



*Additional Actions Are Needed to Help
Ensure Taxpayer Compliance With the
Foreign Investment in Real Property Tax Act*

September 3, 2014

Reference Number: 2014-30-051

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

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

Highlights

Final Report issued on September 3, 2014

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

IMPACT ON TAXPAYERS

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

WHY TIGTA DID THE AUDIT

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

WHAT TIGTA FOUND

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

foreign seller real estate transactions comply with the FIRPTA.

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

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

WHAT TIGTA RECOMMENDED

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

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



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 3, 2014

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 - Additional Actions Are Needed to Help Ensure
Taxpayer Compliance With the Foreign Investment in Real Property
Tax Act (Audit # 201230022)

This report presents the results of our review to determine the effectiveness of the Internal Revenue Service's (IRS) efforts to ensure taxpayer compliance related to the disposition of foreign investments in U.S. real property. This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenges of *Globalization* and *Fraudulent Claims and Improper Payments*.

Management's complete response to the draft report is included as Appendix IX.

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 Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Abbreviations

FIRPTA	Foreign Investment in Real Property Tax Act of 1980
IDRS	Integrated Data Retrieval System
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
LB&I	Large Business and International
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
W&I	Wage and Investment



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Background

Prior to 1980, sales of real property in the United States by a foreign person generally had no tax consequences unless the ownership of the property constituted a trade or business, or the property was used in a trade or business.

Congress passed the Foreign Investment in Real Property Tax Act of 1980¹ (FIRPTA), which added Internal Revenue Code² (I.R.C.) Section (§) 897, to provide Federal tax rules for the sale of U.S. real property by a foreign person.³ This law extended the U.S. capital gains tax to sales of U.S. real property held by a foreign person either directly as a passive investment or through a domestic corporation.

***FIRPTA imposed taxes on gains
from the sale of U.S. real estate
by foreign persons.***

Congress subsequently passed the Deficit Reduction Act of 1984,⁴ which added I.R.C. § 1445, to require a withholding tax on the sale of U.S. real property by foreign sellers. The purpose was to impose a withholding tax on the anticipated taxes due on any capital gain from the sale of a U.S. real property interest by a foreign seller. This is generally the only way the Internal Revenue Service (IRS) has to ensure the collection of these taxes. Once the foreign seller and the sale proceeds leave the United States, it is often difficult for the IRS to enforce collection of any delinquent taxes due. When this happens, the foreign sellers may be able to evade payment of taxes.

The IRS is responsible for enforcing these laws and ensuring that the disposition of real property by foreign sellers is properly reported and the withholding is paid. However, the IRS must rely on self-reporting and voluntary compliance in its enforcement efforts. As specified in the law, the buyer (either domestic or foreign) of a U.S. real property interest from a foreign seller is responsible for determining if the FIRPTA applies, filing the required forms, withholding a portion of the sales proceeds, and remitting the withheld amount to the IRS. However, buyers are dependent on the foreign sellers disclosing that they are subject to the FIRPTA. If the foreign seller is not truthful about being subject to the FIRPTA, the buyer could still be held liable for the FIRPTA tax if it is not withheld. Although a third party, such as a settlement agent⁵

¹ Enacted as Subtitle C of Title XI (the Revenue Adjustments Act of 1980) of the Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, 94 Stat. 2599, 2682 (Dec. 5, 1980).

² See Appendix VIII for a glossary of terms.

³ For purposes of the FIRPTA, a foreign person is defined as a nonresident alien individual (someone who is not a U.S. citizen and either does not have a green card or does not meet the substantial presence test), a foreign corporation, a foreign partnership, a foreign trust, or a foreign estate. For the purposes of this report, the term “foreign seller” is used to encompass all those subject to the law.

⁴ Tax Reform Act of 1984, Pub. L. No. 98-369 § 129, 98 Stat. 494, 655.

⁵ Settlement agents, such as title and/or escrow companies, are typically responsible for ensuring that all of the terms of the real estate sales contract are met and that all parties involved in the transaction get paid what they are due.



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involved in the real estate transaction, may assist in determining if the FIRPTA laws apply, the third party would be held liable only if it knowingly provided false information to the buyer that the FIRPTA laws would not apply.

There are two tax forms used for reporting and paying the FIRPTA withholding related to the disposition of U.S. real property interests by foreign sellers. The FIRPTA withholding is to be reported and remitted using Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Property Interests*, which is required to be filed by the 20th day after the real estate ownership is transferred. During Tax Year 2012, buyers filed 7,747 Forms 8288 remitting approximately \$473 million in FIRPTA withholding to the IRS.⁶ A Form 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Property Interests*, is also required to be attached to Form 8288 for each seller listed on the real estate deed.

Generally, the buyer is required to withhold 10 percent of the amount realized on the sale of property by the foreign seller.⁷ There are a number of exceptions from the FIRPTA withholding requirements, which include:

- The buyer acquires the property for use as a home and the amount realized (generally the sales price) is not more than \$300,000. The buyer or a member of his or her family must have definite plans to reside at the property for at least 50 percent of the number of days during each of the first two 12-month periods following the date of ownership transfer.
- The foreign seller provides the buyer with an affidavit indicating that the seller is not subject to the FIRPTA filing requirements.

In certain circumstances, such as the property selling for a loss, either the buyer or the foreign seller can apply for reduced FIRPTA withholding by submitting Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*, no later than the date of the property transferring ownership.⁸ A foreign seller that applies for a withholding certificate must notify the buyer in writing that the certificate has been applied for on the day of or prior to the transfer of the property ownership. The buyer is not required to remit the funds withheld to the IRS until the IRS's determination is made. The IRS generally provides a Form 8288-B determination letter (*i.e.*, a withholding certificate) within 90 days of the date the Form 8288-B is received. If the IRS approves the request for reduced withholding and no amount of FIRPTA withholding is required, the buyer does not have to file the Forms

⁶ Appendix V contains information on the number of Forms 8288 filed and the amount of FIRPTA withholding reported during Tax Years 2008 through 2012.

⁷ A foreign corporation that distributes a U.S. real property interest must withhold a tax equal to 35 percent of the gain it recognizes on the distribution to its shareholders.

⁸ A formal letter containing the same information on the Form 8288-B may also be used, although the use of Form 8288-B expedites the application process.



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8288 and 8288-A. If the request is denied or approved for reduced withholding, the Forms 8288 and 8288-A are due 20 days after the IRS's determination.⁹

The FIRPTA withholding serves as an incentive for the foreign seller to file a U.S. income tax return¹⁰ reporting the sale of the real estate because the foreign seller can claim a refundable FIRPTA withholding credit (hereafter referred to as a FIRPTA credit) up to the amount withheld by the buyer. These tax returns are usually filed in the year following the sale of the property. The Wage and Investment (W&I) Division verifies FIRPTA credits claimed on U.S. income tax returns filed by foreign sellers against information in the FIRPTA Database to ensure that the Forms 8288 and 8288-A were filed by the buyer and that the FIRPTA withholding was remitted to the IRS. If the tax liability is less than the amount of the FIRPTA credit, the foreign seller gets a refund of the difference. If the foreign seller does not file a tax return claiming the FIRPTA credit, the amount becomes revenue for the United States.¹¹

The Large Business and International (LB&I) Division provides oversight of FIRPTA withholding tax matters, with an emphasis on Service-wide coordination of technical issues, compliance, and processing. The W&I Division is responsible for processing Forms 8288, 8288-A, and related withholding payments; making determinations on Form 8288-B reduced withholding requests; verifying and processing FIRPTA credits claimed on Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, and 1120-F, *U.S. Income Tax Return of a Foreign Corporation*, for withholding that was paid; and responding to buyer or seller inquiries related to the FIRPTA.

This review was performed at the W&I Division's Submission Processing and Accounts Management functions in Ogden, Utah, with additional information obtained from the LB&I Division's Foreign Payments and International Information Reporting Program. This audit was conducted during the period August 2012 through December 2013. 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.

⁹ Appendix VI contains information on the number of Forms 8288-B requests filed and the number approved during Tax Years 2008 through 2012.

¹⁰ Most U.S. income tax returns filed by foreign sellers reporting real estate transaction are Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1120-F, *U.S. Income Tax Return of a Foreign Corporation*.

¹¹ Appendix VII contains the results of our analysis of foreign sellers that filed income tax returns and the FIRPTA credits claimed.



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Results of Review

The IRS cannot identify all foreign seller real estate transactions subject to the FIRPTA and determine whether they are in compliance with the requirements of the law. Changes in the law and associated regulations could help to improve the IRS's ability to effectively administer the FIRPTA. Internal control weaknesses in processing withholding payments submitted with Forms 8288 and FIRPTA credits claimed by foreign sellers on their income tax returns resulted in the issuance of erroneous refunds. In addition, some buyers that properly filed Forms 8288 received erroneous balance due notices when the FIRPTA withholding payments submitted with the forms were incorrectly processed to their tax accounts. Further, the IRS did not always take the necessary steps to ensure that buyers filed Forms 8288 and paid the FIRPTA withholding tax after Form 8288-B determinations.

There Are Some Barriers to Effective Enforcement of the Foreign Investment in Real Property Tax Act

IRS management cannot provide assurance that foreign sellers subject to the FIRPTA are in compliance because they have been unsuccessful in their attempts to identify transactions that are subject to the law. Our analysis of Form 1099-S, *Proceeds From Real Estate Transactions*, data indicates that there may be significant noncompliance with the FIRPTA filing and payment requirements.

Changes to the law and associated regulations could help improve the IRS's ability to administer the FIRPTA

The intent of the FIRPTA is to ensure that foreign sellers of U.S. real estate pay income taxes on any gains resulting from the sale of the property. However, under existing law, it is difficult for the IRS to ensure that many of the real estate transactions involving foreign sellers are in compliance with the FIRPTA.

When the FIRPTA was first enacted, it did not include a provision that required withholding on the sale proceeds of real estate from a foreign seller because Congress was concerned about protecting withholding agents who might not know that a seller was a foreign person. However, because of subsequent concerns that the FIRPTA was being easily evaded, a provision in the Deficit Reduction Act of 1984 made the buyer in a real estate transaction responsible for withholding on the sale of real estate from foreign sellers.

Because of this change in the law, the responsibility for determining and reporting whether the real estate transaction is subject to the FIRPTA fell to the buyer. Buyers of real estate can also be held liable for the FIRPTA withholding tax even if they do not realize that the seller is



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foreign. Figure 1 details the filing and payment responsibilities of the parties involved in a U.S. real estate transaction involving a foreign seller.

Figure 1: Responsibilities of Parties Involved in a U.S. Real Estate Transaction With a Foreign Seller (X = party is responsible)

Responsibility	Foreign Seller	Buyer	Settlement Agent
Determining if the FIRPTA applies.		X	
Filing Forms 8288 and 8288-A with the IRS.		X	
Withholding a portion of the sales proceeds and remitting it to the IRS.		X	
Filing a Form 8288-B requesting a reduction in FIRPTA withholding.	X	X	
Reporting the real estate transaction on a U.S. income tax return, claiming the FIRPTA credit, and paying any additional taxes due on the capital gain.	X		
Preparing and filing the Form 1099-S reporting the real estate transaction to the IRS.			X

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of responsibilities of parties involved in a U.S. real estate transaction with a foreign seller.

For many buyers, this may be the only real estate they purchase in their lifetime. As such, they may not have the necessary knowledge or expertise to ensure that a real estate transaction involving a foreign seller complies with the FIRPTA. Settlement agents, such as title and/or escrow companies, would be in a better position to facilitate the withholding and remittance of funds to the Federal Government as appropriate. For example, settlement agents, are generally responsible for the preparation of Forms 1099-S,¹² which are used to report real estate sales transactions to the IRS. All foreign sellers are subject to real estate transaction reporting regardless of FIRPTA withholding requirements unless they are exempted under the Form 1099-S reporting exceptions. These exceptions negate the requirement to file a Form 1099-S with the IRS and include the sale or exchange of a residence for \$250,000 or less (or \$500,000 or less if married) if the seller provides an acceptable written assurance that the

¹² Generally, the Form 1099-S is required to be filed with the IRS to report a real estate transaction that consists in whole or in part of the sale or exchange for money, indebtedness, property, or services of any present or future ownership interest including any residential, commercial, or industrial building. A foreign seller of real estate, who receives a Form 1099-S, may be subject to FIRPTA withholding requirements. However, FIRPTA withholding and Form 1099-S reporting are independent of each other.



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residence was the principal residence of the seller and the full amount of the gain on the sale is excludable from gross income.¹³

Affidavit of non-foreign status

The FIRPTA also contains exceptions from its reporting requirements that complicate the IRS's enforcement efforts. One of these exceptions allows the seller, under the penalty of perjury, to provide an affidavit¹⁴ to the buyer indicating that the seller is not a foreign person subject to the FIRPTA. This exempts the buyer from FIRPTA reporting as well as the withholding requirements. However, the buyer could still be held liable if he or she has actual knowledge that the affidavit the seller provided is false.

While I.R.C. § 1445 allows the Secretary of the Treasury to require the buyer through regulation to provide the affidavit, there is currently no requirement for buyers to always submit these affidavits to the IRS. When the IRS does not receive affidavit information, it cannot identify whether foreign sellers are circumventing the FIRPTA by improperly claiming that they are not subject to the law when, in fact, they are. Because the affidavits absolve the buyers of their FIRPTA reporting responsibilities, the IRS is not aware that these transactions may be subject to the FIRPTA. If these affidavits were all filed with the IRS, it would provide the IRS an opportunity to assess their validity, as well as test these transactions for FIRPTA compliance.

Properties purchased from a foreign seller for \$300,000 or less

Another exception to the FIRPTA reporting requirement is if the buyer acquires the property from a foreign seller for use as a home and the amount realized (generally the sales price) is not more than \$300,000. The buyer or a member of his or her family must have definite plans to reside at the property for at least 50 percent of the number of days during each of the first two 12-month periods following the date of ownership transfer. However, the buyer is not required to provide this information to the IRS. Even if this information was provided, the IRS would have difficulty verifying its accuracy because of the wording of this exception. For example, the requirement that the buyer must have "definite plans" to reside at the property is open to interpretation. Other than this exception, all other real estate sales transactions involving a foreign seller under this dollar criterion are subject to the FIRPTA.

Resident aliens

The FIRPTA also does not consider resident aliens to be foreign persons who are subject to the law. A resident alien, for purposes of the FIRPTA, includes a person who has been issued a "green card" or someone who meets the substantial presence test that requires a person to be present in the United States for a certain number of days in a year. Undocumented aliens who meet the substantial presence test are not subject to the FIRPTA.

¹³ If the residence is the principal residence of a foreign seller, the seller should meet the physical presence test and would not be subject to the FIRPTA withholding.

¹⁴ This affidavit is required to contain the seller's name, Taxpayer Identification Number, and home address.



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IRS efforts to independently identify transactions subject to the FIRPTA have generally been unsuccessful

To achieve voluntary compliance with the FIRPTA, the IRS primarily relies on its customer outreach to educate real estate professionals on FIRPTA filing requirements and self-reporting by buyers of real estate from foreign sellers. *****2*****

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Since the enactment of the FIRPTA, the IRS has made several efforts to obtain and use information from other Government agencies and the private sector to identify sales of U.S. property by foreign sellers that would be subject to the FIRPTA. The IRS's efforts to identify transactions subject to the FIRPTA have included:

- Contacting the U.S. Department of Commerce for assistance in identifying foreign sales of U.S. property. The Department of Commerce information did not identify property subject to the FIRPTA.
- Purchasing records from a private company that compiled information from real estate transactions. The IRS indicated that the data were not useful because they did not specifically indicate that a foreign person was the seller of the property.
- Obtaining U.S. Department of Agriculture data to identify foreign sellers of U.S. agricultural property. The IRS analyzed this data and determined that most of these transactions were in compliance with U.S. tax laws.
- Obtaining data from the U.S. Securities and Exchange Commission and analyzing it to identify foreign persons that had at least a 5-percent interest in a corporation. The IRS analyzed this data and determined that in many instances the foreign person was a resident alien and not subject to the FIRPTA.



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Form 1099-S data indicate potential noncompliance with the FIRPTA

Approximately 53 percent of the real estate sales reported on Forms 1099-S that we tested may not have properly complied with the FIRPTA. To identify potential noncompliance with FIRPTA filing requirements, we analyzed data from 6,631 Forms 1099-S that reported approximately \$1.6 billion in real estate transactions to the IRS during Tax Years 2009 through 2011 that met the following criteria that may indicate the real estate sale transaction involved a foreign seller:

- 3,818 Forms 1099-S in which the seller's Taxpayer Identification Number (TIN) was an Individual Taxpayer Identification Number (ITIN) requested by a nonresident alien.¹⁵
- 2,813 Forms 1099-S in which the seller's TIN was blank, but the seller had a foreign address.

We selected these transactions for testing because they were more likely to be subject to the FIRPTA. We compared the information from the Forms 1099-S to the FIRPTA Database to determine if a Form 8288, 8288-A, or 8288-B were filed and the FIRPTA withholding tax was paid. Our analysis determined that there could be potential noncompliance with the FIRPTA filing requirements. We reviewed the FIRPTA Database and could not find evidence that a Form 8288, 8288-A, or 8288-B were filed with the IRS for 53 percent of the real estate transactions that appear to involve a foreign seller. Figure 2 details the results of our testing, including those Forms 1099-S transactions that were not reported to the IRS with Forms 8288, 8288-A, or 8288-B.

¹⁵ We determined whether these ITINs were requested by nonresident aliens by comparing the Form 1099-S data to archived ITIN Database information maintained by TIGTA's Strategic Data Services Division and to an extract from the ITIN Real-Time System. We determined that an ITIN belonged to a nonresident alien by reviewing the reason the ITIN was requested. For example, if the ITIN was requested for FIRPTA purposes, we concluded that the ITIN was requested by a nonresident alien.



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Figure 2: Analysis of Form 1099-S Data for Tax Years 2009 Through 2011

	Seller's TIN Was a Nonresident Alien ITIN ¹⁶		Seller's TIN Was Blank and Address Was in a Foreign Country		Totals	
	Number of Forms 1099-S	Gross Amount of Proceeds (in millions)	Number of Forms 1099-S	Gross Amount of Proceeds (in millions)	Number of Forms 1099-S	Gross Amount of Proceeds (in millions)
1) Total Form 1099-S real estate transactions tested.	3,818 (100%)	\$1,126.8	2,813 (100%)	\$456.5	6,631 (100%)	\$1,583.3
2) Reported to the IRS (on Forms 8288, 8288-A, or 8288-B)	1,884 (49%)	\$780.3	1,218 (43%)	\$289.8	3,102 (47%)	\$1,070.1
3) Not reported to the IRS (on Forms 8288, 8288-A, or 8288-B)	1,934 (51%)	\$346.5	1,595 (57%)	\$166.7	3,529 (53%)	\$513.2

Source: TIGTA analysis of Tax Years 2009 through 2011 Form 1099-S data from the Information Returns Master File and the FIRPTA Database.

While our analysis identified potential noncompliance with the FIRPTA, it was time-consuming and labor intensive to perform. It would not be efficient for the IRS to use this approach and the Form 1099-S information in its current format to identify noncompliance. For example, the Form 1099-S does not contain an identifier, such as a checkbox, that would allow the IRS to easily identify that the transaction may be subject to the FIRPTA. In addition, the current Form 1099-S does not include buyer identifying information¹⁷ that would allow the IRS to effectively take enforcement action, because the buyer is currently responsible for filing Forms 8288 and 8288-A and is liable for withholding the FIRPTA tax from the foreign seller. Revisions to the Form 1099-S would be needed to ensure that information is provided which would allow the IRS to identify and pursue noncompliance with the FIRPTA.

¹⁶ We systemically matched the ITINs from Forms 1099-S to information on the FIRPTA Database and the Master File. If the ITIN was erroneously input into the FIRPTA Database or the Forms 8288, 8288-A, or 8288-B were filed by a different person, we would not have identified a match.

¹⁷ The current Form 1099-S contains the identifying information for the settlement agent that filed the information document; however, these third parties are not liable for withholding the FIRPTA tax or for remitting it to the IRS.



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Recommendations

The Commissioner, LB&I Division, should:

Recommendation 1: Revise Form 1099-S to include information that is necessary to identify transactions subject to the FIRPTA, along with the pertinent buyer identifying information that would allow the IRS to effectively enforce compliance with the current law.

Management's Response: The IRS agreed with this recommendation. The LB&I Division will work with Counsel, the Small Business/Self-Employed Division, the W&I Division, and the Information Technology organization to decide whether changes to Form 1099-S are feasible and when they could be implemented. The IRS stated that consideration will be given to budget, resources, priorities, and taxpayer burden, and noted that all tax form changes also require approval of the Office of Management and Budget.

Recommendation 2: Coordinate with the Department of the Treasury's Office of Tax Policy to consider establishing a regulation to require buyers to submit to the IRS all affidavits of non-foreign status related to U.S. real estate sales transactions.

Management's Response: The IRS disagreed with this recommendation. Although the IRS agreed that having such affidavits would provide critical information related to the FIRPTA, it believes that sufficient additional information can be obtained more efficiently, and with less taxpayer burden, through the potential revisions to Form 1099-S included in Recommendation 1 of this report.

Office of Audit Comment: Even if the IRS successfully implements the recommended changes to Form 1099-S, it would not identify all transactions that are subject to the FIRPTA because not all real estate transactions are subject to the Form 1099-S filing requirements. In addition to the principal residency exemption explained in this report, transactions in which the seller was a corporation are not subject to the Form 1099-S filing requirements. Requiring buyer submission of these affidavits to the IRS would help the IRS determine if the related transactions are in compliance with the FIRPTA. During the course of our audit, IRS officials expressed concerns about improper affidavits being used to circumvent FIRPTA requirements, as well as the difficulty in identifying the full extent of this problem. Given these concerns, we continue to believe that the IRS should follow through on this recommendation.

Legislative Recommendation

Recommendation 3: Coordinate with the Department of the Treasury's Office of Tax Policy to evaluate the feasibility of a legislative proposal to reduce the barriers to effective administration of the FIRPTA.



Weaknesses in Processing Controls Led to the Issuance of Erroneous Refunds and Balance Due Notices

[illegible]



Additional Actions Are Needed to Help Ensure Taxpayer Compliance With the Foreign Investment in Real Property Tax Act

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Our review of Master File information for 16,152 Forms 8288 filed during Tax Years 2010 through 2012 identified 509 tax accounts for which refunds were issued totaling \$60,564,542. We reviewed the 509 tax accounts and determined that in most instances the refunds were appropriate. However, our analysis identified that 32 (6.3 percent) of the 509 refunds totaling \$1,507,146 were erroneously issued to the buyer during Tax Years 2010 through 2012.

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*****2***** Figure 3 provides the reasons that the 32 erroneous refunds occurred.

Figure 3: Erroneous Refunds Issued As a Result of Form 8288 Processing Errors During Tax Years 2010 Through 2012

Reason for Issuance	Erroneous Refunds Issued	
	Number	Total Amount
FIRPTA withholding payments were not properly frozen when the required hold code or freeze code was not properly input.	29	\$1,496,966
FIRPTA withholding payments were erroneously posted twice or misapplied from other tax periods.	3	\$10,180
Totals	32	\$1,507,146

Source: TIGTA analysis of Form 8288 information on the Master File.

Fifteen of the 32 erroneous refunds from the buyers' tax accounts (totaling \$1,170,284) could not be delivered or were repaid, resulting in a net of \$336,862 in erroneous refunds. We provided the results of our analysis to the W&I Division officials and they agreed with our conclusions that these were all erroneous refunds. As a result, the IRS issued a Service-wide Electronic Research Program alert in May 2013 to remind Accounts Management function employees to always input the appropriate hold code on these accounts. In addition, the W&I Division used the erroneous refund procedures to try and recover the refunds that have not been repaid by the buyers and make any necessary corrective adjustments to the buyers' tax accounts. As a result, \$165,219 of the \$336,862 had been recovered as of the end of our fieldwork.

In addition, after the alert was issued in May 2013, the W&I Division reviewed eight instances in which the hold code was required and found that it was being properly applied to those buyers'



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accounts. While these early results are positive, the W&I Division should develop formalized procedures to periodically review refunds originating from buyer tax accounts to ensure that the internal controls to prevent erroneous refunds are working as intended.

Erroneous balance due notices were sent to buyers that timely filed the Form 8288 and properly paid the FIRPTA withholding

If the Form 8288 is not filed and/or the FIRPTA withholding payment is not paid to the IRS by the 20th day after the real estate ownership is transferred, the buyer is subject to penalty and interest charges. A balance due notice would be systemically generated and sent to the buyer if the Form 8288 or the FIRPTA withholding payment is not submitted timely.

If a Form 8288-B was filed to request reduced FIRPTA withholding but was denied by the IRS, the buyer is required to file the Form 8288 and remit the FIRPTA withholding by the 20th day after the day the IRS mails the determination letter.¹⁸ The buyer is instructed to attach the Form 8288-B determination letter to the Form 8288. When that occurs, the tax period is based on the date of the letter and the return due date for the Form 8288 should be adjusted on the Master File. For example, property scheduled to be sold on May 5, 2013, with a request for reduced FIRPTA withholding, has a determination letter dated June 3, 2013. The Form 8288 due date would now be June 23, 2013 (not May 25, 2013), and the filing tax period would be June 2013 instead of May 2013. The withholding paid with the return by June 23, 2013, should be applied to the June 2013 tax period. However, if the IRS incorrectly processed the withholding payment received in June 2013 to the May 2013 tax period, this would result in the erroneous assessment of penalties and interest and the issuance of a balance due notice to the buyer.

To determine if the withholding payments were correctly processed when the Form 8288 was filed, we reviewed a statistical stratified random sample of 146 Forms 8288 and 8288-B¹⁹ from the total 11,947 Forms 8288 and 8288-B filed during Tax Year 2012. We identified 19 instances (13 percent) in which interest and penalties totaling approximately \$44,200 were erroneously assessed after the Form 8288 was filed, which resulted in the issuance of erroneous balance due notices to the buyers. The reasons that the 19 erroneous assessments occurred were:

- In 11 instances, the FIRPTA withholding payment was applied to the incorrect tax period, which was based on the original date the property transferred ownership and not the date of the Form 8288-B determination letter (which was a later tax period).

¹⁸ A Form 8288 is not required to be filed if the IRS determined that no FIRPTA withholding was due. This would occur when evidence was provided with the Form 8288-B showing the real estate was sold for a loss.

¹⁹ The 146 consisted of 50 Forms 8288, 49 Forms 8288-B for which the reduced withholding was approved, and 47 Forms 8288-B for which the reduced withholding was denied. These were statistically valid random samples from Tax Year 2012 populations of 7,747 Forms 8288, 3,396 Forms 8288-B that were approved, and 804 Forms 8288-B that were denied.



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- In seven instances, the FIRPTA withholding payments were not timely posted to the correct tax account or were originally posted to an incorrect tax period after the Forms 8288 were filed. In all seven instances identified, the FIRPTA Database showed that the FIRPTA withholding was submitted with the Form 8288.
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The IRS has information on the FIRPTA Database that may ensure that most FIRPTA withholding payments are correctly processed, thus preventing erroneous penalty and interest assessments to Form 8288 tax accounts. For example, the FIRPTA Database contains information indicating whether a Form 8288-B was filed that would provide the date of the determination letter, which is used to determine the adjusted due date of the Form 8288 and the correct tax period if the IRS determination was completed. A review of this information in the FIRPTA Database could help ensure that the FIRPTA withholding is applied correctly to buyers' tax accounts.

Based on the results of our statistical sample, we estimate that a total of 1,446 incorrect balance due notices containing \$1,048,110 in erroneous penalty and interest assessments²⁰ were issued to buyers during Tax Year 2012. When the sample is forecast over five years, we estimate that 7,230 in incorrect notices containing \$5,240,550 in erroneous penalty and interest assessments could be sent.²¹ The issuance of erroneous balance due notices creates unnecessary taxpayer burden and additional work for the IRS in terms of mailing the notices, responding to taxpayers' inquiries, and reversing the erroneous penalties and interest from the taxpayers' accounts as well as processing and refunding any additional payments made by the buyer as a result of the notices. It is important that the IRS take steps to prevent the issuance of erroneous balance due notices to buyers who timely file Form 8288 and properly remit FIRTPA withholding to the IRS.

Controls need to be strengthened to ensure that FIRPTA credits applied to foreign sellers' tax accounts are proper

The IRS does not have effective controls to ensure that foreign sellers receive only the credits to which they are entitled. These weak controls resulted in the issuance of erroneous refunds to some foreign sellers.

Foreign sellers can claim a FIRPTA credit in the amount of sale proceeds withheld by the buyer and remitted to the IRS when they file a U.S. income tax return reporting the sale of real estate.

²⁰ We are 90 percent confident that the number of incorrect collection notices range from 784 to 2,109 and the amount of erroneous penalty and interest assessments range from \$229,442 to \$1,866,788.

²¹ See Appendix IV. The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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If the sale of real estate did not result in a capital gain, the foreign seller would be entitled to a full refund of the FIRPTA withholding absent any other tax obligations.

W&I Division officials stated that all FIRPTA credits claimed on income tax returns filed by foreign sellers are required to be verified against information in the FIRPTA Database to ensure that the Forms 8288 and 8288-A were filed by the buyer and that the FIRPTA withholding was remitted to the IRS. This is a manual verification process conducted by W&I Division personnel on a case-by-case basis when a tax return filed by a foreign seller claims the FIRPTA credit. According to IRS policy, claims for FIRPTA credits should be denied if they cannot be verified by information in the FIRPTA Database. However, for situations in which the foreign seller claims the FIRPTA credit by providing supporting documentation²² that the FIRPTA withholding was actually withheld but not remitted by the buyer, a Form 8288-A record must be established in the FIRPTA Database. The FIRPTA credits claimed on tax returns are verified by tax examiners from the W&I Division's Submission Processing function at the Austin Campus for Forms 1040NR and at the Ogden Campus for Forms 1120-F. In addition, customer service representatives from the IRS's Accounts Management function at the Cincinnati and Philadelphia Campuses respond to buyer and foreign seller inquiries and are also authorized to process claims for FIRPTA credits.

Foreign sellers received FIRPTA credits they were not entitled to, resulting in the issuance of erroneous refunds

We identified a total of 14 foreign sellers that received \$681,829 in FIRPTA credits to which they were not entitled. This resulted in the issuance of \$572,409 in erroneous refunds to the foreign sellers.

We compared 18,786 FIRPTA credits applied to individual foreign seller tax accounts on the Master File during Processing Years 2009 through 2012 to the credits claimed on their related Forms 1040NR and to information on the FIRPTA Database. We identified nine instances in which individual foreign sellers received \$212,058 in FIRPTA credits for which they were not entitled, resulting in the issuance of \$211,031 in erroneous refunds.

- In eight instances, FIRPTA credits that the individual foreign sellers were not entitled to were processed and applied to the foreign sellers' tax accounts by customer service representatives at the Philadelphia Campus. Typically, the Austin and Ogden Campuses would process the first credit applied to the tax account when the Form 1040NR is initially received. The Philadelphia Campus would process all subsequent credits applied

²² IRS Chief Counsel Advisory 201028040, issued on July 16, 2010, instructed that the IRS can verify a FIRPTA credit for the foreign seller even though Forms 8288 and 8288-A have not been filed and the withholding was not paid by the buyer, as long as the foreign seller can provide supporting documentation (e.g., a settlement statement) showing that the FIRPTA withholding tax was withheld during the sale of the property. In these circumstances, the W&I Division's Submission Processing function is required to establish a nonfiler Form 8288-A record in the FIRPTA Database and provide supporting documentation to the applicable campus compliance functions to initiate collection of the FIRPTA withholding from the buyer.



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to the tax account. The W&I Division official stated that the issuance of these erroneous refunds could be the result of miscommunication between the customer service representatives at the Philadelphia Campus and tax examiners at the Austin Campus that process the claims for individual FIRPTA credits.

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In addition, we identified 318 FIRPTA credits claimed by business foreign sellers on their Tax Year 2011 or 2012 tax returns that the IRS verified on the FIRPTA Database. We compared the FIRPTA credits claimed to the Master File to determine if the credits were correctly processed.

- In four instances, business foreign sellers received \$361,378 in FIRPTA credits for which they were not entitled when the IRS incorrectly applied duplicate FIRPTA credits to their tax accounts. This resulted in the issuance of \$361,378 in erroneous refunds.
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In all five of these cases, these errors occurred because the FIRPTA credits were incorrectly applied to the business foreign sellers' Master File tax accounts due to inaccurate credit reference numbers.²³

We provided information on the 14 foreign sellers that received erroneous FIRPTA credits to W&I Division officials, and they agreed with our conclusions. They stated that they would review current procedures to ensure that they clearly instruct the customer service representative processing the foreign seller's claim for the FIRPTA credit and the tax examiner verifying the credit to communicate with each other to verify the total amount of FIRPTA credit available. They also stated that these cases were forwarded to the Ogden and Philadelphia Campuses for necessary corrections and recovery of the erroneous refunds. As a result, three erroneous refunds totaling \$342,250 from the total of \$572,409 issued had been recovered as of the end of our fieldwork.

²³ According to IRS guidance and W&I Division training manuals, once a FIRPTA credit has been verified, it is to be applied to the foreign seller's Master File tax account using Transaction Code 766 with Credit Reference Number 332. In these five instances, the credits were applied to the tax account with incorrect credit reference numbers. Credit reference numbers are important in that they distinguish between the types of credits applied to a Master File account.



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Our review of the 318 business FIRPTA credits claimed during Tax Years 2011 and 2012 also identified an additional 247 credits totaling \$62,459,649 that had incorrect credit reference numbers on the business foreign sellers' Master File tax accounts. While these errors did not result in the issuance of erroneous refunds because duplicate FIRPTA credits were not applied to the foreign seller's Master File tax account, credit reference numbers are important in that they provide information as to the type of credit and, in these cases, would be useful in helping IRS personnel identify whether the FIRPTA credits claimed by the foreign sellers are legitimate and available on the Master File.

Foreign sellers may have received erroneous FIRPTA credits without any evidence to validate their claims

We identified a total of 4,253 FIRPTA credits on the Master File claimed by individual foreign sellers that were processed by the IRS during Processing Year 2012. We matched these credits that the foreign sellers received to information on the FIRPTA Database to substantiate the claims for the FIRPTA credit. Our analysis found that 163 individual foreign sellers²⁴ may have received \$2,558,415 in erroneous FIRPTA credits that were applied to their tax accounts on the Master File but did not have corresponding evidence in the FIRPTA Database indicating that the foreign seller was entitled to receive the credit. When forecast over five years, we estimate that there would be 815 individual foreign sellers receiving \$12,792,075 in potentially erroneous credits as a result of the IRS allowing them to claim unsupported FIRPTA credits.²⁵

W&I Division officials advised us that this could have happened because the foreign seller's information (e.g., name or TIN) originally reported on the Form 8288 and 8288-A was incorrect or there was an IRS processing error when inputting the data. We agree that there may be instances in which the foreign seller's identifying information may have been incorrectly reported on Forms 8288 and 8288-A or incorrectly input into the FIRPTA Database that would have affected our ability to find any supporting evidence. However, if the W&I Division staff found evidence that would allow them to process the FIRPTA credit claimed on a tax return, then the FIRPTA Database should have been updated with this additional information at the time the claim was processed. Updating the information immediately could help alleviate processing errors that result in sellers receiving FIRPTA credits to which they are not entitled. For example, an erroneous refund could result when a foreign seller contacts a customer service representative at the Philadelphia Campus regarding a claim for the FIRPTA credit and the FIRPTA Database incorrectly shows that a credit has not been claimed and processed on the account.

Without stronger controls, the IRS is at risk of foreign sellers receiving more FIRPTA credits than they are entitled to receive. The IRS agreed and made revisions during this audit to the

²⁴ For all 163 foreign sellers, we manually compared their names and the addresses of the property sold to information on the FIRPTA Database. We also reviewed information on the Integrated Data Retrieval System to identify information that would allow us to verify the credit.

²⁵ See Appendix IV. The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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Internal Revenue Manual to strengthen the credit verification procedures. This includes requiring the review of information on the Integrated Data Retrieval System (IDRS) to verify any FIRPTA credits allowed during initial processing or any later adjustments. The IDRS information is then compared to information on the FIRPTA Database to determine the amount of allowable credits. If these revisions to the procedures are successfully implemented, they should help ensure that foreign sellers do not receive erroneous FIRPTA credits to which they are not entitled.

These various errors identified through our review of the FIRPTA credits also occurred in part because monitoring procedures were not effective in identifying internal control weaknesses and ensuring that claims for FIRPTA credits were correctly processed. W&I Division officials indicated that their procedures require that all tax account adjustments are reviewed to evaluate the quality of account actions; however, based on our results, it does not appear that these reviews were always effective.

FIRPTA credits not only have the potential to reduce a foreign seller's tax liability to zero, they also allow the foreign seller to receive a refund of any remaining credit amount. It is important that the IRS improve controls over the processing of FIRPTA credits to ensure that foreign sellers do not receive credits to which they are not entitled, resulting in the issuance of erroneous refunds.

Recommendations

The Commissioner, LB&I Division, should coordinate with the Commissioner, W&I Division, to:

Recommendation 4: Develop quality review procedures to periodically review refunds originating from buyer tax accounts and the processing of FIRPTA credits to provide assurance that internal controls are working as intended to prevent the issuance of erroneous refunds. This could be incorporated into the case reviews already being conducted by W&I Division managers.

Management's Response: The IRS agreed with this recommendation. The IRS will perform periodic reviews to ensure that internal controls are working as intended.

Recommendation 5: Develop procedures to reduce the risk that erroneous balance due notices are sent to buyers that timely filed the Form 8288 and remitted the FIRPTA withholding.

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate existing controls and determine where corrective actions can be implemented to most effectively prevent the issuance of erroneous balance due notices arising from timely filings of Form 8288.

Recommendation 6: Ensure that FIRPTA credits are applied to tax accounts with the correct credit reference number.



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Management's Response: The IRS agreed with this recommendation. The IRS stated that the cause of the erroneous credit reference numbers recorded when FIRPTA credits were posted was found to have been a programming error. The error caused duplicate credit reference number postings that resulted in some erroneous refunds. The Information Technology organization corrected the error. A second programming error, causing the posting of duplicate credits, was also identified and subsequently corrected. The IRS believes that the programming errors were the cause of the exception cases identified by our analysis and, with the corrections that were made, does not believe additional corrective actions are necessary to address this issue.

Office of Audit Comment: Because we were notified of these corrective actions after the conclusion of our review, we did not have the opportunity to evaluate the effectiveness of the programming changes in preventing these errors. However, if the programming changes were implemented as described by the IRS, we believe that the changes should correct the issue we identified.

The Internal Revenue Service Did Not Always Ensure Buyer Filing and Paying Compliance After a Withholding Determination Was Made on Form 8288-B

The IRS did not take the necessary actions to ensure that 200 buyers filed Form 8288 and paid the FIRPTA withholding after a determination was made on a submitted Form 8288-B. Our analysis of Calendar Year 2011 Form 8288-B data from the FIRPTA Database identified 587 Forms 8288-B for which a request for a reduction of FIRPTA withholding was denied and 522 Forms 8288-B for which a request for a reduced FIRPTA withholding amount was approved.

We compared the Form 8288-B data to the Form 8288 filing data from the FIRPTA Database, as well as the Master File, to determine if the buyers subsequently filed a Form 8288 and paid the FIRPTA withholding. We found that for 158 (26.9 percent) of the 587 Forms 8288-B that were denied and for 42 (8 percent) of the 522 Forms 8288-B that were approved for a lesser amount of FIRPTA withholding, no Forms 8288 were filed and no FIRPTA withholding was paid. As a result, 200 buyers did not properly withhold from the foreign sellers and remit \$8,956,060 in FIRPTA withholding to the IRS. When forecast over five years, we estimate that there would be 1,000 taxpayers that fail to properly file Form 8288, resulting in \$44,780,300 in FIRPTA withholding taxes not being paid.²⁶

Figure 4 shows the results of our analysis to determine if a Form 8288 was subsequently filed and the FIRPTA withholding was paid after the IRS made a Form 8288-B determination.

²⁶ See Appendix IV. The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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Figure 4: Analysis of Buyer Form 8288 Filing and Withholding Payment Compliance After a Form 8288-B Determination

Tax Year 2011	Population	Number of Forms 8288 Not Filed	Amount of FIRPTA Withholding Not Paid
Forms 8288-B FIRPTA withholding reduction denied.	587	158	\$8,651,422
Forms 8288-B FIRPTA withholding reduction approved.	522	42	\$304,638
Totals	1,109	200	\$8,956,060

Source: TIGTA analysis of FIRPTA Database and Master File data.

The IRS has a process to match the Forms 8288-B that were denied to the Forms 8288 that were filed to identify those buyers that did not subsequently file a Form 8288 after a request for reduced FIRPTA withholding was denied. A report is to be generated that identifies those instances in which a Form 8288 was not filed. W&I Division personnel are then required to follow up on this information to ensure buyer compliance with the FIRPTA. This includes sending a contact letter to the buyer indicating that the Form 8288 and the FIRPTA withholding were due and referring any applicable cases for examination. These steps are to be documented in the FIRPTA Database to ensure that the proper enforcement actions were taken. However, the IRS does not have a similar procedure to identify those buyers that did not file a Form 8288 after the Form 8288-B was approved for a reduced withholding amount.

We provided our results to IRS management, and they agreed with our conclusions. They discovered that the report needed to identify those buyers that did not file a Form 8288 after the Form 8288-B was denied was not generating. As a result, IRS personnel did not follow up with these buyers to ensure their compliance. In addition, a lack of procedures to follow up on Form 8288-B requests that were approved for a reduced withholding amount prevented the IRS from identifying buyer noncompliance in this area of the population. Without stronger monitoring and procedural controls, the IRS cannot ensure buyer compliance with Form 8288 filing and FIRPTA withholding payment requirements.

Recommendation

The Commissioner, LB&I Division, should coordinate with the Commissioner, W&I Division, to:

Recommendation 7: Establish a process to identify noncompliant buyers with Forms 8288-B approved for a reduced FIRPTA withholding amount. In addition, strengthen monitoring controls to ensure that the required reports are generated and that W&I Division personnel take



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the necessary actions to ensure buyer compliance with the FIRPTA after Form 8288-B withholding reduction requests are evaluated.

Management's Response: The IRS agreed with this recommendation. The IRS stated that the Accounts Management function is working with the Information Technology organization to restart the necessary report. They are taking steps to reinstate the reporting process and reviewing procedures to ensure that monitoring controls are effective in identifying necessary follow-up actions with regard to Forms 8288 and 8288-B compliance. Evaluation of the report output and procedural changes will occur through the close of Fiscal Year 2015.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine the effectiveness of the IRS's efforts in ensuring taxpayer compliance related to the disposition of foreign investments in U.S. real property. To accomplish our objective, we:

- I. Evaluated the controls related to the detection of noncompliance with FIRPTA requirements and the processing of the following forms by reviewing IRS policies and procedures and interviewing key LB&I and W&I Divisions personnel. Forms included:
 - A. Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, reporting the sale of real property by foreign persons subject to FIRPTA and remitting the FIRPTA withholding tax.
 - B. Form 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*, attached to Form 8288 for each seller listed on the real estate deed.
 - C. Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*, requesting reduced FIRPTA withholding.
 - D. Related tax return forms (*i.e.*, Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, and 1120-F, *U.S. Income Tax Return of a Foreign Corporation*) claiming FIRPTA tax withholding credits.
- II. Evaluated IRS case processing actions taken by W&I Division Accounts Management function¹ and Submission Processing function personnel when Forms 8288, 8288-A, and 8288-B were received.
 - A. Selected a judgmental sample² of 50 Forms 8288 with the associated Forms 8288-A from the population of 7,747 Forms 8288 filed during Tax Year 2012 according to information on the FIRPTA Database. We determined whether the Forms 8288 were properly processed by comparing the information on the forms to real estate information on the law enforcement Consolidated Lead Evaluation and Reporting Database and reviewing the information entered onto the FIRPTA Database. We used a judgmental sample because we were not projecting the review results.
 - B. Selected judgmental samples of 25 Forms 8288-B from the population of 3,396 that were approved for reduced withholding and 25 Forms 8288-B from the population of

¹ See Appendix VIII for a glossary of terms.

² A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.



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- 804 that were denied according to information on the FIRPTA Database. These Form 8288-B requests were all filed during Tax Year 2012. We determined whether the IRS's determinations on the Form 8288-B requests were correct by analyzing supporting documentation provided with the form. We used a judgmental sample because we were not projecting the review results.
- C. Selected a statistical stratified random sample of 146 Forms 8288 and 8288-B from the total of 11,947 filed during Tax Year 2012 according to the FIRPTA Database and, using the IDRS, determined whether the withholding payments were correctly processed when the Form 8288 was filed. We selected the sample using a confidence level of 90 percent, a precision rate of ± 7 percent, and an error rate of 10 percent. A statistical sample was taken because we wanted to estimate the number of erroneous collection notices issued to filers of Form 8288. We shared our sampling methodology with our contracted statistician, who confirmed the accuracy of our methodology.
 - D. Analyzed Master File information from TIGTA's Data Center Warehouse and identified a population of 509 Forms 8288 filed during Tax Years 2010 through 2012 with refunds issued totaling \$60,564,542 and, using the IDRS, determined whether the refunds were appropriate.
- III. Determined whether FIRPTA credits claimed by the foreign seller on Forms 1040NR or 1120-F were properly verified and processed by IRS personnel.
- A. Identified a total of 4,253 individual FIRPTA credits that were applied to Master File tax accounts during Processing Year 2012 from our analysis of data on TIGTA's Data Center Warehouse. We compared these 4,253 credits to data on the FIRPTA Database and Master File using the IDRS and determined whether the FIRPTA credits were properly supported with a Form 8288 withholding payment.
 - B. Identified a total of 318 business FIRPTA credits that were claimed by a foreign seller and verified by the IRS that the seller was entitled to the claim for Tax Year 2011 and 2012 business tax returns³ from the FIRPTA Database. We compared these 318 credits to Master File data extracted from TIGTA's Data Center Warehouse and by analyzing the IDRS and determined whether the credits were correctly processed.
 - C. Identified a total of 18,786 individual FIRPTA credits that were applied to Master File tax accounts during Processing Years 2009 through 2012. We compared these 18,786 credits to data on the Return Transaction File data extracted from TIGTA's

³ Although these credits are generally claimed on Form 1120-F, this category also includes FIRPTA credits claimed by partnerships on Form 8804, *Annual Return for Partnership Withholding*.



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Data Center Warehouse and to data on the FIRPTA Database and determined whether the credits applied to the accounts were correctly processed.

- IV. Evaluated the IRS's processes for identifying noncompliance with FIRPTA withholding and filing requirements.
- A. Identified a total of 587 Forms 8288-B that were denied and 522 Forms 8288-B that were approved but a reduced amount of FIRPTA withholding was still due. These Forms 8288-B were all filed during Tax Year 2011 according to the Form 8288-B request data from the FIRPTA Database. We compared information from the 1,109 Forms 8288-B to the Form 8288 filing data from the FIRPTA Database and determined whether a Form 8288 was filed and the FIRPTA withholding was paid.
 - B. Identified 6,631 Forms 1099-S, *Proceeds From Real Estate Transactions*, filed during Processing Years 2009 through 2011 from the Information Returns Master File. These Form 1099-S transactions were those for which the seller's TIN was an ITIN requested by a nonresident alien⁴ or the seller's TIN was blank and the seller had a foreign address. We compared the Forms 1099-S for which the seller's TIN was an ITIN requested by a nonresident alien by matching the ITIN on the form to the seller's ITIN on the FIRPTA Database to determine if a Form 8288 or 8288-B was filed. We compared the Forms 1099-S for which the seller's TIN was blank and the seller had a foreign address by comparing the seller's name and the address of the real estate purchased to information on the FIRPTA Database to determine whether a Form 8288 or 8288-B was filed.
 - C. Identified 3,482 Forms 8288-A for which the date of the property ownership transfer was Tax Year 2011 with a FIRPTA withholding amount of at least \$10,000 from the FIRPTA Database. We reviewed these records on the FIRPTA Database to determine if a tax return was filed claiming the FIRPTA credit. For those records indicating that a tax return was not filed claiming the FIRPTA credit but a foreign seller's TIN was present, we compared this information to Master File data to determine whether a tax return was filed by the foreign seller for Tax Year 2011.

Data validation methodology

During this review, we relied on data extracts from the IRS's Master File and the Return Transaction File located at 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 relied on data extracts from the IRS's Information Returns Master File that were

⁴ We determined if these ITINs were requested by nonresident aliens by comparing the Form 1099-S data to archived ITIN Database information maintained by TIGTA's Strategic Data Services Division and to an extract from the ITIN Real-Time System. We determined that an ITIN belonged to a nonresident alien based on reviewing the reason the ITIN was requested. For example, if the ITIN was requested for FIRPTA purposes, we concluded that the ITIN was requested by a nonresident alien.



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provided by the TIGTA Office of Investigations' Strategic Data Services and the FIRPTA Database provided by the IRS's Information Technology organization. Before relying on this data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured on the IRS's IDRS. As a result, we determined that the data used in our review were sufficiently reliable to perform our audit analyses.

We determined if ITINs were requested by nonresident aliens by analyzing archived ITIN Database information maintained by TIGTA's Strategic Data Services Division. However, we were informed that this information was used for specific investigative purposes, and while accurate, may not be complete for auditing purposes. As a result, there is a possibility that the number of exceptions may actually be higher in the population than we reported. We also relied on an extract from the ITIN Real-Time System provided by the Strategic Data Services Division. Before relying on this data, we selected random samples from both extracts and verified that the data were the same as the data captured on the IRS's IDRS. 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 the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices for identifying noncompliance with FIRPTA filing requirements; the processing of the Forms 8288, 8288-A, and 8288-B; and the processing of FIRPTA credits claimed on the income tax returns of foreign sellers. We evaluated these controls by interviewing key personnel, analyzing data, and reviewing policies and procedures.



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Appendix II

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Appendix III

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 Commissioner, Wage and Investment Division SE:W
Assistant Secretary of the Treasury for Tax Policy



Additional Actions Are Needed to Help Ensure Taxpayer Compliance With the Foreign Investment in Real Property Tax Act

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 1,446 taxpayers (*i.e.*, buyers) incorrectly issued balance due notices during Tax Year¹ 2012 containing \$1,048,110 in erroneous penalty and interest assessments, or 7,230 taxpayers incorrectly issued balance due notices containing \$5,240,550 in erroneous penalty and interest assessments when the sample is forecast over five years (see page 11).²

Methodology Used to Measure the Reported Benefit:

We reviewed a statistical stratified random sample of 146 Forms 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons*, and 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*,³ from the total of 11,947 Forms 8288 and 8288-B filed during Tax Year 2012. We identified 19 buyers (13 percent) for which interest and penalties totaling approximately \$44,200 were erroneously assessed after the Form 8288 was filed, which resulted in the issuance of erroneous balance due notices to the buyers.

To project our results, we used a stratified random sample of 146. Our analysis of the sample identified a total of 19 errors. The average error rate of incorrect balance due notices issued to buyers was determined to be 12.107 percent, and the average amount of erroneously assessed interest and penalties was \$87.73. Based on the error rates, we project the number of incorrect balance due notices issued during Tax Year 2012 was 1,446 (11,947 x 12.107 percent) and the amount of erroneous interest and penalty assessments was \$1,048,110 (11,947 x \$87.73).

¹ See Appendix VIII for a glossary of terms.

² The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.

³ The 146 consisted of 50 Forms 8288, 49 Forms 8288-B for which the reduced withholding was approved, and 47 Forms 8288-B for which the reduced withholding was denied. These were statistically valid random samples from Tax Year 2012 populations of 7,747 Forms 8288, 3,396 Forms 8288-B that were approved, and 804 Forms 8288-B that were denied.



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We also forecast that 7,230 (1,446 x 5) incorrect balance due notices could be issued to buyers with erroneous interest and penalty assessment of \$5,240,550 (\$1,048,110 x 5) over the next five years.⁴

Type and Value of Outcome Measure:

- Revenue Protection – Actual; 17 taxpayers (*e.g.*, buyers) received erroneous refunds totaling \$336,862 during Tax Years 2010 through 2012 in FIRPTA withholding payments (see page 11).

Methodology Used to Measure the Reported Benefit:

Our review of Master File information for 16,152 Forms 8288 filed during Tax Years 2010 through 2012 identified 509 buyers' tax accounts with refunds issued totaling \$60,564,542. We reviewed the 509 tax accounts and found that 32 of the refunds (6.3 percent) totaling \$1,507,146 were erroneously issued to the buyers during Tax Years 2010 through 2012. Fifteen of the erroneous refunds from the buyers' tax accounts totaling \$1,170,284 could not be delivered or were repaid, resulting in a net of \$336,862 in erroneous refunds.

Type and Value of Outcome Measure:

- Revenue Protection – Actual; 14 taxpayers (*i.e.*, foreign sellers) received \$681,829 in erroneous FIRPTA credits to which they were not entitled (see page 11).

Methodology Used to Measure the Reported Benefit:

We compared 18,786 FIRPTA credits applied to individual tax accounts on the Master File during Processing Years 2009 through 2012 to the FIRPTA withholding credits claimed on the related Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, and to information on the FIRPTA Database. We identified nine instances in which individual foreign sellers received \$212,058 in FIRPTA credits for which they were not entitled, resulting in the issuance of \$211,031 in erroneous refunds.

We also identified 318 business FIRPTA credits claimed by foreign sellers on their Tax Year 2011 or 2012 tax returns that the IRS verified on the FIRPTA Database. We compared the FIRPTA credits claimed to the Master File to determine if the credits were correctly processed. We identified four instances in which business foreign sellers received \$361,378 in FIRPTA credits for which they were not entitled, resulting in the issuance of \$361,378 in erroneous refunds.

⁴ The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



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In one other instance, a business foreign seller received a FIRPTA credit of \$108,393 for which they were not entitled; however, a potentially erroneous refund of \$108,393 was frozen prior to issuance because an unrelated examination of the taxpayer's tax return was initiated which froze the credit on the taxpayer's account. After we provided this information to the IRS, the erroneous FIRPTA credit was reversed.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 247 tax accounts on the Master File for which FIRPTA credits had incorrect credit reference numbers (see page 11).

Methodology Used to Measure the Reported Benefit:

We compared 318 FIRPTA credits claimed by business foreign sellers and processed by the IRS according to the FIRPTA Database for Tax Years 2011 and 2012 to the Master File. We identified 247 tax accounts on the Master File with FIRPTA credits totaling \$62,459,649 that had incorrect credit reference numbers.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; 163 taxpayers (*i.e.*, individual foreign sellers) received \$2,558,415 in erroneous FIRPTA credits. When forecast over five years, we estimate that 815 taxpayers will receive \$12,792,075 in erroneous FIRPTA credits (see page 11).⁵

Methodology Used to Measure the Reported Benefit:

We identified a total of 4,253 FIRPTA credits claimed by individual foreign sellers that were processed by the IRS during Processing Year 2012. We matched the credits the foreign sellers received to the information on the FIRPTA Database to substantiate their claims for the FIRPTA credit. Our analysis found that 163 individual foreign sellers⁶ may have received \$2,558,415 in erroneous FIRPTA credits that were applied to their tax accounts on the Master File but did not have corresponding evidence in the FIRPTA Database indicating that the foreign seller was entitled to the credit. When forecast over five years, we estimate that there would be 815 individual foreign sellers receiving \$12,792,075 in potentially erroneous credits as a result of the IRS allowing them to claim unsupported FIRPTA credits.

⁵ The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.

⁶ For all 163 foreign sellers, we manually compared their names and the addresses of the property sold to information on the FIRPTA Database. We also reviewed information on the IDRS to identify information that would allow us to verify the credit.



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Type and Value of Outcome Measure:

- Revenue Protection – Potential; 200 taxpayers (*i.e.*, buyers) that did not properly file Forms 8288 and remit \$8,956,060 in FIRPTA withholding to the IRS. When forecast over five years, we estimate that there would be 1,000 taxpayers that fail to properly file Form 8288, resulting in \$44,780,300 in FIRPTA withholding taxes not being paid (see page 19).⁷

Methodology Used to Measure the Reported Benefit:

Our analysis of Calendar Year 2011 Form 8288-B request data from the FIRPTA Database identified 587 Forms 8288-B for which a request for a reduction of FIRPTA withholding was denied and 522 Forms 8288-B for which a request for a reduced FIRPTA withholding amount was approved. We compared this data to the Forms 8288 filing data from the FIRPTA Database to determine if the buyers subsequently filed a Form 8288 and paid the FIRPTA withholding. We did not find evidence that buyers filed a Form 8288 for 158 of the 587 Forms 8288-B that were not approved and for which \$8,651,422 in withholding tax was due. We also did not find evidence that buyers filed a Form 8288 for 42 of the 522 Forms 8288-B that were approved but for which reduced FIRPTA withholding totaling \$304,638 was still owed. As a result, 200 buyers did not properly withhold from foreign sellers and remit \$8,956,060 in FIRPTA withholding to the IRS. When forecast over five years, we estimate that there would be 1,000 buyers that fail to properly file Form 8288, resulting in \$44,780,300 million in FIRPTA withholding taxes not being paid.

⁷ The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.



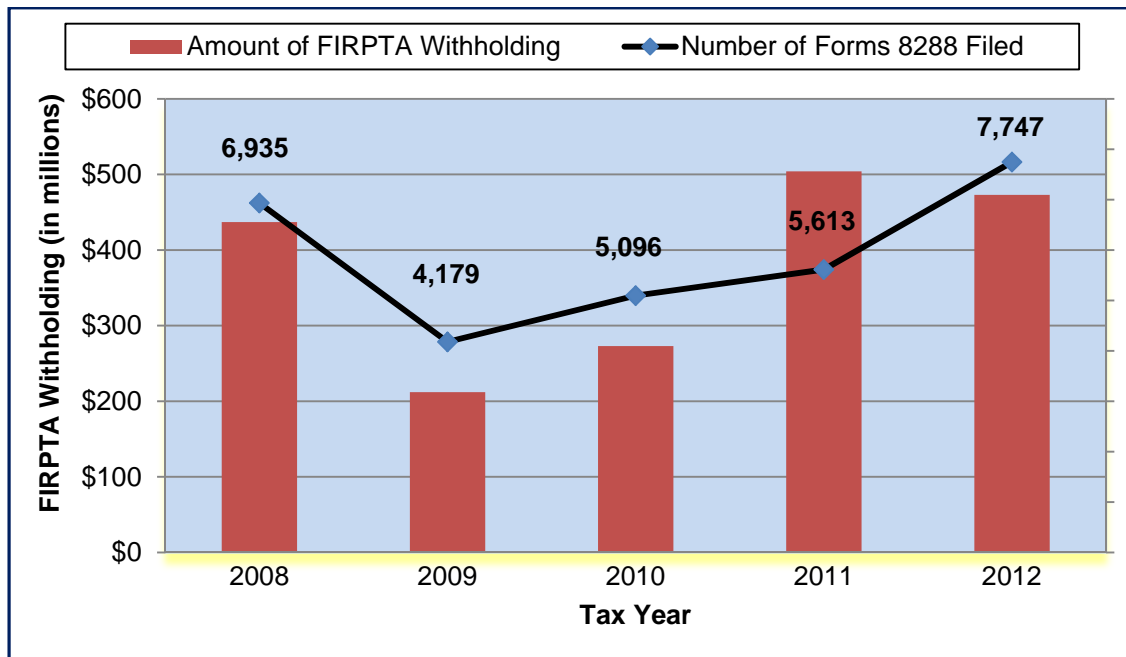
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Appendix V

Form 8288 and Foreign Investment in Real Property Tax Act Withholding Statistics

While the number of Form 8288, *U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests*, tax returns filed has increased, the amount of FIRPTA withholding remitted by buyers of U.S. properties from foreign sellers has decreased slightly in the past year. According to data in the IRS's FIRPTA Database,¹ a total of 7,747 Form 8288 tax returns were filed during Tax Year 2012, which represents a 38 percent increase from the prior tax year. In addition, the amount of FIRPTA withholding decreased by 6 percent from \$504 million in Tax Year 2011 to \$473 million in Tax Year 2012. Figure 1 shows the number of Forms 8288 filed and the amount of FIRPTA withholding reported during Tax Years 2008 through 2012.

Figure 1: Comparison of the Number of Forms 8288 to the Amount of FIRPTA Withholding During Tax Years 2008 Through 2012



Source: TIGTA analysis of the FIRPTA Database.

¹ See Appendix VIII for a glossary of terms.



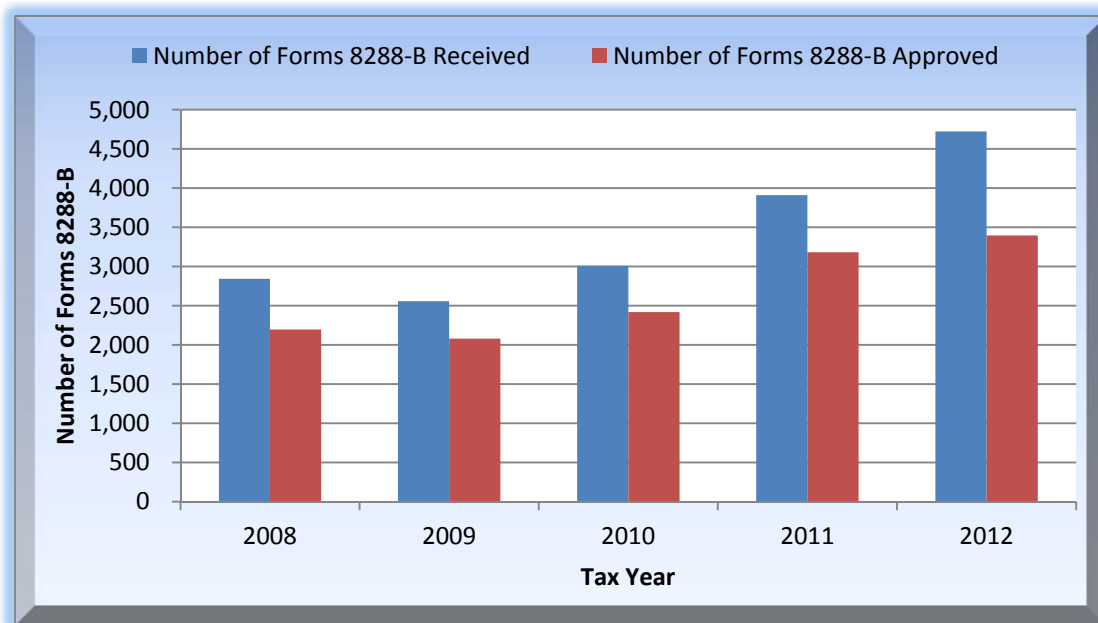
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Appendix VI

Form 8288-B Statistics

The number of Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*, determination requests filed has increased in recent years. There were a total of 4,723 requests during Tax Year¹ 2012, a 21 percent increase from the prior tax year. Figure 1 compares the number of Form 8288-B requests received to the number approved during Tax Years 2008 through 2012. During that period, about 80 percent of the requests were approved by the IRS granting either an exemption from or a reduction in FIRPTA withholding.

Figure 1: Comparison of the Number of Forms 8288-B Received to the Number Approved During Tax Years 2008 Through 2012



Source: TIGTA analysis of the FIRPTA Database.

¹ See Appendix VIII for a glossary of terms.



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Appendix VII

Income Tax Returns Filed by Foreign Sellers and Foreign Investment in Real Property Tax Act Credits Claimed¹

We conducted an analysis of 3,482 Forms 8288-A, *Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests*, for sales transacted in Tax Year² 2011³ for which the withholding tax paid was at least \$10,000 (we judgmentally selected this amount as representative of a large withholding) to determine if a Tax Year 2011 U.S. income tax return was filed by the foreign seller. The analysis showed that 71 percent of the 2,882 individual and 78 percent of the 600 business foreign sellers tested filed a tax return the following year to claim the FIRPTA credit. However, we did not find evidence that 982 foreign sellers filed a tax return reporting real estate transactions claiming the FIRPTA credit. This resulted in approximately \$60.7 million in revenue for the United States. Figure 1 provides additional details of our analysis of the 3,482 foreign sellers.

Figure 1: Analysis of Tax Year 2011 Income Tax Returns Filed for Which the FIRPTA Withholding Paid Was at Least \$10,000

	Individuals	FIRPTA Tax Paid (millions)	Businesses	FIRPTA Tax Paid (millions)	Total Tax Returns	Total FIRPTA Tax Paid (millions)
Forms 8288-A filed with the IRS during Tax Year 2011 for which the FIRPTA withholding was at least \$10,000.	2,882	\$147.7	600	\$192.4	3,482	\$340.1
Total Tax Year 2011 U.S. income tax returns not filed by the foreign seller resulting in the Tax Year 2011 FIRPTA withholding becoming revenue for the United States.	849 (29%)	\$40.0	133 (22%)	\$20.7	982 (28%)	\$60.7

Source: TIGTA analysis of the FIRPTA Database and Master File data.

¹ Information on this page was updated on 2/4/2015.

² See Appendix VIII for a glossary of terms.

³ We analyzed the Forms 8288-A filed during Tax Year 2011 because that allowed us to determine if Tax Year 2011 income tax returns were filed during Processing Year 2012.



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Appendix VIII

Glossary of Terms

Term	Definition
Accounts Management Function	This is the organization within the W&I Division responsible for taxpayer service by answering taxpayer tax law/account inquiries, providing information on the status of their tax returns/refunds, and resolving the majority of issues and questions to settle their tax accounts.
Campus	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.
Consolidated Lead Evaluation and Reporting Database	A commercial investigative platform designed for professionals who need information about people and companies, including real estate transactions.
Credit Reference Number	A three-digit number that distinguishes between the types of credits applied to a Master File tax account.
Data Center Warehouse	A collection of IRS databases containing various types of taxpayer accounts and IRS and TIGTA employee information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.
FIRPTA Database	<p>A computer application used for the processing, storage, and retrieval of the following forms:</p> <ul style="list-style-type: none"> • Form 8288, <i>U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests</i>. • Form 8288-A, <i>Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests</i>. • Form 8288-B, <i>Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests</i>. <p>This system is also used to send correspondence to the buyer if the Form 8288-A is incomplete.</p>
Hold Code	These codes are used to prevent or delay the issuance of a refund or notice, such as when a particular adjustment action or correction is being made to a tax account.



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Term	Definition
Individual Taxpayer Identification Number	A tax processing number issued by the IRS to individuals who are required to have a U.S. TIN but who do not have, and are not eligible to obtain, a Social Security Number from the Social Security Administration. Individuals who need an ITIN include U.S. resident aliens and nonresident aliens who are required to file U.S. income tax returns.
Information Returns Master File	IRS database that contains third-party information documents for taxpayers, such as Form W-2, <i>Wage and Tax Statement</i> , and Form SSA-1099, <i>Social Security Benefit Statement</i> .
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Internal Revenue Code	Federal tax law begins with the I.R.C., enacted by Congress in Title 26 of the U.S. Code. It is the main body of domestic statutory tax law of the United States organized topically, including laws covering the income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.
Internal Revenue Manual	Provides procedural guidance for IRS operations.
ITIN Database	IRS application processing system used to control and track applications for ITINs. This system was replaced by the ITIN Real-Time System in July 2006.
ITIN Real-Time System	A web-based application used by ITIN tax examiners to process and record applicant submissions. Tax examiners review all applications and attached documents, then input the information into the ITIN Real-Time System.
Master File	The IRS database that maintains transactions or records of tax accounts.
Nonresident Alien	Any individual who is not a U.S. citizen or U.S. national. A nonresident alien is an alien who has not passed the green card test or the substantial presence test.
Processing Year	The calendar year in which the tax return or related document is processed by the IRS.
Resident Alien	Any individual who is not a U.S. citizen or U.S. national. A resident alien is an alien who has passed either the green card test or the substantial presence test.



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Term	Definition
Return Transaction File	Contains data transcribed from initial input of the original tax returns during return processing.
Service-wide Electronic Research Program Alert	A Service-wide electronic research portal designed to provide employees from all IRS functions intranet access to the Internal Revenue Manual and other reference materials and to retrieve frequently referenced documents required to perform their jobs. The use of alerts is reserved for quick, need-to-know information that does not change the content of the Internal Revenue Manual.
Settlement Agent	An individual or firm responsible for completing the final stages of a sale (known as the “settlement”) between the buyer and seller. Settlement agents are usually responsible for facilitating payment from the buyer to the seller and transferring the real estate property from the seller to the buyer.
Social Security Number	In the United States, a Social Security Number is a nine-digit number issued to U.S. citizens, permanent residents, and temporary (working) residents by the Social Security Administration.
Strategic Data Services Division	The organization within the TIGTA that uses computer code to extract data from IRS systems not readily available to auditors.
Submission Processing Function	The data processing arm of the IRS that processes paper and electronic submissions, corrects errors, and forwards data to the Computing Centers for analysis and posting to taxpayer accounts.
Tax Period	The tax period corresponding to the filing of a Form 8288 is one month. For example, the filing of a Form 8288 received by the IRS in January 2013 would be reflected in the taxpayer’s record as 201301, a Form 8288 received in February 2013 would be recorded as 201302, and so on. There are 12 tax periods in one calendar year.
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.
Taxpayer Identification Number	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number, or an ITIN.
Transaction Code	A three-digit code used to identify a processed transaction and to maintain a history of actions posted to a taxpayer’s account on the Master File.



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Term	Definition
U.S. Department of Agriculture	The mission of the U.S. Department of Agriculture is to provide leadership on food, agriculture, natural resources, rural development, nutrition, and related issues based on sound public policy, the best available science, and efficient management. Foreign persons with 10 percent or more ownership in U.S. agricultural property are required to file the Form ASCS-153, <i>Agriculture Foreign Investment Disclosure Act Report</i> , with local Agricultural Stabilization and Conservation Service offices.
U.S. Department of Commerce	The mission of the U.S. Department of Commerce is to promote job creation, economic growth, sustainable development, and improved standards of living for all Americans by working in partnership with businesses, universities, communities, and our Nation's workers. According to the department, it impacts the daily lives of the American people in many ways, with a wide range of responsibilities in the areas of trade, economic development, technology, entrepreneurship and business development, environmental stewardship, and statistical research and analysis.
U.S. Real Property Interest	An interest in real property located in the United States or U.S. Virgin Islands.
U.S. Securities and Exchange Commission	The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. It requires public companies to disclose meaningful financial and other information to the public.



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Appendix IX

Management's Response to the Draft Report



COMMISSIONER
LARGE BUSINESS AND
INTERNATIONAL DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

August 11, 2014

MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *FOR* Heather Maloy *Douglas W. Donnell*
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report – Additional Actions Are Needed to Help Ensure Taxpayer Compliance with the Foreign Investment in Real Property Tax Act (Audit #201230022)

Thank you for the opportunity to review and provide comments on your draft report entitled, *Additional Actions Are Needed to Help Ensure Taxpayer Compliance with the Foreign Investment in Real Property Tax (FIRPTA) Act*. We appreciate your recommendations to address potential barriers and to improve our processes related to FIRPTA.

We agree that there are some barriers to effective enforcement of FIRPTA, and that improvements to our processing controls would help to ensure that erroneous refunds and balance due notices are not issued. We note that the focus of this audit was primarily on compliance with FIRPTA as it pertains to real estate transactions involving individuals, and while that represents a significant number of transactions, the FIRPTA compliance universe is also significantly impacted by real estate transactions involving businesses.

We note that Figure 2 of the draft report highlights potential noncompliance with FIRPTA based on an analysis performed using Form 1099-S (*Proceeds From Real Estate Transactions*) and Form 8288 (*U.S. Withholding Tax Return For Dispositions By Foreign Persons of U.S. Real Property Interests*) data. The report concludes that 53 percent of real estate transactions appearing to involve a foreign seller were not reported to the IRS. The report did not disclose potential reasons for this discrepancy, which may include valid exemptions which would not require reporting to the IRS. Accordingly, the percentage stated above may be overstated.

We agree with recommendations 1, 4, 5, and 7 in your report, we disagree with recommendations 2 and 3, and we believe we have already taken corrective actions to address recommendation 6. We have attached a detailed response outlining the corrective actions that the IRS has taken or will take to address your audit recommendations, or where applicable, our reasons for disagreement.



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If you have any questions, please contact Sharon R. Porter, Acting Director,
International Business Compliance, at (630) 493-5931.

Attachment



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Attachment

The Commissioner, Large Business and International (LB&I) Division should:

RECOMMENDATION 1:

Revise the Form 1099-S to include information that is necessary to identify transactions subject to the FIRPTA along with the pertinent buyer identifying information that would allow the IRS to effectively enforce compliance with the current law.

CORRECTIVE ACTIONS:

LB&I will work with Counsel, the Small Business/Self-Employed (SBSE) Division, the Wage and Investment (W&I) Division, and Information Technology (IT) to decide whether changes to Form 1099-S are feasible, and when they could be implemented. A decision on whether to fully pursue changes to Form 1099-S will be made by December 31, 2015. Consideration will be given to budget, resources, priorities, and taxpayer burden, and we note that all tax form changes also require approval of OMB.

IMPLEMENTATION DATE:

December 31, 2015

RESPONSIBLE OFFICIAL(S):

Director, International Business Compliance, Large Business & International Division

CORRECTIVE ACTION(S) MONITORING PLAN:

The Internal Control Coordinator will track the implementation date for the corrective actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

RECOMMENDATION 2:

Coordinate with the Department of Treasury's Office of Tax Policy to consider establishing a regulation to require buyers to submit all affidavits of non-foreign status related to U.S. real estate sales transactions to the IRS.

CORRECTIVE ACTIONS:

LB&I does not agree with this recommendation. Although we agree that having such affidavits submitted to the IRS could provide critical information related to FIRPTA, we believe that sufficient additional information can be obtained more efficiently, and with



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less taxpayer burden, through potential revisions to Form 1099-S included in Recommendation 1 of TIGTA's report.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL(S):

Director, International Business Compliance, Large Business & International Division

RECOMMENDATION 3:

Coordinate with the Department of Treasury's Office of Tax Policy to evaluate the feasibility of a legislative proposal to reduce the barriers to effective administration of the FIRPTA.

CORRECTIVE ACTIONS:

As the report recognizes, the Secretary of the Treasury has delegated the formulation of tax policy, including legislative initiatives, to the Assistant Secretary, Tax Policy. See Treasury Order 111-01 (Mar. 16, 1981); Treasury Directive 27-10 (Oct. 15, 1990). Because speculation on potential policy implications is beyond the scope of tax administration in this report, we will ask ACCI to apprise the Treasury Office of Tax Policy of TIGTA's recommendation.

IMPLEMENTATION DATE:

January 2015

RESPONSIBLE OFFICIAL(S):

Director, International Business Compliance, Large Business & International Division

CORRECTIVE ACTION(S) MONITORING PLAN:

The Internal Control Coordinator will track the implementation date for the corrective actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

RECOMMENDATION 4:

Develop quality review procedures to periodically review refunds originating from buyer tax accounts and the processing of FIRPTA credits to provide assurance that internal controls are working as intended to prevent the issuance of erroneous refunds. This



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could be incorporated into the case reviews already being conducted by W&I Division managers.

CORRECTIVE ACTION:

We agree with this recommendation and will perform periodic reviews to ensure internal controls are working as intended.

IMPLEMENTATION DATE:

October 15, 2014

RESPONSIBLE OFFICIAL(S):

Director, Accounts Management, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION(S) MONITORING PLAN:

The Internal Control Coordinator will track the implementation date for the corrective actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

RECOMMENDATION 5:

Develop procedures to reduce the risk that erroneous balance due notices are sent to buyers that timely filed the Form 8288 and remitted the FIRPTA withholding.

CORRECTIVE ACTION:

We will evaluate existing controls and determine where corrective actions can be implemented to most effectively prevent the issuance of erroneous balance due notices arising from timely filings of Form 8288, *U.S. Withholding Tax Return for Disposition by Foreign Persons of U.S. Real Property Interests*.

IMPLEMENTATION DATE:

June 15, 2015

RESPONSIBLE OFFICIAL(S):

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



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CORRECTIVE ACTION(S) MONITORING PLAN:

The Internal Control Coordinator will track the implementation date for the corrective actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

RECOMMENDATION 6:

Ensure that FIRPTA credits are applied to tax accounts with the correct credit reference number.

CORRECTIVE ACTION:

The cause of the erroneous credit reference numbers recorded when FIRPTA credits were posted was found to have been a programming error. The error caused duplicate credit reference number postings that resulted in erroneous refunds. The Information Technology organization corrected the error the week of March 24, 2013. A second programming error, causing the posting of duplicate credits, was identified and subsequently corrected the week of June 9, 2013. We believe the programming errors were the cause of the exception cases identified by the Treasury Inspector General for Tax Administration's analysis and, with the corrections that were made in 2013, do not believe additional corrective actions are necessary to address the issue.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL(S):

N/A

RECOMMENDATION 7:

Establish a process to identify noncompliant buyers with Forms 8288-B approved for a reduced FIRPTA withholding amount. In addition, strengthen monitoring controls to ensure that the required reports are generated and that W&I Division personnel take the necessary actions to ensure buyer compliance with the FIRPTA after Form 8288-B withholding reduction requests are evaluated.

CORRECTIVE ACTION:

Accounts Management is working with IT to restart the necessary report. We are taking steps to reinstate the reporting process and reviewing procedures to ensure monitoring controls are effective in identifying necessary follow-up actions with regard to Form 8288 and Form 8288-B, *Application for Withholding Certificate for Dispositions by*



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Foreign Persons of U.S. Real Property Interests, compliance. Evaluation of the report output and procedural changes will occur through the close of Fiscal Year 2015.

IMPLEMENTATION DATE:

October 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Accounts Management, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION(S) MONITORING PLAN:

The Internal Control Coordinator will track the implementation date for the corrective actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.