

F.A.T.C.A. – WHERE DO WE STAND TODAY?

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Tags

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On July 5, 2018, the Treasury Inspector General for Tax Administration (“T.I.G.T.A.”) issued a final audit report on enforcement of the Foreign Account Tax Compliance Act (“F.A.T.C.A.”) enacted in 2010. It concluded that after spending nearly \$380 million, the I.R.S. is still not prepared to enforce F.A.T.C.A. compliance. According to the report, the I.R.S. has taken limited or no action to follow the activities outlined in the F.A.T.C.A. Compliance Roadmap, last updated in 2016.

T.I.G.T.A. found that many Foreign Financial Institutions (“F.F.I.’s”) and withholding agents did not include correct Taxpayer Identification Numbers (“T.I.N.’s”) for individuals, and as a result, the I.R.S. has not been able to match the data from the forms filed by F.F.I.’s, withholding agents, and taxpayers.

T.I.G.T.A. provided six recommendations to the I.R.S. on how to improve F.A.T.C.A. compliance, of which the I.R.S. agreed to four. This article will cover the recommendations and the I.R.S. response.

BACKGROUND

In conjunction with the Hiring Incentives to Restore Employment Act of 2010, F.A.T.C.A. introduced Chapter 4, which added Code §§1471-1474 and §6038D. It was designed to improve compliance with reporting of foreign financial assets and offshore accounts and was projected to raise \$8.7 billion from fiscal years 2010 to 2020.

The F.A.T.C.A. reporting obligation applies not only to individual taxpayers but also to F.F.I.’s and withholding agents. It also goes much further than previous international agreements: F.A.T.C.A. requires F.F.I.’s to report to the I.R.S. about their U.S. customers on an annual basis.

Who has a reporting obligation under F.A.T.C.A.?

Individual Taxpayers – Code §6038D requires individuals to file Form 8939, *Statement of Specified Foreign Financial Assets*, with their income tax returns if the aggregate value of the foreign financial assets exceeds certain dollar thresholds.

F.F.I.’s – To avoid a 30% withholding on U.S.-source income, certain F.F.I.’s must register with and agree to report certain information about their U.S. account holders to the I.R.S.¹ In 2014, there were more than 77,000 entities registered with the I.R.S. This list has increased to 293,020 in 2017.

¹ The reporting obligation extended to foreign entities that have a U.S. account holder.

The U.S. Department of Treasury has negotiated Intergovernmental Agreements (“I.G.A.’s”) with many foreign governments to implement F.A.T.C.A. The privacy laws of many foreign countries prevent F.F.I.’s from reporting account information directly to the I.R.S. To remove an F.F.I.’s legal impediments to report the accounts, the I.R.S. created two model I.G.A.’s: (i) the Model 1 I.G.A., where an F.F.I. reports U.S.-related accounts to their home country tax authority, which in turn will automatically provide the information to the I.R.S., and (ii) the Model 2 I.G.A., where an F.F.I. reports U.S.-related accounts directly to the I.R.S in a manner consistent with F.A.T.C.A. regulations.

A participating F.F.I. files Form 8966, *F.A.T.C.A. Report*, annually with the I.R.S. The form must reflect the name, address, and T.I.N. of each specified U.S. person; the account number; the account balance or value; and gross receipts and gross withdrawals or payments from the account. The reporting obligation for the form took effect in 2015.

Withholding Agents – Withholding agents are required to withhold 30% on payments of U.S.-source income to the following:

- Non-participating F.F.I.’s and nonfinancial foreign entities
- Any account holder of a participating F.F.I. who fails to provide
 - the information required to determine whether the account is a U.S. account,
 - the information required to be reported by the F.F.I., or
 - a waiver of a foreign law that would prevent reporting to the I.R.S.

Withholding agents use 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*, to report payments and amounts withheld. The information required to be reported for the payor and payee includes (i) name, (ii) address, (iii) T.I.N., (iv) Chapter 4 status of each payee, (v) the gross amount paid, (vi) the tax withheld, and (vii) the identifying information of the withholding agent.

T.I.G.T.A. FINDINGS AND RECOMMENDATIONS

During the review, T.I.G.T.A. determined that the I.R.S. continues to experience delays in implementing its F.A.T.C.A. compliance strategy. There seem to be many causes for the delay.

The issues identified by the I.R.S. include (i) a lack of automated processes, (ii) the need for development and implementation of additional system requirements, (iii) the prioritization of F.A.T.C.A. work by the information technology organization, (iv) the timing of regulatory deadlines, (v) the lack of data to verify compliance, and (vi) the categorization of activities as low risk and low priority in terms of I.R.S. operations.

Error Notices

Form 8966 filed by the F.F.I. is scanned in the first two stages of review² for improper encryption, improper electronic reporting format, failed decryption, an invalid Form 8966 X.M.L. schema reporting format, an invalid digital certificate, a failed virus scan, and validation errors caused by missing data.

If the file is rejected at the first stage, the filer will receive an alert containing a general description of the cause for the rejection. In contrast, if a file is rejected at the second stage, the filer will receive an overview of the error, the cause for file rejection, and the potential resolution.

F.F.I.'s have 120 days from the date an alert or notification was sent to resolve the issue(s) that caused the rejection. Filers may contact the helpdesk if they need further assistance.

After the original alert or notification, the I.R.S. only follows up with Model 1 I.G.A. rejected files. It does so by sending a follow-up letter at the 60-day mark and maintains communication until all errors or substantially all errors are corrected. Currently, follow up in Model 2 I.G.A. jurisdictions is not available, but the I.R.S. has indicated that it is in the process of creating a follow-up process for stage one error notices.

Once the file successfully passes through the first two stages of processing, the form is tested for data elements or fields at the record level. If a mandatory data element is missing, such as the name of the filer, the filer's identifying number (e.g., Global Intermediary Identification Number), the name of account holder, the account holder's T.I.N., etc., the case is handled as a record-level error. Nonetheless, the file is accepted, and the I.R.S. will issue a notification to the filer regarding any failure relating to mandatory data elements.

However, it appears that not all record-level errors get resolved. For example, the calendar years 2014 and 2015 were regarded as a transition period, during which the I.R.S. did not treat a missing T.I.N. as an error. In addition, Model 1 I.G.A. F.F.I.'s were not required to obtain and report T.I.N.'s related to certain preexisting U.S.-owned accounts if the U.S. account holder's T.I.N. was not on record. These F.F.I.'s were given until January 1, 2017, to develop a rule to obtain T.I.N.'s for subsequent years. In September 2017, the Department of the Treasury and the I.R.S. noted that some reporting Model 1 I.G.A. F.F.I.'s needed additional time to implement procedures to obtain and report the required T.I.N.'s. As a result, Model 1 I.G.A. jurisdictions will be considered compliant for the calendar years 2017, 2018, and 2019.

Recommendation #1: T.I.G.T.A. recommends the I.R.S. establish follow-up procedures and initiate actions to address error notices related to file submissions rejected at the early stages, to ensure that non-I.G.A. F.F.I.'s and Model 2 I.G.A. F.F.I.'s submit F.A.T.C.A. reports properly, and to address unresolved record-level errors to ensure that the F.F.I.'s correctly provide data for mandatory fields.

I.R.S. Response: The I.R.S. agreed with this recommendation and will establish a compliance initiative to address error notices and unresolved record-level errors,



² Files containing Form 8966 records are processed first through the International Data Exchange Service ("I.D.E.S.") and then through the International Compliance Management Model ("I.C.M.M.").

including follow-up procedures, to improve the accuracy of data in F.A.T.C.A. reports.

Missing Forms 8938

A penalty for failing to file Forms 8938 may be assessed on specified domestic entities or individuals. Thus far, there has not been a penalty assessment against specified domestic entities, as the filing requirement began after December 31, 2015. However, the I.R.S. has indicated that, between October 1, 2016, and September 30, 2017, 75 failure-to-file Form 8938 penalty assessments were made on individuals. These penalties totaled \$1,180,000, of which \$660,000 was initial penalties and \$520,000 was continuation penalties. These penalties were asserted through the normal examination process. The I.R.S. noted that some taxpayers may have submitted delinquent or incomplete/incorrect Forms 8938 as part of the Streamlined Program or Offshore Voluntary Disclosure Program.

Recommendation #2: T.I.G.T.A. recommends the I.R.S. initiate compliance efforts to address taxpayers who did not file a Form 8938 but who were reported on a Form 8966 filed by an F.F.I.

I.R.S. Response: The I.R.S. agreed with this recommendation and will continue its efforts to systemically match Form 8966 and Form 8938 data to identify non-filers and underreporting related to U.S. holders of foreign accounts and to F.F.I.'s. The I.R.S. has initiated development of a data product to automate risk assessments across the F.A.T.C.A. filing population.

Thus far, the I.R.S.' efforts to match information between these forms have been significantly hindered, primarily due to the absence of T.I.N.'s on a high volume of Forms 8966 filed during the transition period.

Global Intermediary Identification Numbers

For the 2016 tax year, Form 8938 was updated to include a Global Intermediary Identification Number; the I.R.S. believes that this will help match records with missing T.I.N.'s. However, at this stage, the information on the Form 8938 is still optional, as requiring the Global Intermediary Identification Number would place a potential burden on taxpayers.

Recommendation #3: T.I.G.T.A. recommends the I.R.S. reduce the burden on taxpayers when locating a Global Intermediary Identification Number for an F.F.I.

I.R.S. Response: The I.R.S. agreed with this recommendation and will update Form 8938 instructions to provide a search tool for identifying an F.F.I.'s Global Intermediary Identification Number.

Missing Forms 8966

As of November 1, 2017, there were 293,030 F.F.I.'s registered and approved to participate in the F.A.T.C.A. program. Out of these, only 104,692 F.F.I.'s have filed Forms 8966. This is possibly due to the fact that certain F.F.I.'s do not have to file Form 8966 if the thresholds are not met.

Recommendation #4: T.I.G.T.A. recommends the I.R.S. initiate compliance efforts to address and correct missing or invalid T.I.N.'s on Form 8966 filings by non-I.G.A. F.F.I.'s and Model 2 I.G.A. F.F.I.'s.

“T.I.N. accuracy is critical in granting a credit to a taxpayer based upon Form 1042-S withholding.”

I.R.S. Response: The I.R.S. disagreed with this recommendation as such a system would be cost prohibitive and the steps taken under Recommendation 1 would address the issue.

Form 1042-S Filings

When issuing a refund to the taxpayer, the I.R.S. must match the withholding agent’s and recipient’s copies of Form 1042-S. If the taxpayer does not provide all the required forms, the I.R.S. will communicate with the taxpayer to obtain the information. The I.R.S. follows the same procedure if there is a mathematical error on the return filed by the taxpayer. At this stage, the I.R.S. does not have a tally of the number of refunds denied to taxpayers.

The Compliance Initiative Project, relating to Chapter 3 and Chapter 4 withholding, was replaced by the “Form 1120-F Withholding” campaign.³ This campaign will focus on verifying that, for every Form 1042-S on which the taxpayer claims a credit, a corresponding Form 1042-S has been filed by the withholding agent. The campaign does not include reconciling withholding agent filings and deposits, as the I.R.S. has decided it would be better to address withholding agent compliance in a separate campaign. The “Form 1042/1042-S Compliance” campaign will address filing inconsistencies through several filters, including Forms 1042-S that do not have a corresponding Form 1042 and insufficient deposits by withholding agents.

T.I.G.T.A. observed that 66% of the Form 1042-S documents received for the tax year 2014 did not have a valid T.I.N. and 88% of the Form 1042-S documents received for the tax year 2015 did not have a valid T.I.N. In the tax year 2015, 62,398 Forms 1042-S with invalid T.I.N.’s reported more than \$717 million in U.S.-source income, of which just over \$47 million was withheld.

Recommendation #5: Expand compliance efforts to address and correct invalid T.I.N.’s on all Form 1042-S filings by non-I.G.A. F.F.I.’s and Model 2 I.G.A. F.F.I.’s.

I.R.S. Response: The I.R.S. agreed with this recommendation to the extent that it will strengthen overall compliance efforts directed toward improving the accuracy of reporting by Form 1042-S filers. The I.R.S. already initiated compliance initiatives that address invalid T.I.N.’s on Forms 1042-S filed by non-I.G.A. F.F.I.’s and Model 2 I.G.A. F.F.I.’s. Specifically, the “Verification of Form 1042-S Credit Claimed on Form 1040NR” campaign matches credits claimed on Form 1042-S with Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, and the “Form 1120F Chapter 3 and Chapter 4 Withholding” campaign matches the credits claimed on Forms 1042-S with the Form 1120-F. In addition, the upcoming “Withholding Agent Compliance” campaign (which has not yet been publicly announced) will match Form 1042 with Form 1042-S and will include proper withholding rates.

Further, the I.R.S. stated that T.I.N. accuracy does not have an effect on revenue collection if withholding occurs at the correct rate. However, T.I.N. accuracy is critical in granting a credit to a taxpayer based upon Form 1042-S withholding.

Form 1099 Filings

F.A.T.C.A. requires information reporting on transactions for which F.F.I.’s may

³ Form 1120-F is filed to obtain refund on the withholding that is reported on Form 1042-S.

already be issuing Form 1099 series information returns. F.F.I.'s may elect to comply with the F.A.T.C.A. Form 8966 reporting requirements by continuing to file Forms 1099 through enhanced Form 1099 reporting.

Recommendation #6: T.I.G.T.A. recommends the I.R.S. initiate compliance efforts to compare Form 1099 filings with valid T.I.N.'s to corresponding Form 8938 filings to identify non-filers or mismatches in reporting of foreign financial assets.

I.R.S. Response: The I.R.S. disagreed with this recommendation. In their response, I.R.S. management stated that they have already assessed the risks associated with Forms 1099 filed by F.F.I.'s and determined the risk was minimal. The number of forms filed relative to Forms 8966 was very low once a significant 2015 filing error was identified and corrected.

Furthermore, the I.R.S. stated that T.I.N. accuracy does not have an effect on revenue collection if withholding occurs at the correct rate. However, T.I.N. accuracy is critical in granting a credit to a taxpayer based upon Form 1099 withholding.

CONCLUSION

It has been eight years since F.A.T.C.A. was enacted. The compliance program is still ongoing, and its real impact is not entirely clear at this time. Delays in implementing F.A.T.C.A. compliance should not be interpreted as an opportunity for taxpayers to remain non-compliant. Taxpayers should take this opportunity to obtain all the necessary information to come into compliance.

In the near future, Model 2 I.G.A. jurisdictions should expect first stage error follow-up similar to that available in Model 1 I.G.A. jurisdictions.

The I.R.S. may delay matching Forms 8938 and Forms 8966 due to missing T.I.N.'s, but it has implemented Global Intermediary Identification Number requirements on Form 8938 regardless. At this stage, including a Global Intermediary Identification Number on the form is merely advised. However, once the I.R.S. makes Global Intermediary Identification Numbers readily available on their website, their inclusion is expected to be mandatory.

The I.R.S. is not expected to match information on Forms 1042 with that on Forms 1042-S, as inaccuracies between these forms do not affect revenue collection. Taxpayers should make sure that the correct Form 1042 was filed by the withholding agent to avoid delays in the refund process.

Delays in implementing F.A.T.C.A. compliance should not be interpreted as an opportunity for taxpayers to remain non-compliant. Taxpayers should take this time to obtain all the necessary information to come into compliance.