayers or held by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

### WHY TIGTA DID THE AUDIT

The FATCA is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts held by U.S. taxpayers. This audit was initiated to assess the IRS's progress in implementing the FATCA.

### WHAT TIGTA FOUND

TIGTA found that the IRS has taken steps to provide information to affected stakeholders that

explains the FATCA requirements and expectations.

However, TIGTA identified improvements that are required to ensure compliance and to measure performance for foreign financial institutions. If plans are not properly documented, implementation and performance of compliance activities could experience unnecessary delays.

TIGTA also identified some limitations with the processing of paper Forms 8938. Specifically:

- Transcribed data are not validated to ensure accuracy.
- Data on Form 8938 continuation statements (used to report additional foreign accounts or other foreign assets) are not transcribed.
- Losses reported by taxpayers cannot be input as negative amounts.

If these issues are not properly addressed, it could limit management's ability to make informed decisions and achieve the IRS's compliance objectives related to the FATCA.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) update the compliance activities in the FATCA Compliance Roadmap for identifying noncompliance by foreign financial institutions; 2) initiate a periodic quality review process for the processing of paper Forms 8938 to ensure the accuracy of the data being transcribed; and 3) ensure that the transcription issues identified in this report are addressed.

The IRS agreed with the first two recommendations but disagreed with some programming changes related to the third recommendation due to budgetary constraints, limited resources, and competing priorities. The accuracy of the data obtained from Forms 8938 is a critical component for the success of the IRS's compliance activities with implementing the FATCA. As such, TIGTA believes that the IRS should make these programming changes a priority.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 23, 2015

**MEMORANDUM FOR** COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL  
DIVISION  
COMMISSIONER, WAGE AND INVESTMENT DIVISION

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Internal Revenue Service Has Made  
Progress in Implementing the Foreign Account Tax Compliance Act  
(Audit # 201430015)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) progress in implementing the Foreign Account Tax Compliance Act. This audit is included in our Fiscal Year 2015 Annual Audit Plan and addresses the major management challenge of Globalization.

Management's complete response to the draft report is included as Appendix VII. Copies of this report are also being sent to the IRS managers affected by the report recommendations.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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## *Abbreviations*

FATCA	Foreign Account Tax Compliance Act
FFI	Foreign Financial Institution
HCTA	Host Country Tax Authority
IGA	Intergovernmental Agreement
IRS	Internal Revenue Service
LB&I	Large Business and International
NFFE	Nonfinancial Foreign Entity
PFFI	Participating Foreign Financial Institution
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States



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## *Background*

The Internal Revenue Service (IRS) continues to work towards addressing the challenges of international tax administration. To improve U.S. taxpayer compliance with reporting their foreign financial assets and offshore accounts, Congress passed the Foreign Account Tax Compliance Act (FATCA) in March 2010 as part of the Hiring Incentives to Restore Employment Act of 2010.<sup>1</sup>

The FATCA is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts held by U.S. taxpayers. The FATCA legislation affects the following three groups.

**Individual Taxpayers** – The FATCA requirement for individual taxpayers to report specified foreign financial assets to the IRS is established under Internal Revenue Code Section (§) 6038D.<sup>2</sup> This requirement is met when individual taxpayers file Form 8938, *Statement of Specified Foreign Financial Assets*, with their income tax returns if the aggregate value of the assets exceeds certain dollar thresholds.<sup>3</sup>

Specified foreign financial assets include financial accounts maintained by a foreign financial institution (FFI); stocks, securities, financial instruments, and contracts issued by a person other than a U.S. person; and any interest in a foreign entity. More specifically,

- For a foreign financial account, individual taxpayers are required to report the name and address of the financial institution in which the financial account is maintained as well as the account number.
- For any stock or security, the name and address of the non-U.S. issuer, as well as information necessary to identify the class or issue of which the stock or security is a part, must be reported.
- In the case of any other financial instrument, contract, or interest in a foreign entity, the names and addresses of all issuers and counterparties must be reported, together with the information necessary to identify the instrument, contract, or interest.

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<sup>1</sup> Pub. L. No. 111-147, 124 Stat. 71 (2010). See Appendix VI for a glossary of terms.

<sup>2</sup> The legislation states that a specified person means specified individual or specified domestic entity. As of May 2015, the proposed regulations relating to domestic entities have not been adopted as final. Therefore, only specified individuals are currently required to report specified foreign financial assets. For purposes of this report, individual taxpayer is used instead of specified person.

<sup>3</sup> The foreign financial asset value as calculated on the last day of the tax year or at any time during the tax year. See Figure 1 below.



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The maximum value of each specified foreign financial asset during the taxable year must also be reported. The reporting thresholds vary based on filing status and where the taxpayer resides. Figure 1 shows the specified foreign financial asset dollar thresholds by type of filer based on where the taxpayer resides.

**Figure 1: Specified Foreign Financial Asset Dollar Thresholds to Be Reported to the IRS on Form 8938 by Type of Filer and Where the Taxpayer Resides**

<i>Type of Taxpayer</i>	<i>Asset Value Last Day of Tax Year</i>	<i>Asset Value Any Time During Tax Year</i>
<b><i>If living in the United States</i></b>		
Unmarried or married filing separately	\$50,000	\$75,000
Married filing jointly	\$100,000	\$150,000
<b><i>If living outside the United States</i></b>		
Unmarried or married filing separately	\$200,000	\$300,000
Married filing jointly	\$400,000	\$600,000

*Source: Form 8938 instructions for Tax Year 2014.*

The IRS began accepting Form 8938 filings from individual filers in January 2012 for Tax Year 2011. Although this obligation went into effect with income tax returns filed for Tax Year 2011, the requirement was deferred to Tax Year 2012 if: 1) the taxpayer was required to file Form 8938; 2) the taxpayer had a tax year that began after March 18, 2010, but before January 1, 2011; and 3) the taxpayer filed his or her Tax Year 2011 income tax return before Form 8938 was released on December 21, 2011.<sup>4</sup> In this situation, the taxpayer was instructed to attach the Forms 8938 for Tax Years 2011 and 2012, if applicable, to his or her Tax Year 2012 income tax return. Figure 2 shows the number of individual income tax returns filed with a Form 8938 attached by tax year.

<sup>4</sup> Internal Revenue Bulletin 2011-29, Notice 2011-55.



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**Figure 2: Individual Income Tax Returns Filed With a Form 8938 Attached**

<i>Tax Year</i>	<i>Total Filed</i>
2011	150,492
2012	242,067
2013	284,416
2014	111,944

*Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Individual Master File data for Tax Years 2011 through 2013 as of December 31, 2014, and for Tax Year 2014 as of April 30, 2015.*

**Foreign Financial Institutions** – Under the FATCA, to avoid being subject to a 30 percent withholding rate on U.S. source payments made to them, FFIs must register with and agree to report to the IRS certain information about their accounts owned by U.S. taxpayers, including the accounts of foreign entities with substantial U.S. ownership. The FFIs may register either online or by paper.

- Access to the online FATCA FFI registration system became available in August 2013, and submission to establish an agreement with the IRS became available in January 2014.
- Acceptance of the paper registration to establish an agreement with the IRS using Form 8957, *Foreign Account Tax Compliance Act (FATCA) Registration*, also began in January 2014.

The first list of FFIs that registered to participate in the FATCA program was released by the IRS in June 2014 and contained over 77,000 entities.<sup>5</sup> As of May 1, 2015, the list of approved participating FFIs (PFFI) has increased to 162,610 entities.

- **Intergovernmental Agreements (IGAs)** – Due to jurisdictional privacy laws that prevent some FFIs from reporting account information directly to the IRS, the U.S. Department of the Treasury has negotiated with some foreign governments to establish IGAs. IGAs establish an alternative framework for implementing the FATCA while removing legal impediments to reporting account information. IGAs include a provision for FFIs to report directly to the IRS or through their host country tax authority (HCTA) to the IRS.

<sup>5</sup> Registered FFIs are assigned a unique 19-character Global Intermediary Identification Number to identify that they are registered and approved to withholding agents and the IRS.



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There are two IGAs, Model 1 and Model 2, which have been designed for foreign governments to enter into an agreement with the U.S. Department of the Treasury.<sup>6</sup>

- For a Model 1 IGA, an FFI will report U.S.-related account information to its HCTA, which in turn will automatically provide the information to the IRS.<sup>7</sup>
- For a Model 2 IGA, an FFI will be directed to enter into an FFI agreement with the IRS and will report U.S.-related account information directly to the IRS in a manner consistent with FATCA regulations.

One of the reporting requirements of PFFIs, including Model 2 FFIs, is met by electronically filing Form 8966, *FATCA Report*, annually with the IRS.<sup>8</sup> Information required to be reported includes the name, address, and Taxpayer Identification Number of each account holder who is a specified U.S. person; the account number; the account balance or value; and the gross receipts and gross withdrawals or payments from the account. The IRS began accepting Form 8966 in January 2015, and the deadline for non-IGA PFFIs, Reporting Model 2 FFIs, and direct-reporting nonfinancial foreign entities (NFFE) to file the first information reports with respect to Tax Year 2014 was June 29, 2015.<sup>9</sup>

**Withholding Agents** – Withholding agent requirements are met under the FATCA by withholding 30 percent on payments of U.S. source income to:

- Non-PFFIs and NFFEs.
- Any account holder of a PFFI that fails to provide:
  - The information required to determine whether the account is a U.S. account.
  - The information required to be reported by the FFI.
  - A waiver of a foreign law that would prevent reporting to the IRS.<sup>10</sup>

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<sup>6</sup> See Appendix V for a listing of countries with IGAs related to the FATCA.

<sup>7</sup> Model 1 IGAs can be either reciprocal or nonreciprocal. Under a nonreciprocal Model 1 IGA, the HCTA will provide certain information about foreign financial accounts held by U.S. taxpayers to the IRS. Under a reciprocal Model 1 IGA, the HCTA will provide certain information about foreign financial accounts held by U.S. taxpayers to the IRS, and the IRS will provide certain information about U.S. financial accounts held by foreign taxpayers to the HCTA.

<sup>8</sup> FFIs can elect to be subject to the same reporting as U.S. financial institutions. In this case, the FFI would file the appropriate Form 1099 (e.g., 1099-DIV, *Dividends and Distributions*; 1099-INT, *Interest Income*; 1099-MISC, *Miscellaneous Income*) in lieu of Form 8966.

<sup>9</sup> The usual deadline is March 31 each year, but for Tax Year 2014 only, there is an automatic 90-day extension that does not require the taxpayer to take additional action. The deadline for receiving information reporting from HCTAs in Model 1 IGA jurisdictions for Tax Year 2014 is September 30, 2015.

<sup>10</sup> The U.S. source income rules are contained in Internal Revenue Code §§ 861 through 865. Income tax treaties can sometimes modify these rules.



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Withholding agents report payments and amounts withheld on Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*. Information required to be reported includes the name, address, Taxpayer Identification Number, and Chapter 4 status (applicability of FATCA withholding) of each payee; the gross amount paid; the tax withheld; and the identifying information of the withholding agent. Withholding on U.S. fixed, determinable, annual, or periodical income payments to PFFIs, NFFEs, and direct account holders of PFFIs began on July 1, 2014. In addition, FFIs and withholding agents were required to file Form 1042-S with respect to withholding during Tax Year 2014 by March 16, 2015.

This review was performed at the Wage and Investment Division's Submission Processing function in the Kansas City, Missouri, campus with additional information obtained from the Large Business and International (LB&I) Division's International Data Management Program in Washington, D.C.; International Individual Compliance and International Business Compliance Programs in Downers Grove, Illinois; and the Wage and Investment Division's Submission Processing function in the Austin, Texas, campus. This review was performed during the period September 2014 through June 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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## *Results of Review*

During our review, we determined that the IRS took steps to provide guidance to external stakeholders. However, we determined that some improvements are required to ensure compliance and to measure performance for FFIs. We also identified some limitations with the processing of paper Forms 8938.

### ***The Internal Revenue Service Took Steps to Educate External Stakeholders About the Foreign Account Tax Compliance Act***

To assist U.S. taxpayers, FFIs, Direct Reporting NFFEs, and withholding agents in meeting their requirements under the FATCA, the IRS has taken steps to provide information that explains FATCA requirements and expectations. The IRS has a website solely dedicated to providing information about the FATCA.<sup>11</sup> The website provides a variety of FATCA-related information for individuals, financial institutions, and foreign governments. For example, there is information on FATCA regulations and other guidance, financial institution registration, international data exchange service enrollment, and current FATCA alerts and other news as well as a large number of detailed Frequently Asked Questions to help guide external stakeholders in participating and complying with the FATCA.

In addition, the IRS conducted several outreach events to provide external stakeholders with information about the FATCA.<sup>12</sup> For example, representatives from the Small Business/Self-Employed Division reported that they provided FATCA information as part of 17 outreach events between January 2013 and June 2014 to a total of 1,920 participants, many of which were representatives of practitioner organizations. Specific Small Business/Self-Employed Division events included the January 2013 Annual Tri-State Tax Update in Falls Church, Virginia, and the January 2014 IRS/California Society of Enrolled Agents Practitioner Seminar in Anaheim, California. In addition, representatives from the LB&I Division reported that they discussed FATCA topics during 35 outreach events, primarily to U.S. withholding agents and FFIs, between November 2011 and September 2014. Specific LB&I Division events included a September 2012 presentation organized by the Securities Industry and Financial Managers Association and a September 2014 presentation organized by the Tax Executives Institute. Based on the information made available by the IRS on its website and the outreach events conducted, we believe that the IRS has made a reasonable effort to keep external stakeholders informed on the status and events related to the implementation of the FATCA.

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<sup>11</sup> The FATCA homepage link is <http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA>.

<sup>12</sup> The outreach events include the IRS providing presentations at professional conferences, seminars, symposiums, and tax institutes. The external stakeholders include tax accountants, attorneys, and practitioners.



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## ***While Planned Compliance Activities for Taxpayer and Withholding Agent Noncompliance Seem Sufficient, Foreign Financial Institution Compliance Plans Need to Be Updated***

Overall, the FATCA Compliance Roadmap is fairly comprehensive. If implemented, it should enable the IRS to take appropriate enforcement action on compliance activities in relation to the FATCA.<sup>13</sup> The IRS put together a cross-functional working group that developed the compliance activities in the FATCA Compliance Roadmap.<sup>14</sup> Each identified activity addresses a specific compliance type (*i.e.*, taxpayer, FFI, or withholding agent) and is prioritized based on the following two factors:

- **Data Availability** – Given that the FATCA data will become available over time, the IRS sequenced compliance activities and set timelines to take advantage of the data as soon as they become available.<sup>15</sup>
- **Compliance Value** – The IRS evaluated its planned compliance activities and assigned each activity a value/priority.

The IRS has experienced some delays in implementing its compliance strategy and anticipates that some of the estimated implementation dates may change due to the availability and accessibility of FATCA data and budget limitations (*e.g.*, information technology funding and human resources funding). The compliance strategy also shows that the IRS will continue to evaluate its FATCA compliance activities and refine them over time. The description below provides some of the compliance activities that the IRS has planned for taxpayers, withholding agents, and FFIs. Despite the comprehensive nature of the FATCA Compliance Roadmap, we determined that the activities to address FFI compliance with the FATCA should be updated to include additional information.

### **Taxpayer compliance with filing Forms 8938**

The IRS began accepting Forms 8938 from individual filers in January 2012 for Tax Year 2011. In Calendar Year 2012, the LB&I Division's Planning, Analysis, Inventory, and Research function conducted an initial analysis of the Form 8938 filings for Tax Year 2011. It completed the Tax Year 2012 analysis in Calendar Year 2014. This analysis identified specific filer characteristics and assessed the filing behaviors of taxpayers that could indicate potential

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<sup>13</sup> A detailed compliance strategy made up of compliance activities that use FATCA-related data. The latest draft version is dated November 2014.

<sup>14</sup> The FATCA working group consisted of representatives from the LB&I, Small Business/Self-Employed, and Wage and Investment Divisions; Criminal Investigation; the Office of Compliance Analytics; the Office of Research, Analysis, and Statistics; and the Information Technology organization.

<sup>15</sup> See Appendix IV for the FATCA timeline.



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noncompliance with the FATCA.<sup>16</sup> The LB&I Division's International Individual Compliance function further analyzed potentially high-risk returns and identified significant changes for the Form 8938 filings for some taxpayers from Tax Year 2011 to 2012 by comparing the Form 8938 information. Based on the significant differences identified from this comparative analysis, the IRS selected seven cases on which to conduct a pilot study on taxpayer compliance and referred these cases for examination.<sup>17</sup> According to the IRS, as of July 2015, five of these cases have combined adjustments of over \$122,000 related to offshore issues. For the audits of the two remaining cases, \*\*\*\*\*1\*\*\*\*\*.

According to the FATCA Compliance Roadmap, the IRS plans to continue using Form 8938 comparative analysis by searching for significant changes in taxpayer reporting each year. For Tax Year 2013, the IRS plans to review Foreign Bank and Financial Account Report filings to detect taxpayer noncompliance (*i.e.*, nonfiling and underreporting) with Form 8938 filing requirements.<sup>18</sup> In addition, the IRS plans to use soft notices in some cases, which will request that the taxpayer either: 1) provide the appropriate information on a Form 8938 or 2) provide the form on which the indicated assets were reported elsewhere. Based on taxpayer responses to the soft notices, cases may be referred for examination.

### **Withholding agent compliance with the FATCA**

FATCA withholding on payments of U.S. fixed, determinable, annual, and periodical income (*e.g.*, dividends, interest, and insurance premiums) made to unregistered FFIs, NFFEs, and direct account holders of PFFIs began in July 2014. After January 1, 2015, the IRS began to receive Tax Year 2014 withholding agent and recipient filings of Form 1042-S.<sup>19</sup>

The Tax Year 2014 Form 1042-S filing deadline was March 16, 2015, and in May 2015 the data for withholding deposits and the Form 1042-S information became available for the IRS to analyze. The IRS has developed plans to detect withholding agent noncompliance and has outlined them in the FATCA Compliance Roadmap. The IRS plans to use comparative analysis to identify withholding agent noncompliance with respect to withholding, reporting, and

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<sup>16</sup> As of February 2015, the Planning, Analysis, Inventory, and Research function was still analyzing Processing Year 2013 and delayed the start of the Processing Year 2014 analysis.

<sup>17</sup> The IRS determined that 24 taxpayers with potential FATCA compliance issues were already under examination for other offshore tax compliance issues. The seven cases are in addition to those examinations.

<sup>18</sup> The reporting requirements under the FATCA are in addition to the reporting of foreign financial assets to the U.S. Department of the Treasury on the Financial Crimes Enforcement Network Form 114, *Report of Foreign Bank and Financial Accounts* (Formerly Treasury Department Form 90-22.1), for foreign financial accounts exceeding \$10,000. The Form 8938, which is required for foreign financial assets exceeding \$50,000, does not replace the Foreign Bank and Financial Account Report.

<sup>19</sup> The Form 1042-S for Tax Year 2014 was modified to accommodate reporting of payments and amounts withheld under the FATCA provisions (or Chapter 4 of the Internal Revenue Code) as well as those amounts required to be reported under Chapter 3. In addition, the modified form includes the Global Intermediary Identification Number and additional line items specifically for FATCA reporting purposes.



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depositing duties; identify collusion between withholding agents and noncompliant taxpayers; and identify and prevent fraudulent and erroneous international withholding refund/credit claims.

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Many of the compliance activities completed for taxpayers and FFIs will also be used to identify withholding agent noncompliance (e.g., comparing information on the various FATCA forms; identification of trends and collection/reporting patterns; and the use of sampling to select and review Forms 8938, Forms 8966, Forms 1042-S, etc., to identify potential FATCA noncompliance).

However, due to constraints with the implementation of some information technology systems, IRS management said that some of these analyses may be delayed. The cross-functional working group is continuing to update the FATCA data timeline and compliance activities as more information becomes available.

**Plans to ensure FFI compliance with the FATCA need to be updated in the IRS's FATCA Compliance Roadmap**

For Tax Year 2014, the deadline for non-IGA PFFIs, reporting Model 2 FFIs, and direct-reporting NFFEs to file their first information reports (e.g., Form 8966) was June 29, 2015.<sup>20</sup> The IRS expects to begin receiving the data from the Forms 8966 in October or November 2015. Using the Form 8966 data, the IRS plans to analyze the filing trends and patterns for FFIs in order to detect potential FFI noncompliance with the FATCA.

According to the FATCA Compliance Roadmap, the IRS plans to:

- **PFFIs** – Ensure that Forms 8966 filed by registered PFFIs contain complete information with respect to each of its U.S. reportable accounts. In addition, the IRS will ensure that penalties are imposed and that withholding takes place in instances of noncompliance with Form 8966 reporting requirements.
- **Reporting Model 1 FFIs** – Ensure that U.S. taxpayer account information is provided to the IRS with respect to each U.S. reportable account. In addition, ensure that any minor/administrative errors or any substantial noncompliance identified is communicated to the HCTA.

<sup>20</sup> The usual deadline is March 31, but for Tax Year 2014 only, there is an automatic 90-day extension that does not require the taxpayer to take additional action. The deadline for receiving information reporting from HCTAs in Model 1 IGA jurisdictions for Tax Year 2014 is September 30, 2015.



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- **Reporting Model 2 FFIs** – Ensure that Forms 8966 filed by registered Model 2 FFIs contain information with respect to each of its U.S. reportable accounts. In addition, ensure that any minor/administrative errors identified are communicated to the FFI and that any substantial noncompliance identified is communicated to the HCTA.
- **NFFEs** – Ensure that substantial U.S. owners are properly disclosed and reported on and that penalties are imposed for instances of noncompliance with the FATCA.<sup>21</sup>

\*\*\*\*\*2\*\*\*\*\*  
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\*\*\*\*\*2\*\*\*\*\*. If the IRS identifies potential noncompliance with Form 8966 filings, cases will be referred for examination and penalties or withholding will be imposed.

While the IRS has developed some plans and activities to monitor FFI compliance with the FATCA, it has not effectively outlined these details in the FATCA Compliance Roadmap. We reviewed the IRS’s plans and determined that it needs to update the FATCA Compliance Roadmap to include more information on how the IRS will specifically ensure that FFIs comply with the FATCA (such as when, what, and how the data related to FFI compliance will be reviewed and what outcomes are expected). IRS management believes that until they receive a complete set of data, they cannot fully define how they will detect FFI noncompliance.<sup>22</sup>

In developing the FATCA Compliance Roadmap, the cross-functional working group members were provided a generic compliance activity template to document their plans to identify noncompliant taxpayers, FFIs, and withholding agents. The documented activities related to FFI compliance did not fully reflect the objective of the compliance activity template and were vague in details. Although the compliance data are not yet available on IRS information technology systems, the IRS should have knowledge of what information (*e.g.*, form line items, other form data) will become available and should be able to plan accordingly. If the IRS’s plans to ensure that FFIs comply with the FATCA are not properly documented in the FATCA Compliance Roadmap, the IRS could experience unnecessary delays or other issues with implementing and performing its compliance activities.

With the availability of the FATCA data and the development of the information technology systems being spread out over the next several years, the IRS must ensure that its plans are flexible. With exception of the plans for FFIs, we believe that the IRS’s current plans to measure and monitor its efforts related to FATCA noncompliance seem appropriate. With a continued cross-functional effort to execute its compliance activities, the IRS should be able to effectively meet the challenges of implementing the FATCA.

<sup>21</sup> Registered direct-reporting NFFEs are required to report information on Form 8966 as detailed in Internal Revenue Code § 1.1472-1T(c)(3). Like Model 1 FFIs, non-direct-reporting NFFEs report to their HCTA.

<sup>22</sup> IRS management expressed the need for two full years of data in order to be able to adequately conduct this analysis.



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## **Recommendation**

**Recommendation 1:** The Commissioner, LB&I Division, should update the compliance activities in the FATCA Compliance Roadmap for identifying noncompliance by FFIs to include more detail, such as when, what, and how the data related to FFI compliance will be reviewed and what outcomes are expected.

**Management's Response:** The IRS agreed with this recommendation and intends to update the activities in the FATCA Compliance Roadmap for identifying noncompliance by FFIs. In particular, the LB&I Division intends to include updated information and additional detail about when relevant data are expected to be available, how such data may be reviewed, and what outcomes may be expected.

## **Performance Measures Are Planned to Monitor Foreign Account Tax Compliance Act Noncompliance**

The IRS plans to measure its performance in relation to the FATCA. The FATCA Compliance Roadmap states that compliance activities will be tracked using conventional IRS performance measures for each type of compliance activity (*i.e.*, taxpayer, FFI, or withholding agent). The IRS performance measures can be generally categorized into four areas:

- **Compliance Rate** – The IRS plans to use comparative analyses to detect taxpayer noncompliance as well as provide compliance rates. For example, the IRS may determine that a number of taxpayers failed to file Form 8938 based on a comparison with other forms such as Forms 8966 or Forms 1042-S. Another example of what the IRS plans to monitor is the compliance rate of Offshore Voluntary Disclosure Program participants who are required to file Form 8938 but did not.
- **Response Rate** – Since the compliance rate will identify potential taxpayer noncompliance with the filing and reporting of FATCA forms and information, the IRS plans to use soft notices to notify potentially noncompliant taxpayers of the filing requirements under the FATCA regulations. The IRS plans to track the results of the responses to the soft notices. This could include:
  - The taxpayer initially failed to file a Form 8938, and as a result of the soft notice, the IRS secured a completed Form 8938.
  - The IRS received a response from the taxpayer explaining why he or she did not file a Form 8938, and the IRS took no further action.
  - The IRS received an inadequate or no response from the taxpayer and referred the case for examination.



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- **Examination Results** – Based on the compliance rate and response rate results, the IRS can also send potentially noncompliant cases to its Examination function and track the examination results to measure compliance. For example, a case referred for an examination can result in no change or in an additional tax assessment. If Form 8938 was not properly filed, appropriate penalties may be considered.
  - Every examination involving offshore activity also requires consideration of delinquent Foreign Bank and Financial Account Reports and related penalty assessments. If a taxpayer filed information returns (*e.g.*, Foreign Bank and Financial Account Report and Form 8938), examiners must ensure that the forms are accurate and complete.
  - Each information return has specific filing requirements and associated penalties for examiners to consider. The IRS plans to use unique project codes to track FATCA-related examinations, which will enable it to determine their effectiveness.
- **Cost** – The IRS will monitor the costs associated with the compliance activities using performance measures such as dollars per hour, dollars per case, *etc.*

If the IRS implements the performance measures laid out in the FATCA Compliance Roadmap as planned, it should be in a position to measure the cost and effectiveness of its efforts to reduce FATCA noncompliance.

### ***Limitations Were Identified With the Processing of Paper Forms 8938***

We reviewed the procedures, guidelines, and practices related to the processing of paper Forms 8938 as well as conducted a walkthrough of Form 8938 processing in the IRS's Submission Processing function in the Kansas City, Missouri, campus. We also spoke with officials in the Submission Processing function in the Austin, Texas, campus to obtain an overview of how they process Form 8938 and to ensure consistency between the two campuses. Based on our discussions and walkthrough, we observed the following limitations in processing paper Forms 8938.

- Transcribed data were not validated to ensure accuracy.
- Data on Form 8938 continuation statements (used to report additional foreign accounts or other foreign assets) were not transcribed.
- Losses reported by taxpayers could not be input as negative amounts.

The IRS reported that there were 111,626 Tax Year 2013 Forms 8938 filed on paper during Processing Year 2014. In comparison, it noted that 192,378 Forms 8938 were filed electronically. Although the electronically filed data were available for analysis, the paper-filed data were not. In order to have complete information, LB&I Division management determined



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that it was necessary to capture the data from the paper forms and contacted the Wage and Investment Division's Submission Processing function for assistance with transcribing the data.

**Manual data transcription without validation**

LB&I Division management explained that the transcription of paper Forms 8938 is being performed as an "exception process." According to LB&I Division management, the transcription of the Forms 8938 had to be done through the Integrated Submission and Remittance Processing System. This is not the same course that most tax returns go through to be processed by the IRS. As a result, the Form 8938 transcription information does not have the same data validity input controls and correction processes as the other tax forms the IRS transcribes.

Accuracy of the paper Form 8938 data is reliant upon manual input by data transcribers. The IRS initially considered having a two-person data entry process to verify the information as it was being input to the IRS's computer system, but LB&I Division management made a risk-based decision not to use additional resources for this purpose. If a taxpayer is selected for audit, LB&I Division management stated that the original return would be pulled and verified and that the data collected under the transcription process would not be used during the audit of a taxpayer. However, because the information used to select a case for audit could be inaccurate, the IRS may be unnecessarily burdening some taxpayers and potentially wasting resources selecting cases that are not in fact problematic but instead appear to have issues due to transcription errors.

Therefore, we discussed with the IRS the feasibility of implementing some type of periodic quality review of the Form 8938 data transcription process. LB&I Division management stated that if a quality review process for Form 8938 transcription were implemented, very little of this work would get pulled in the overall quality sample because the number of transcribed Forms 8938 in comparison to the total population of transcribed forms already selected for quality review is relatively small. They believe that as long as the majority of entries are substantially correct, they can consider the data to be sufficient for needed purposes. However, while they agreed that it may be possible to sample the data after input to make sure tolerances are within acceptable standards, they noted that those standards would still have to be determined.

We inquired as to whether the IRS has any additional processes or methods that could potentially be used to validate transcribed data. Wage and Investment Division management identified the Embedded Quality Submission Process as a possibility. They described it as a quality review application used by managers to capture evaluative and nonevaluative data obtained from reviewing submission processing programs.



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**Limitations of the program used to transcribe paper Forms 8938**

The remaining data input limitations involved the inability of Submission Processing function employees to transcribe Form 8938 continuation statements and negative dollar amounts from paper Forms 8938.

The IRS initially piloted the process of transcribing the data from paper Forms 8938 in June 2014, but when it determined that some fields were not being properly captured by the transcription program, the pilot was suspended. The transcription program was then revised and the process restarted in October 2014. However, when we identified and discussed the issues noted above with IRS Submission Processing management at the Kansas City, Missouri, campus in November 2014, we were told that the transcription program was going to be updated and replaced again in January 2015.

In March 2015, IRS management stated that the transcription program had been revised to enable transcription of the data from all Form 8938 continuation statements beginning with Tax Year 2014 data submitted in Processing Year 2015. They also stated that adding the continuation statements to the process has been in their plan for the past two years. In July 2015, IRS management said that programming changes to capture negative dollar amounts from paper Forms 8938 would not be completed until January 2016. Because transcription of Form 8938 continuation statements for Tax Year 2014 is not scheduled to begin until July 2015 and the remaining programming change will not be completed until January 2016, we were not able to determine whether the new programming will resolve our concerns. If the issues identified are not properly addressed, any analysis of the potentially inaccurate and/or incomplete paper Form 8938 data will likely limit management's ability to make informed decisions and achieve IRS compliance objectives for the FATCA.

Management should always try to ensure that it has quality information to achieve an entity's objectives.<sup>23</sup> As such, IRS management should ensure that paper Form 8938 data are processed into quality information that is accurate and complete. Having accurate and complete information will enable management to make informed decisions and evaluate the IRS's performance in achieving key objectives and addressing business risks.

**Recommendations**

**Recommendation 2:** The Commissioner, Wage and Investment Division, should initiate some type of periodic post-input quality review specifically for the processing of paper Forms 8938 to identify any potential errors in the data being transcribed.

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<sup>23</sup> Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).



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**Management's Response:** The IRS agreed with this recommendation and stated that it has already included Form 8938 as part of the Submission Processing function's Quality Review Program's random sample of data transcription work performed by employees. It believes the level of quality review already performed is adequate and does not intend to take additional action.

**Recommendation 3:** The Commissioner, Wage and Investment Division, should ensure that the data transcription issues identified in this report are addressed in the newest version of the Form 8938 transcription program.

**Management's Response:** The IRS agreed that data transcription quality could be improved and has implemented programming in July 2015, as noted in the report, which permits the transcription of Form 8938 continuation sheets. Additional program changes have been requested that will address the remaining issues of data validation and negative amount entries; however, such programming changes are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, the IRS disagreed with the recommendation.

**Office of Audit Comment:** The IRS has requested programming changes to address the remaining data validation issues and negative amount entries. However, the IRS will not guarantee that these programming changes will be implemented due to budgetary constraints, limited resources, and competing priorities. The accuracy of the data obtained from Forms 8938 is a critical component for the success of the IRS's compliance activities with implementing the FATCA. As such, we believe that the IRS should make these programming changes a priority.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to assess the IRS's progress in implementing the FATCA.<sup>1</sup> To accomplish our objective, we:

- I. Assessed the IRS's education/outreach efforts related to the FATCA.
  - A. Interviewed FATCA program management to identify what education/outreach has been provided to external stakeholders (*e.g.*, taxpayers, taxpayer representatives, domestic banks/withholding agents, foreign governments, and FFIs) related to the FATCA.
  - B. Reviewed the IRS's Internet website to identify any education/outreach information provided to external stakeholders related to the FATCA.
- II. Assessed the status of the IRS's efforts to process Form 8938, *Statement of Specified Foreign Financial Assets*.
  - A. Determined what procedures, guidelines, and practices the IRS uses for processing Form 8938.
    1. Interviewed FATCA program management to determine what procedures, guidelines, and practices are used to process Forms 8938, specifically for any Forms 1040, *U.S. Individual Income Tax Return*, or Forms 1040-NR, *U.S. Nonresident Alien Income Tax Return*, with an attached Form 8938.
    2. Obtained and reviewed any documentation related to the processing of Forms 8938 to determine if adequate controls are in place to ensure that the processing of the forms are timely and accurate.
  - B. Obtained information on how Form 8938 is processed at the Austin, Texas, and Kansas City, Missouri, IRS campuses and compared the results to the procedures, guidelines, and practices identified in Step II.A.
  - C. Extracted tax return information from the IRS's Individual Master File located at the TIGTA's Data Center Warehouse for returns that were filed with an attached Form 8938 for Tax Years 2011 through 2014.

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<sup>1</sup> See Appendix VI for a glossary of terms.



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- III. Assessed the IRS's plans for ensuring that taxpayers, FFIs, and withholding agents comply with the FATCA.
- A. Assessed the IRS's plans for ensuring taxpayer compliance with filing Form 8938.
1. Interviewed FATCA program management to determine what procedures, guidelines, and practices the IRS plans to use for ensuring that taxpayers who are required to file Form 8938 comply with the FATCA.
  2. Obtained and reviewed any documentation concerning IRS compliance plans related to taxpayers filing Form 8938 to determine if adequate controls are planned to ensure that taxpayers who are required to file Form 8938 comply with the FATCA.
- B. Assessed the IRS's plans for ensuring FFI compliance with the FATCA, including FFIs related to Model 1 and Model 2 IGAs.
1. Interviewed FATCA program management to determine what procedures, guidelines, and practices the IRS plans to use for ensuring that FFIs comply with the FATCA.
    - a) Determined how the IRS plans to ensure that PFFIs (non-IGA) are in compliance with U.S. taxpayer account information reporting requirements under the FATCA.
    - b) Determined how the IRS plans to ensure that the FFIs under Model 1 IGAs are in compliance with U.S. taxpayer account information reporting requirements under the FATCA.
    - c) Determined how the IRS plans to ensure that the FFIs under Model 2 IGAs are in compliance with U.S. taxpayer account information reporting requirements under the FATCA.
  2. Obtained and reviewed any documentation concerning IRS compliance plans related to the FFIs to determine if adequate controls are planned to ensure that FFIs comply with the FATCA.
- C. Assessed the IRS's plans for ensuring withholding agent compliance with the FATCA.
1. Interviewed FATCA program management and determined what procedures, guidelines, and practices the IRS plans to use for ensuring that withholding agents comply with the FATCA, specifically related to withheld payments to non-PFFIs.
  2. Obtained and reviewed any documentation concerning IRS compliance plans related to the withholding agents and the withholding of payments to non-PFFIs



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to determine if adequate controls are in place to ensure that withholding agents comply with the FATCA.

- IV. Evaluated the IRS's plans to measure and monitor its efforts related to the FATCA.
  - A. Interviewed FATCA program management and determined what systems, data, and/or reports the IRS plans to use to measure and monitor its efforts related to the FATCA.
  - B. Obtained and reviewed any documentation concerning the IRS's plans to measure and monitor its efforts related to the FATCA.

**Data validation methodology**

During this review, we relied on data extracts from the IRS's Individual Master File located at the TIGTA's Data Center Warehouse. We relied on data validation tests conducted by the TIGTA Office of Investigations' Strategic Data Services for the accuracy of the data. We also verified the accuracy of the volume of the data with counts identified by the IRS. As a result, we determined that the data used in our review were sufficiently reliable to perform our audit analyses.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS procedures, guidelines, and practices for processing Forms 8938 timely and accurately and for identifying noncompliance with FATCA filing/reporting requirements for taxpayers, FFIs, and withholding agents. We evaluated these controls by interviewing key personnel and reviewing procedures, guidelines, and practices.



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**Appendix II**

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**Appendix III**

*Report Distribution List*

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Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Wage and Investment Division SE:W  
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Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, International Individual Compliance, Large Business and International Division  
SE:LB:IN:IIC  
Director, International Business Compliance, Large Business and International Division  
SE:LB:IN:IBC  
Director, Foreign Payments Practice, Large Business and International Division SE:LB:IN:FPP  
Director, International Data Management, Large Business and International Division  
SE:LB:IN:IDM  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Audit Coordination OS:PPAC:AC  
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Audit Liaisons:  
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    Commissioner, Wage and Investment Division SE:W



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**Appendix IV**

*Foreign Account Tax Compliance Act Timeline*

<b>Processing Year</b>	<b>Month</b>	<b>FATCA Activity</b>
<b>2010</b>	<b>March</b>	<ul style="list-style-type: none"> <li>The FATCA legislation was enacted as part of the Hiring Incentives to Restore Employment Act.<sup>1</sup></li> </ul>
<b>2011</b>	<b>December</b>	<ul style="list-style-type: none"> <li>The IRS and the U.S. Department of the Treasury issued temporary regulations (TD 9567) and proposed regulations (REG-130302-10) that provided guidance to individual taxpayers regarding their reporting requirements under the FATCA.<sup>2</sup></li> </ul>
<b>2012</b>	<b>January</b>	<ul style="list-style-type: none"> <li>Paper and electronic Form 8938, <i>Statement of Specified Foreign Financial Assets</i>, filing began for individual taxpayers.</li> </ul>
	<b>February</b>	<ul style="list-style-type: none"> <li>The IRS and the U.S. Department of the Treasury issued proposed regulations (REG-121647-10) that provided guidance to FFIs on their reporting requirements and to withholding agents on their withholding requirements.<sup>3</sup></li> </ul>
<b>2013</b>	<b>January</b>	<ul style="list-style-type: none"> <li>Proposed regulations (REG-121647-10) that provided guidance to FFIs on their reporting requirements and to withholding agents on their withholding requirements were adopted as final (TD 9610).<sup>4</sup></li> </ul>
<b>2014</b>	<b>January</b>	<ul style="list-style-type: none"> <li>Registration using Form 8957, <i>Foreign Account Tax Compliance Act (FATCA) Registration</i>, began for FFIs.</li> </ul>
	<b>March</b>	<ul style="list-style-type: none"> <li>The IRS and the U.S. Department of the Treasury issued temporary regulations (TD 9657) updating TD 9610 and temporary regulations (TD 9658) regarding withholding of tax on certain U.S. source income paid to foreign persons and other non-FATCA-related rules necessary to coordinate with the FATCA regulations.</li> </ul>
	<b>July</b>	<ul style="list-style-type: none"> <li>Withholding began on certain U.S. fixed, determinable, annual, or periodical income payments to FFIs.</li> </ul>
	<b>December</b>	<ul style="list-style-type: none"> <li>Temporary regulations (TD 9567) that provided guidance to individual taxpayers regarding their reporting requirements under the FATCA were adopted as final (TD 9706).<sup>5</sup></li> </ul>

<sup>1</sup> Pub. L. No. 111-147, 124 Stat. 71 (2010). See Appendix VI for a glossary of terms.

<sup>2</sup> Temp. Treas. Reg. §§ 1.6038D-0T through 5T, 1.6038D-7T, and 1.6038D-8T (2011). Prop. Treas. Reg. §§ 1.6038D-2 and 1.6038D-4 (2011).

<sup>3</sup> Prop Treas. Reg. §§ 1.1471 - 1474 and 301.1474 (2012).

<sup>4</sup> Treas. Reg. §§ 1.1471 - 1474 (2013).

<sup>5</sup> Treas. Reg. §§ 1.6038D-0 through 5, 1.6038D-7, and 1.6038D-8 (2014).



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Processing Year	Month	FATCA Activity
<b>2015</b>	<b>January</b>	<ul style="list-style-type: none"> <li>• Paper and electronic Form 8966, <i>FATCA Report</i>, submissions began for Tax Year 2014 (non-IGA PFFIs, reporting Model 2 FFIs, and direct-reporting NFFEs).</li> <li>• Form 1042-S, <i>Foreign Person's U.S. Source Income Subject to Withholding</i>, withholding agent copies provided to the IRS throughout Processing Year 2015.</li> <li>• Certain Model 2 IGA countries filed Form 8966 for groups of noncompliant account holders for Tax Year 2014.</li> <li>• Data became available upon deployment of the International Compliance Management Model for the IRS to analyze:               <ul style="list-style-type: none"> <li>○ Data captured from electronic and paper Forms 8966.</li> <li>○ Data captured from Form 1042-S recipient copies.</li> </ul> </li> <li>• Received corrections to Form 8966 information from reporting Model 2 FFIs and non-IGA PFFIs.</li> </ul>
	<b>March</b>	<ul style="list-style-type: none"> <li>• Deadline for filing of Form 8966 for Tax Year 2014 (non-IGA PFFIs, reporting Model 2 FFIs, and direct-reporting NFFEs). There is an automatic 90-day extension for Tax Year 2014 only.</li> <li>• Deadline for filing of Form 8966 for groups of noncompliant account holders for Tax Year 2014 (reporting Model 2 FFIs).</li> <li>• Deadline for filing of Form(s) 1099 (<i>e.g.</i>, 1099-MISC, <i>Miscellaneous Income</i>; 1099-INT, <i>Interest Income</i>; 1099-DIV, <i>Dividends and Distributions</i>), in lieu of Form 8966 (FFIs and certain PFFIs).</li> </ul>
	<b>May</b>	<ul style="list-style-type: none"> <li>• Withholding deposit information for Tax Year 2014 became available in the Business Master File for IRS analysis. Chapter 3 withholding was done before the FATCA and will continue to be done regardless of the FATCA. Amounts withheld under Chapter 4 are not treated any differently than amounts withheld under Chapter 3.</li> </ul>
	<b>June</b>	<ul style="list-style-type: none"> <li>• Deadline of the 90-day extension for filing of Form 8966 for Tax Year 2014 (non-IGA PFFIs, reporting Model 2 FFIs, and direct-reporting NFFEs).</li> <li>• Data became available upon deployment of the International Compliance Management Model for the IRS to analyze data captured from paper Form 8938 (full data capture).</li> </ul>
	<b>September</b>	<ul style="list-style-type: none"> <li>• Reciprocal reporting prepared by the IRS will be sent to Model 1 IGA partners (Model 1 HCTAs).</li> <li>• Deadline for receiving information reporting for Tax Year 2014 from the HCTAs in Model 1 IGA jurisdictions.</li> </ul>
	<b>October/ November</b>	<ul style="list-style-type: none"> <li>• Began receiving error and noncompliance notifications regarding reciprocal reporting from Model 1 IGA partners (Model 1 HCTAs).</li> <li>• Data captured from electronic and paper Forms 8966 become available on the International Compliance Management Model.</li> </ul>
	<b>November/ December</b>	<ul style="list-style-type: none"> <li>• Substantially complete sets of Tax Year 2014 Form 8938 and Form 8966 data would be received and processed (assuming compliance with filing deadlines).</li> </ul>



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<b>Processing Year</b>	<b>Month</b>	<b>FATCA Activity</b>
<b>2016</b>	<b>August</b>	<ul style="list-style-type: none"> <li>• Deadline for Responsible Officers to submit certifications with respect to preexisting accounts required under the final regulations.</li> </ul>
<b>2016 and beyond</b>	<b>N/A</b>	<ul style="list-style-type: none"> <li>• Deadline to be established for receiving details on reporting of groups of noncompliant account holders in response to follow-up data requests from the HCTAs with Model 2 IGAs.</li> </ul>
	<b>N/A</b>	<ul style="list-style-type: none"> <li>• Substantially complete set of Tax Year 2014 FATCA data from all timely filed FATCA forms would be available for use in identifying taxpayer, FFI, and withholding agent noncompliance.</li> </ul>
	<b>N/A</b>	<ul style="list-style-type: none"> <li>• Additional FATCA data will become available in Processing Year 2016 and beyond in accordance with regulatory deadlines and future information technology project releases. According to the International Compliance Management Model requirements, anticipated data needs for Processing Year 2016 and beyond include:               <ul style="list-style-type: none"> <li>○ Transcribed data from forms listed in Part IV of Form 8938:                   <ul style="list-style-type: none"> <li>▪ Form 3520, <i>Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts</i>.</li> <li>▪ Form 3520-A, <i>Annual Return of Foreign Trust With a U.S. Owner</i>.</li> <li>▪ Form 5471, <i>Information Return of U.S. Persons With Respect to Certain Foreign Corporations</i>.</li> <li>▪ Form 8621, <i>Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund</i>.</li> <li>▪ Form 8865, <i>Return of U.S. Persons With Respect to Certain Foreign Partnerships</i>.</li> <li>▪ Form 8891, <i>U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans</i>.</li> <li>▪ Form 8938 entity filings (earliest date is for Tax Year 2015).</li> </ul> </li> <li>○ FATCA Registration Data (Form 8957).</li> </ul> </li> <li>• Form 1042-S Withholding Agent.</li> </ul>

Source: *The IRS's FATCA Compliance Roadmap as of November 2014.*



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**Appendix V**

*Listing of Countries With  
Intergovernmental Agreements Related to  
the Foreign Account Tax Compliance Act*

**Figure 1: Jurisdictions With a Signed Intergovernmental Agreement<sup>1</sup>**

<b>Model 1 IGAs</b>			
Australia	Cyprus	Israel	Netherlands
Bahamas	Czech Republic	Italy	New Zealand
Barbados	Denmark	Jamaica	Norway
Belarus	Estonia	Jersey	Poland
Belgium	Finland	Kosovo	Qatar
Brazil	France	Kuwait	Singapore
British Virgin Islands	Germany	Latvia	Slovenia
Bulgaria	Gibraltar	Liechtenstein	South Africa
Canada	Guernsey	Lithuania	Spain
Cayman Islands	Honduras	Luxembourg	Sweden
Costa Rica	Hungary	Malta	Turks and Caicos Islands
Croatia	Ireland	Mauritius	United Kingdom
Curacao	Isle of Man	Mexico	Uzbekistan
<b>Model 2 IGAs</b>			
Austria	Chile	Japan	Switzerland
Bermuda	Hong Kong	Moldova	

Source: U.S. Department of the Treasury website as of May 12, 2015.

<sup>1</sup> See Appendix VI for a glossary of terms.



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**Figure 2: Jurisdictions Treated As Having an Intergovernmental Agreement**

<b>Model 1 IGAs</b>			
Algeria	Georgia	Montenegro	Seychelles
Angola*	Greece*	Montserrat*	Slovak Republic
Anguilla	Greenland	Panama	South Korea
Antigua and Barbuda	Grenada	Peru	Thailand
Azerbaijan	Guyana	Philippines*	Trinidad and Tobago*
Bahrain	Haiti	Portugal	Tunisia*
Cabo Verde	Holy See*	Romania	Turkey
Cambodia*	Iceland*	St. Kitts and Nevis	Turkmenistan
China	India	St. Lucia	Ukraine
Colombia	Indonesia	St. Vincent and the Grenadines	United Arab Emirates
Dominica	Kazakhstan*	Saudi Arabia	
Dominican Republic	Malaysia	Serbia	
<b>Model 2 IGAs</b>			
Armenia	Macao*	Paraguay	Taiwan <sup>+</sup>
Iraq	Nicaragua	San Marino	
<p>Jurisdictions without an asterisk reached agreements in substance as of June 30, 2014.            * Jurisdictions with an asterisk reached agreements in substance as of November 30, 2014.            All of the jurisdictions listed have consented to being included on this list as of the date of their agreements.  <sup>+</sup> Consistent with the Taiwan Relations Act, Pub. L. No. 96-8, (1979), the parties to the agreement would be the American Institute in Taiwan and the Taipei Economic and Cultural Representative Office in the United States.</p>			



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**Appendix VI**

*Glossary of Terms*

<b>Term</b>	<b>Definition</b>
<b>Business Master File</b>	The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.
<b>Campus</b>	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
<b>Comparative Analysis</b>	The item-by-item comparison of two or more comparable alternatives, processes, products, qualifications, sets of data, systems, or the like.
<b>Continuation Statement</b>	Statement attached to Form 8938, <i>Statement of Specified Foreign Financial Assets</i> , used to report additional foreign accounts or other foreign assets.
<b>FATCA Compliance Roadmap</b>	The purpose of the FATCA Compliance Roadmap is to document compliance planning involving FATCA data and to provide a baseline for future compliance planning and implementation activities across the IRS.
<b>Fixed, Determinable, Annual, and Periodical Income</b>	<p>Includes all income, except:</p> <ul style="list-style-type: none"> <li>• Gains derived from the sale of real or personal property (including market discount and option premiums but not including original issue discount).</li> <li>• Items of income excluded from gross income without regard to the U.S. or foreign status of the owner of the income, such as tax-exempt municipal bond interest and qualified scholarship income.</li> </ul> <p>Income is fixed when it is paid in amounts known ahead of time.</p> <p>Income is determinable when there is a basis for figuring the amount to be paid.</p> <p>Income can be periodic if it is paid from time to time. It does not have to be paid annually or at regular intervals.</p> <p>Income can be determinable or periodic even if the length of time during which the payments are made is increased or decreased.</p>



*The Internal Revenue Service Has Made Progress in Implementing the Foreign Account Tax Compliance Act*

<b>Term</b>	<b>Definition</b>
<b>Foreign Account Tax Compliance Act (FATCA)</b>	Law passed in Calendar Year 2010 that targets tax noncompliance by U.S. taxpayers with foreign accounts. The FATCA requires U.S. taxpayers to report certain foreign financial accounts and offshore assets. The FATCA also requires FFIs to report about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest. U.S. taxpayers and FFIs that do not report the required information will be subject to withholding.
<b>Foreign Financial Institution (FFI)</b>	Any financial institution that is a foreign entity. An entity is a financial institution that: (1) accepts deposits in the ordinary course of a banking or similar business; (2) as a substantial portion of its business, holds financial assets for the account of others; or (3) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.
<b>Host Country Tax Authority (HCTA)</b>	Tax agency of a foreign country.
<b>Individual Master File</b>	The IRS database that maintains transactions or records of individual tax accounts.
<b>Integrated Submission and Remittance Processing System</b>	An application designed to capture, format, and forward information related to tax submissions and remittances in electronically readable formats to downstream IRS systems.
<b>Internal Revenue Code</b>	The Federal statutory tax law, enacted as Title 26 of the U.S. Code, is organized according to topic and covers all relevant rules pertaining to income, gift, estate, payroll, and excise taxes. The IRS is the implementing agency.
<b>Model 1 IGA</b>	Agreement between the United States and a foreign government under which an FFI will report U.S. account information to its HCTA, which in turn will automatically provide the information to the IRS.
<b>Model 2 IGA</b>	Agreement between the United States and a foreign government under which an FFI will be directed to enter into an agreement with the IRS and will report U.S. account information directly to the IRS in a manner consistent with the FATCA regulations.
<b>Nonfinancial Foreign Entity (NFFE)</b>	Any foreign entity that is not a financial institution.



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<b>Term</b>	<b>Definition</b>
<b>Non-IGA Participating FFI</b>	The use of this term signifies that the agreement between the PFFI and the IRS is not bound to an IGA. When a PFFI in a non-IGA jurisdiction completes its FATCA registration, the PFFI is agreeing to comply with the terms of the FFI Agreement.
<b>Participating Foreign Financial Institution (PFFI)</b>	An FFI (including a reporting Model 2 FFI) that has entered into a registration agreement with the IRS to identify U.S. accounts, report certain information to the IRS regarding U.S. accounts, and withhold a 30 percent tax on certain U.S. payments to non-PFFI and account holders who are unwilling to provide the required information.
<b>Processing Year</b>	The calendar year in which the tax return or document is processed by the IRS.
<b>Registered Deemed-Compliant Foreign Financial Institution</b>	An FFI that may use one or more agents to perform the necessary due diligence to identify its account holders and to take any required action associated with obtaining and maintaining its deemed-compliant status. The FFI, however, remains responsible for ensuring that the requirements for its deemed-compliant status are met.
<b>Reporting Model 1 FFI</b>	A financial institution, including a foreign branch of a U.S. financial institution, treated as a reporting financial institution under a Model 1 IGA. Financial institutions that are treated as reporting financial institutions under a Model 1 IGA should register as registered deemed-compliant FFIs.
<b>Reporting Model 2 FFI</b>	A financial institution or branch of a financial institution treated as a reporting financial institution under a Model 2 IGA. A reporting Model 2 FFI should register as a PFFI and is agreeing to comply with the terms of the FFI agreement as modified by the applicable Model 2 IGA.
<b>Soft Notice</b>	A letter that informs a taxpayer that he or she may be required to file a particular tax form with the IRS ( <i>e.g.</i> , Form 8938) or provide an explanation as to why no form is required. Soft notices do not require that the taxpayer pay more tax, provide documentation, or even respond to the IRS. Instead, the notices are designed to serve as an educational tool, encourage taxpayer self-correction, and improve voluntary compliance.
<b>Submission Processing</b>	The area within the IRS that receives and processes tax forms and controls other documents.



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<b>Term</b>	<b>Definition</b>
<b>Substantial U.S. Owner</b>	<p>Except as otherwise provided in Section 26 Code of Federal Regulations §§ 1.1473-1(b)(4) or (5), the term substantial United States owner (or substantial U.S. owner) means:</p> <ul style="list-style-type: none"> <li>• With respect to any foreign corporation, any specified U.S. person that owns, directly or indirectly, more than 10 percent of the stock of such corporation (by vote or value);</li> <li>• With respect to any foreign partnership, any specified U.S. person that owns, directly or indirectly, more than 10 percent of either the profit interests or the capital interests in such partnership; or</li> <li>• In the case of a trust, any specified U.S. person treated as an owner of any portion of the trust under sections 671 through 679 and any specified U.S. person that holds, directly or indirectly, more than 10 percent of the beneficial interests of the trust.</li> </ul>
<b>Tax Year</b>	<p>The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.</p>
<b>Withholding Agent</b>	<p>Any person required to withhold tax is a withholding agent. A withholding agent may be an individual, trust, estate, partnership, corporation, nominee, government agency, association, or tax-exempt foundation, whether domestic or foreign. For purposes of Chapter 4, a withholding agent includes a PFFI or registered deemed-compliant FFI to the extent such FFI is required to withhold tax.</p>



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**Appendix VII**

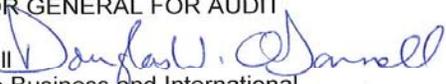
*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

September 10, 2015

MEMORANDUM FOR MICHAEL MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell   
Commissioner, Large Business and International

SUBJECT: Draft Audit Report # 2014-30-015 - The Internal Revenue  
Service Has Made Progress in Implementing the Foreign  
Account Tax Compliance Act

Thank you for the opportunity to review and comment on the subject draft report. The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 and represents an important development in U.S. efforts to improve tax compliance by U.S. persons holding investments in offshore accounts. Under FATCA, certain U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS. In addition, foreign financial institutions must report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Prior to the enactment of FATCA, the IRS implemented a Voluntary Disclosure Program (VDP) in 2009 to address non-compliance by U.S. taxpayers using foreign accounts. Under the VDP, individuals who had evaded taxes were offered the opportunity to avoid criminal prosecution, pay civil penalties, and enter back into the tax system. Over 18,000 individuals came forward, and the closed cases averaged more than \$200,000 in tax collections per case.

To achieve the goal of improving U.S. taxpayer compliance in this area, the IRS developed a compliance strategy that uses FATCA and other data to identify potential compliance risk, build and assign cases, conduct enforcement activities, and measure results. We appreciate your feedback on our comprehensive FATCA Compliance Roadmap, which was created to document compliance planning involving FATCA data and to provide a baseline for future compliance planning and implementation activities across the IRS. The FATCA Compliance Roadmap is continuously updated, revised and corrected to reflect the most current available information regarding FATCA compliance activities. It serves as the blueprint for measuring and documenting FATCA compliance for the future.

FATCA data is expected to open new approaches for the identification and assessment of compliance risks, as well as support many existing IRS tax compliance programs, all of which will provide for greater tax compliance by this sector and hinder the opportunities for off-shore tax evasion. While elements of the legislation have been in effect since 2011, the main elements of FATCA reporting began in 2015 and will



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continue to unfold over the next few years. As a result, this year IRS began preparation for application of the first full substantive wave of FATCA data for compliance purposes, specifically for the Tax Year (TY) 2014 filing population.

We appreciate your acknowledgement of IRS's efforts to educate, train and ensure that the public and our employees are fully aware of FATCA policies and guidelines. IRS used multiple communication modes and activities to ensure that taxpayers were fully aware of FATCA implementation and the associated laws and regulations that govern FATCA. IRS continues to provide numerous outreach efforts, training and other communication modes including social media and [irs.gov](http://irs.gov) to provide frequent and consistent information on FATCA.

We appreciate your recommendations, as we are always seeking ways to improve our programs. Attached is a detailed response outlining the corrective actions the IRS will take to address your recommendations. If you have any questions, please contact me, or members of your staff may contact David W. Horton, Acting Deputy Commissioner (International) at (630) 493-5937.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Commissioner, Large Business and International Division should update the compliance activities in the FATCA Compliance Roadmap for identifying noncompliance by FFIs to include more detail, including when, what and how the data related to FFI compliance will be reviewed and what outcomes are expected.

**CORRECTIVE ACTIONS:**

The Commissioner, Large Business and International (LB&I) Division, agrees with the recommendation and intends to update the activities in the FATCA Compliance Roadmap for identifying noncompliance by FFIs. In particular, LB&I intends to include updated information and additional detail about when relevant data is expected to be available, how such data may be reviewed, and what outcomes may be expected.

**IMPLEMENTATION DATE:**

February 1, 2016

**RESPONSIBLE OFFICIAL:**

Director, Foreign Payments Practice, International Business Compliance, Large Business and International Division

**CORRECTIVE ACTIONS MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2:**

The Commissioner, Wage and Investment Division, should initiate some type of periodic post-input quality review specifically for the processing of paper Forms 8938 to identify any potential errors in the data being transcribed.

**CORRECTIVE ACTIONS:**

We agree with this recommendation and have already included Form 8938 as part of the Submission Processing function's Quality Review Program's random sample of data transcription work performed by employees. We believe the level of quality review already performed is adequate and do not intend to take additional action.

**IMPLEMENTATION DATE:**

N/A



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**RESPONSIBLE OFFICIAL:**

Director, Submission Processing, Customer Account Services, Wage and Investment Division

**CORRECTIVE ACTIONS MONITORING PLAN:**

N/A

**RECOMMENDATION 3:**

The Commissioner, Wage and Investment Division, should ensure that the data transcription issues identified in this report are addressed in the newest version of the Form 8938 transcription program.

**CORRECTIVE ACTIONS:**

We agree that data transcription quality can be improved and have implemented programming in July 2015, as noted in the report, that permits the transcription of Form 8938 continuation sheets. Additional programming changes have been requested that will address the remaining issues of data validation and negative amount entries; however, such programming changes are subject to budgetary constraints, limited resources, and competing priorities. Consequently, and due solely to those constraints, we disagree with the recommendation.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL:**

N/A

**CORRECTIVE ACTIONS MONITORING PLAN:**

N/A