

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

September 28, 2020

Reference Number: 2020-30-071

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## HIGHLIGHTS: More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions



Final Audit Report issued on September 28, 2020  
Reference Number 2020-30-071

### Why TIGTA Did This Audit

With the rising number of taxpayers giving up or abandoning their U.S. citizen or resident status, it is important that the IRS have controls in place to enforce the tax provisions applicable to expatriates. This audit was initiated to determine the effectiveness of the IRS's efforts in ensuring compliance with the expatriation tax provisions under Internal Revenue Code Sections 887 and 877A and related efforts to reduce taxpayer burden.

### Impact on Taxpayers

There may be tax consequences when taxpayers (expatriates) relinquish their citizenship or when long-term residents terminate their U.S. residency. Pursuant to Section 877A, expatriates are required to conduct a deemed sale of their worldwide assets and pay an "exit tax" on the net unrealized gain as if the property had been sold for its fair market value on the day before expatriation.

### What TIGTA Found

Since the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act), the number of taxpayers expatriating increased significantly from Calendar Year 2008 through Calendar Year 2018. During the same period, TIGTA found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules. Instead, TIGTA found that the IRS is primarily focused on collecting and publishing data on expatriates as required under Section 6039G.

Expatriates are required to file Form 8854, *Initial and Annual Expatriation Statement*, to certify that they have been in compliance with all Federal tax laws during the five years preceding the year of expatriation. TIGTA found that the IRS database of expatriates was incomplete for 16,798 expatriates who did not file Form 8854. In addition, TIGTA found instances of potential nonfiling, underreporting of income, and/or payment compliance issues by expatriates. From a sample of 26 expatriates who did not file a Form 8854, five had potential unreported income over \$6 million. From a sample of 61 expatriates who filed a Form 8854, 15 had potential unreported income over \$17 million. Lastly, TIGTA also found that expatriates with high net worth appear to not be paying their exit tax. Without a centralized compliance effort, Congress's attempts to create disincentives to expatriate via Section 877A will not be effective.

### What TIGTA Recommended

TIGTA recommended that the IRS: 1) contact the Department of State, via the Federal Intergovernmental Program, for the Social Security Number data field to be added to the Form DS-4083, *Certificate of Loss of Nationality of the United States*, and explore the feasibility of obtaining the Certificate of Loss of Nationality electronically; 2) update the Letter 2399C *Failure to File – Initial Form 8854*, and Letter 4135C, *Failure to Respond to Initial Form 8854 Request*; for compliance under the HEART Act, and develop Internal Revenue Manual procedures to use these letters to obtain Form 8854 when a Certificate of Loss of Nationality is received and no Form 8854; 3) evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriate database to ensure tax compliance of taxpayers who expatriate, e.g., Form 8854, *Part IV, Section B, Property Owned on Date of Expatriation*; 4) develop Internal Revenue Manual procedures for transcribing Form 8854 data, correcting Form 8854 data when information as filed by expatriates is missing or incomplete, and preparing analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under Internal Revenue Code Section 877A; and 5) establish a process to compile information on all expatriates whether they filed Form 8854 with their individual tax return Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*, or filed Form 8854 with the Philadelphia Campus and use this information to identify the highest risk expatriate returns for tax compliance. The IRS agreed with TIGTA's recommendations.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

**U.S. DEPARTMENT OF THE TREASURY**

**WASHINGTON, D.C. 20220**

September 28, 2020

**MEMORANDUM FOR:** COMMISSIONER OF INTERNAL REVENUE

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

**SUBJECT:** Final Audit Report – More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions (Audit # 201930016)

This report presents the results of our review to determine the effectiveness of the Internal Revenue Service's efforts in ensuring compliance with the expatriation tax provisions under Internal Revenue Code Sections 877 and 877A and related efforts to reduce taxpayer burden. This review is part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of the *Impact of Global Economies*.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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### Background

When citizens of the United States relinquish their citizenship or when long-term residents terminate their U.S. residency, there may be tax consequences. These taxpayers must file Form 8854, *Initial and Annual Expatriation Statement*, by which they must certify that they have been in compliance with all Federal tax laws during the five years preceding the year of expatriation and determine if they are a “covered expatriate.” Internal Revenue Code (I.R.C.) Section (§) 877A defines a covered expatriate as someone who expatriated on or after June 17, 2008, and meets one of the following expatriation rules:

- **Tax Liability Rule** – Average annual net income tax liability for the five years ending before the date of expatriation or termination of residency is more than a specified amount that is adjusted for inflation (\$165,000 for Tax Year (TY) 2018).<sup>1</sup>
- **Net-Worth Rule** – Net worth is \$2 million or more on the date of expatriation or termination of residency.
- **Certification Rule** – Failure to certify on Form 8854 compliance with all U.S. Federal tax obligations for the five years preceding the date of expatriation or termination of residency.

If taxpayers are determined to be covered expatriates, then they are deemed to have sold all their worldwide property and are subject to income tax (exit tax) on the net unrealized gain as if the property had been sold for its fair market value on the day before expatriation.<sup>2</sup> Gains from deemed sales are taken into account without regard to other U.S. Internal Revenue laws. Losses from deemed sales are taken into account to the extent otherwise allowed under U.S. Internal Revenue laws. The net gain is reduced by a specified amount that is adjusted for inflation but not below zero (\$711,000 for TY 2018).<sup>3</sup>

If these taxpayers do not file as required, they are also considered a “covered expatriate” under the law.<sup>4</sup> The history of Congress’s attempts to create disincentives to tax-motivated expatriation is lengthy, with significant legislation in 1966, 1996, 2004, and 2008.<sup>5</sup> A description of these legislative approaches is provided in Appendix IV; however, in general, the prior attempts at curbing tax-motivated expatriation failed because they were difficult for the Internal Revenue Service (IRS) to administer because they required proof of the taxpayer’s intent for expatriating and also failed to create a disincentive for expatriation because the expatriation tax regime did not reach foreign-owned property.<sup>6</sup>

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<sup>1</sup> See Appendix III, Figure 1, for tax liability amounts for TYs 2008 through 2019. See Appendix X for a glossary of terms.

<sup>2</sup> I.R.C. § 877A (the HEART Act). There are special provisions applicable to deferred compensation items, specified tax-deferred accounts, and interests in a non-grantor trust of which the covered expatriate was a beneficiary on the day before the expatriation date.

<sup>3</sup> See Appendix III, Figure 2, for net gain reduction amounts for TYs 2008 through 2019.

<sup>4</sup> I.R.C. § 877A(g)(1).

<sup>5</sup> See Appendix IV for synopsis of legislative history.

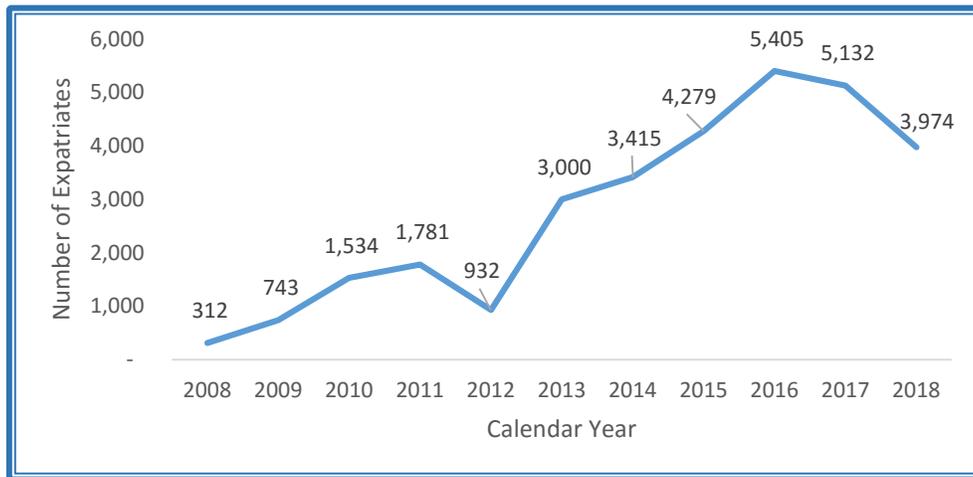
<sup>6</sup> *Congress, Have a Heart: Practical Solutions to Punitive Measures Plaguing the HEART Act’s Expatriate Inheritance Tax*, 26 Temp. Int’l & Comp. L. J. Pg. 69 (2012).



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With the rising number of U.S. citizens and U.S. lawful permanent residents giving up or abandoning their U.S. citizen or resident status, it is important that the IRS has controls in place to enforce the tax provisions applicable to expatriates. Since the enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008 (hereafter referred to as the HEART Act), the number of names published in the Federal Register increased from 312 in Calendar Year (CY) 2008 to a peak of 5,405 in CY 2016. Figure 1 shows the trend in expatriation once the HEART Act was implemented.<sup>7</sup>

**Figure 1: Number of Expatriates Published in the Federal Register From CY 2008 Through CY 2018<sup>8</sup>**



Source: Federal Register.

Expatriates are required to include information on the expatriation rules previously discussed on Form 8854 and attach the Form 8854 to their income tax return (Form 1040, *U.S. Individual Income Tax Return*, or Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*) for the year of expatriation. The income tax return is to be filed by the due date (including extensions). The instructions also state that taxpayers are required to send a copy of the Form 8854, marked "Copy," to the IRS Philadelphia Campus in Philadelphia, Pennsylvania.<sup>9</sup> There, the Small Business/Self-Employed (SB/SE) Division's Examination function Low-Income Housing Credit (LIHC) unit enters the information into the expatriate database.<sup>10</sup> We obtained an extract of this expatriate database on August 30, 2019, which contained 46,275 records dating back to June 4, 2004. Figure 2 shows the 41,058 records in the expatriate database from June 18, 2008,

<sup>7</sup> Pub. L. No. 110-245.

<sup>8</sup> We were unable to validate the accuracy and completeness of the Federal Register. The IRS publishes the names in the Federal Register quarterly as it receives the information from the Department of State and may not correlate to the date when the taxpayer expatriated. For example, the IRS indicated that if the date on the Form DS-4083, *Certificate of Loss of Nationality of the United States*, is used to measure when expatriations occur (as opposed to when the Federal Register publishes the data), the highest year for expatriation was 2014 with 5,208 expatriations.

<sup>9</sup> When a tax return is not required to be filed, the Form 8854 is only filed with the IRS Campus and, as requirements are met, the name is reported in the Federal Register.

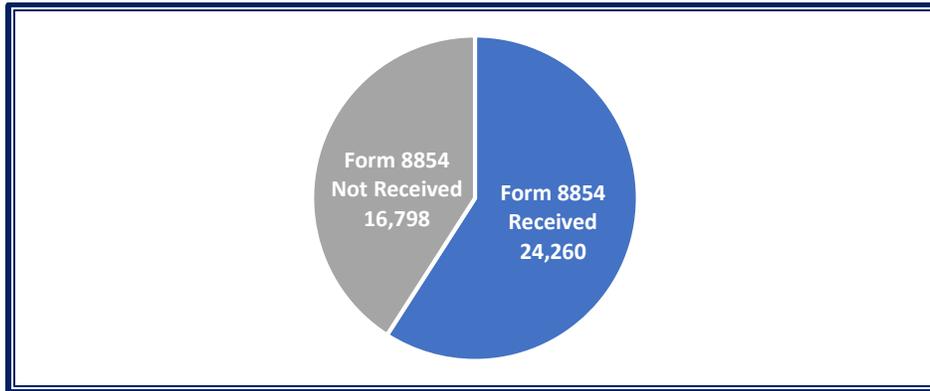
<sup>10</sup> When the expatriate database was established in the 1990s, the International Office responsible for enforcement of the expatriation provisions was in the SB/SE Division, and the SB/SE Division Campus in Philadelphia was responsible for handling documents and forms pertaining to International Tax Administration and has continued to maintain the expatriate database. The SB/SE Division International Office moved to the Large Business and International Division around 2010.



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through December 31, 2018, and the number of Forms 8854 the Philadelphia Campus received.<sup>11</sup>

**Figure 2: Expatriate Database From June 18, 2008, Through December 31, 2018**



*Source: IRS Expatriate Database.*

Forms 1040-NR filed for the year of expatriation with a related Form 8854 attached are edited during processing with an Audit Code K.<sup>12</sup> We determined that for Processing Years 2017 through 2019, 8,861 returns had an Audit Code K for TY 2016 through TY 2018 compared to the 14,511 expatriates reported in the Federal Register for CY 2016 through CY 2018.<sup>13</sup> Procedures for using Audit Code K do not apply to expatriates attaching Form 8854 to their Form 1040.

## Results of Review

As previously shown, the number of names published in the Federal Register increased significantly from CY 2008 through CY 2018 after enactment of I.R.C. § 877A as part of the HEART Act. During the same period, we found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules. The IRS has an expatriate database, but it was not used to identify and/or address expatriates who have not complied with their exit tax obligations under I.R.C. § 877A. Instead, we found that the IRS is primarily focused on collecting and publishing data on expatriates in the Federal Register as required under I.R.C. § 6039G.

We also found that the IRS has a process that identifies expatriates who attached a Form 8854 to a Form 1040-NR, but this Form 8854 information is not in the expatriate database unless the taxpayer also mailed a copy of the Form 8854 to the Philadelphia Campus. Additionally, the IRS does not transcribe the Form 8854 when attached to a paper Form 1040-NR or attached as a Portable Document Format file to an electronically filed return. In addition, the IRS does not have a process to identify expatriates attaching Form 8854 to their Form 1040. Without a

<sup>11</sup> The 41,058 records includes 13 records without an expatriation date.

<sup>12</sup> Audit Code K is entered for the following conditions: Disclosure Statement, Refund Scheme, Preparer Identified, and Forms 1040NR with Form 8854 attached. Because there are several conditions for when Audit Code K is used, it is not a method to identify expatriate examinations. Forms 1040NR are filed with the IRS Campus in Austin, Texas.

<sup>13</sup> The 8,861 represents returns in which the tax year ended in December. There were a total of 16 records not included in this count in which the tax year did not end in December. Further, these 8,861 returns were filed by 8,340 individual taxpayers.



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centralized compliance effort, Congress's attempts to create disincentives for tax-motivated expatriation via I.R.C. § 877A will not be effective.

We analyzed the data in the expatriate database and selected two random samples of covered expatriates who met the tax liability and/or net worth rule. We also analyzed the filing and reporting compliance history of 26 covered expatriates who did not file a Form 8854 with the Philadelphia Campus. Overall, we found that:

- The Philadelphia Campus does not perform tax compliance activities related to expatriates.
- Many expatriates are not filing Form 8854 with the Philadelphia Campus.
- The expatriate database is not sufficient to enforce the exit tax.
- Some expatriates with high net worth appear to not be paying their exit tax.
- The examination rate of expatriate last tax returns is low.

### The Philadelphia Campus Does Not Perform Tax Compliance Activities Related to Expatriates

During CY 2008 through CY 2018, the IRS had no process with the Philadelphia Campus to ensure that taxpayers qualifying as "covered expatriates" were in compliance with the expatriation "exit tax" Form 8854 filing requirements. As previously stated, Form 8854 provides the information the IRS needs to identify covered expatriates who are required to complete a deemed sale of their worldwide assets and pay an exit tax on the unrealized gain from the deemed sale.

When a taxpayer expatriates, Form DS-4083, *Certificate of Loss of Nationality of the United States* (CLN), is completed by the Department of State (hereafter referred to as the State Department).<sup>14</sup> The State Department transmits these forms to the IRS. The SB/SE Division's Examination function has assigned the responsibility for compiling information related to expatriates to LIHC unit tax examiners (Philadelphia Campus), who enter the taxpayer name, date the CLN was received, expatriate address, and expatriation date into the expatriate database. At one point, the SB/SE Division had the expectation that the LIHC unit would take compliance actions as well; however, the LIHC unit at the Philadelphia Campus does not take compliance actions.

For tax purposes, the usefulness of the CLN is limited because it does not contain the Taxpayer Identification Number, *i.e.*, Social Security Number (SSN), which is essential for the IRS to verify filing and payment compliance. The IRS has not developed Internal Revenue Manual (IRM) procedures related to expatriates. LIHC unit tax examiners sometimes research for the expatriate's SSN on the IRS's Individual Master File. However, our review of the expatriate database showed that, in a 10-year period from June 2008 to December 2018, LIHC unit tax examiners did not research for an SSN in 56 percent (9,463 of 16,798) of the records in which only a CLN was received.

In addition, the CLN does not satisfy the expatriate's reporting obligation under I.R.C. § 6039G, nor does it provide any of the financial information, *i.e.*, five-year prior year tax liability and/or

<sup>14</sup> As shown in Appendix VII.



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net worth, required by the IRS to determine whether the expatriate is a covered expatriate under I.R.C. § 877A. As subsequently discussed, it is vital that the IRS works with the State Department to have the expatriate's SSN added to the CLN so the IRS can identify expatriates.

As previously stated, expatriates are required by I.R.C. § 6039G to include information on the expatriation rules on Form 8854 and mail the form to the IRS Philadelphia Campus. There, the LIHC unit enters the information to the expatriate database. While the LIHC unit enters the information into the expatriate database, other than reporting the expatriates into the Federal Register, the LIHC unit is not responsible for any compliance activity, such as pursuing expatriates who did not file Form 8854. Pursuant to the HEART Act, the IRS no longer needed a Form 8854 to publish the names in the Federal Register. Due to LIHC unit resource constraints and other priorities, the LIHC unit stopped pursuing expatriates who did not file Form 8854.

The primary responsibility of the LIHC unit is the LIHC. As stated in the IRM, the LIHC unit is responsible for maintaining the LIHC database, including transcribing data from submitted forms, correcting errors, and preparing analyses of documents as required under I.R.C. § 42.<sup>15</sup> In addition, the LIHC unit supports the classification of returns pertaining to the LIHCs by using predetermined criteria to identify specific noncompliance issues (for referrals to examination).

The workload pertaining to expatriation is a collateral duty for the LIHC unit, and similar IRM procedures do not exist for its Form 8854 and expatriate workload. The Large Business and International (LB&I) Division provided the LIHC unit with a job aid (Expatriate Database – Job Aid) pertaining to its work on expatriates. However, it was last updated July 7, 2006, before enactment of the HEART Act. There are no current IRM documented procedures pertaining to compliance activity because it was set up for collecting and publishing data on expatriates, not as a compliance function. Accordingly, the LIHC unit at the Philadelphia Campus is not performing any compliance activity related to expatriation. As a result, expatriates who do not file Form 8854 are not pursued by the SB/SE Division LIHC unit for noncompliance with the law. Expatriates who do not file Form 8854 are addressed in more detail below.

Those expatriates attaching Form 8854 to their Form 1040-NR filed for the year of their expatriation are identified on the Individual Master File with an Audit Code K. The IRS does not transcribe the Form 8854 regardless if attached to paper returns or provided with electronically filed returns, and the procedures for Audit Code K do not apply to expatriates attaching Form 8854 to their Form 1040. In addition, information from Forms 8854 attached to Forms 1040-NR is not reconciled with the expatriate database data in which a CLN was received but no Form 8854. As a result, expatriates who do not attach Form 8854 to their Form 1040-NR and do not file Form 8854 with the LIHC unit are not identified and pursued by the IRS. Expatriates who file Form 8854 with Form 1040-NR and receive an Audit Code K are discussed below.

The IRS cannot effectively identify and address expatriates who fail to file Form 8854 without consolidating information from the expatriate database and Individual Master File Audit Code K data. Specifically, the expatriate database has the names of known expatriates via CLN data and, combined, the expatriate database and Individual Master File Audit Code K data have the data to support expatriates who filed Form 8854.

<sup>15</sup> IRM 4.19.11.2.19 (June 22, 2016).



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### Many Expatriates Are Not Filing Form 8854 With the Philadelphia Campus

Pursuant to I.R.C. § 6039G, individuals who expatriate are required to send a statement to the IRS (Form 8854) detailing the individual's income, assets, and liabilities. Expatriates use Form 8854 to certify compliance with tax obligations in the five years before expatriation. Form 8854 is critical in determining whether the expatriate is a covered expatriate who is required to comply with I.R.C. § 877A.

Figure 2 shows that, in a 10-year period, from June 2008 to December 2018, 16,798 (or 41 percent) of those individuals who received the CLNs did not send a copy of Form 8854 to the Philadelphia Campus as required. These 16,798 expatriates failed to file a Form 8854 with the Philadelphia Campus to report their prior income tax liabilities and net worth and certify compliance. We identified these expatriates in the expatriate database via analysis that primarily focused on the data field "8854 REC'D" and then determined these records had data field "DATE CLN REC'D" (which is the date the Form DS-4083 (CLN) was received by the IRS from the State Department). By not filing Form 8854, these taxpayers are considered as not certifying their tax compliance as required and are also a covered expatriate under the law.<sup>16</sup>

### **CLN data are not being used to obtain Form 8854**

By filing a complete and valid Form 8854, assuming they are in compliance with all Federal tax laws, the expatriates avoid covered expatriate treatment if the other two tests are not met. While no longer used, the IRS had developed two letters for use when a CLN is received from the State Department and a Form 8854 was not received by the Philadelphia Campus:

- Letter 2399C, *Failure to File – Initial Form 8854*, which should be sent to notify the expatriates that they are receiving the letter because IRS records show loss of U.S. citizenship or terminated lawful permanent resident status, but have not properly given notice to the IRS and that such notice is given by filing an initial Form 8854.
- Letter 4135C, *Failure to Respond to Initial Form 8854 Request*, should be sent to notify the expatriates that they are receiving the letter because IRS records show that they lost their U.S. citizenship or terminated lawful permanent resident status, but have not properly given notice to the IRS.

Our analysis of the expatriate database shows that the LIHC unit mailed 25 Letters 2399C (17 mailed prior to CY 2008 and eight mailed between November 2008 and November 2016), while no Letter 4135C was mailed to secure missing Forms 8854 from expatriates. We also observed that the letters were last revised in July 2005 and 2006, respectively. Thus, the letters have not been updated to reflect tax law changes from the HEART Act. For instance, the Letter 2399C states that the *"taxpayer is receiving the letter because our records show you have lost U.S. citizenship but have not properly given notice to the IRS by filing an initial Form 8854"* and then cites the law from the American Jobs Creation Act of 2004 (AJCA).<sup>17</sup> When we asked why the letters were not used to secure missing Forms 8854, the IRS stated that it can publish the names in the Federal Register based on the CLN without obtaining Form 8854 from the expatriate and therefore does not follow up in these situations.<sup>18</sup> Prior to the HEART Act, the IRS

<sup>16</sup> I.R.C. § 877(a)(2)(C).

<sup>17</sup> See Appendix IV for more details on the legislative history.

<sup>18</sup> New letters performing the same compliance function as part of the Expatriation Campaign will be considered, but not used by the LIHC unit. The Expatriation Campaign is discussed further in the report.



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stated that it needed both a CLN and Form 8854 to publish the names in the Federal Register. Because the IRS is only using CLN information to update and report names quarterly for the Federal Register as required by I.R.C. § 6039G and not for tax compliance purposes, the letters for failure to file Forms 8854 have not been updated or used to obtain Forms 8854 for compliance purposes.

The IRS did not have procedures for the LIHC unit to mail letters to secure Forms 8854 for tax compliance purposes because, according to management, that was not the purpose of the unit when it was established. As a result, the LIHC unit did not take any action to obtain a Form 8854 on the 16,798 records in the expatriate database in which only a CLN was received.

### The SSN is vital for tax compliance

We previously stated that LIHC unit tax examiners sometimes research for the expatriate's SSN using the Individual Master File, and that, in a 10-year period from June 2008 to December 2018, LIHC unit tax examiners did not research for a SSN for 9,463 (56 percent) of the 16,798 records in which only a CLN was received. For the 7,335 records for which the LIHC unit researched the Individual Master File and identified an SSN, we found that LIHC unit tax examiners researched the Individual Master File and recorded in the expatriate database one or more prior tax liabilities (expatriates are required to provide information for five prior years) for 3,315 (45 percent) of 7,335 of the expatriates. Based on this research, 55 records met the tax liability rule as a covered expatriate from June 18, 2008, through December 31, 2018.<sup>19</sup>

We selected the 26 of the 55 cases that were from CY 2016 through CY 2018 for further analysis. We researched information return documents filed with the IRS and the Individual Master File for these 26 cases to determine if receipt of the SSN would help the IRS to identify instances of potential tax compliance issues, *e.g.*, nonfiling, underreporting, and/or nonpayment. Figure 3 provides a breakdown of CLN records with no Form 8854 for which the LIHC unit researched and either found an SSN or did not find an SSN and, for the records in which the LIHC unit found an SSN, whether or not it recorded at least one prior tax liability for CY 2008 through CY 2018.

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<sup>19</sup> See Appendix III, Figure 1, for tax liability amounts for TYs 2008 through 2019.



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**Figure 3: Analysis of CLN Records With No Form 8854 for CY 2008 Through CY 2018**

Calendar Year of Expatriation	Number of Records					
	LIHC Unit Did Not Identify an SSN	LIHC Unit Identified an SSN	No Form 8854	Average Five-Year Tax Liability of \$0.00	LIHC Unit Researched and Recorded at Least One Prior Year Tax Liability	LIHC Unit Determined Five-Year Average Tax Liability Over Specified Amount
2008	191	61	252	35	26	1
2009	386	128	514	69	59	3
2010	500	239	739	120	119	6
2011	606	239	845	125	114	3
2012	836	465	1,301	243	222	7
2013	1,071	850	1,921	492	358	3
2014	1,503	987	2,490	572	415	4
2015	1,182	817	1,999	449	368	2
2016	1,135	876	2,011	502	374	7
2017	1,028	856	1,884	510	346	2
2018	1,021	1,814	2,835	900	914	17
No Date <sup>20</sup>	4	3	7	3	0	0
Totals	9,463	7,335	16,798	4,020	3,315	55

Source: Our analysis of the expatriate database CLN records with no Form 8854 received by the IRS for CY 2008 through CY 2018.

We found tax compliance issues with 10 of 26 cases:<sup>21</sup>

- Seven of 26 cases had potential unreported income, and five of these seven cases had an unfiled tax return either in the year of expatriation or the subsequent tax year. The potential unreported income is based on information return documents filed with the IRS in the year of expatriation or subsequent tax year.<sup>22</sup> After using an aggregate threshold of \$25,000 for the information return documents, we determined that five of the seven cases had potential unreported income over \$6 million, including dividends and/or stock proceeds. The expatriates in these five cases are covered expatriates and should be subject to income tax (exit tax) on the net unrealized gain. The IRS did not identify these cases because it did not have a compliance and/or referral process in place using CLN data. Additionally, the IRS does not have a systemic matching program to compare information return documents to the Form 1040-NR to identify potential unreported income and/or nonfilers.

<sup>20</sup> A CLN was received for seven records but did not have a date of expatriation.

<sup>21</sup> The potential exception cases will not add to 10 because \*\*1\*\* case has both potential unreported income and aggregate balance due from all tax modules.

<sup>22</sup> The information return documents include Forms 1099-INT, *Interest Income*, 1099-DIV, *Dividends and Distributions*, and 1099-B, *Proceeds From Broker and Barter Exchange Transactions*, etc.



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- Four of 26 cases had a balance due on their tax modules. **\*\*1\*\*** of the four cases had balances due from multiple tax modules which totaled nearly \$8 million, and the accounts were notated with "certified seriously delinquent tax."<sup>23</sup>

Overall, we found instances of potential nonfiling, underreporting of income, and/or payment compliance issues for the few cases for which the LIHC unit identified an SSN, researched, and recorded prior tax liabilities in which the expatriate met the tax liability rule. As a result, the IRS should work with the State Department to have the SSN added to the CLN to assist in identifying and addressing tax compliance issues for expatriates.

We also found that not all of their income came from information return documents; some of these taxpayers are involved in more complex entities. For instance, eight of the 26 cases had a Schedule E, *Supplemental Income or Loss*, in a prior tax year, which is used to report income or loss from rental real estate, partnerships, *etc.* Due to the complexity, these types of taxpayers need to be referred to the Examination function for further analysis. When we asked if any referrals were made for examination by the LIHC unit, we were informed that the expatriate database is not used to make referrals for examination because, according to management, that was not the purpose of the unit when it was established.

### Delays in receiving the CLNs from the State Department affect timely reporting in the Federal Register and tax compliance

The IRS has a requirement to timely report the expatriates in the Federal Register per I.R.C. § 6039G. For the 26 CLN cases with no Form 8854 received, we compared the date the IRS received the CLN from the State Department to the date that taxpayers expatriated and determined that it took an average of 179 days for the IRS to receive the CLN from the State Department. When we asked the IRS about these delays, we were informed that the State Department may accumulate the CLNs until it has a sufficient number to mail to the IRS. We also located the expatriates in the Federal Register and determined that, for these 26 cases, seven were timely reported in the same quarter and 12 were reported in the subsequent quarter. However, in six of the 26 cases, the expatriates were reported in the Federal Register a year after they expatriated. For example, a taxpayer expatriated in June 2018, but the IRS did not receive the CLN from the State Department until April 2019 and subsequently reported the expatriation in the Federal Register for the period ending June 30, 2019. This type of delay to receive the CLN from the State Department affects tax compliance and/or timely issuing letters to expatriates when the IRS has not received a Form 8854 and the IRS's requirement to timely report the expatriates in the Federal Register as required by I.R.C. § 6039G. The IRS should work with the State Department to receive the CLN electronically and also to add a data field to the database to indicate the quarter and year the taxpayer is recorded in the Federal Register.

#### **The Commissioner, LB&I Division, should:**

**Recommendation 1:** Contact the State Department, via the Federal Intergovernmental Program, for the SSN data field to be added to the CLN and explore the feasibility of obtaining the CLN electronically.

<sup>23</sup> I.R.C. § 7345, added by § 32101 of Fixing America's Surface Transportation Act of 2015, (Pub. L. No. 114-94). This Act requires the IRS to notify the State Department of taxpayers the IRS has certified as owing a seriously delinquent tax debt.



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**Management's Response:** IRS management agreed with this recommendation and will contact the State Department, via the Federal Intergovernmental Program, to request the SSN data field be added to the CLN. They also agreed to explore the feasibility of obtaining the CLN electronically.

**Recommendation 2:** Update the Letter 2399C and Letter 4135C for compliance under the HEART Act and develop IRM procedures to use these letters to obtain Form 8854 when a CLN is received and no Form 8854.

**Management's Response:** IRS management agreed with this recommendation and will update Letters 2399C and 4135C to include the requirements of I.R.C. § 877A and remove any language no longer applicable under the HEART Act. They also agreed to develop IRM or other procedures on how, and when appropriate, to obtain Form 8854 when a CLN but no Form 8854 is received while taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

### The Expatriate Database Is Not Sufficient to Enforce the Exit Tax

We previously stated that the primary responsibility of the LIHC unit is the LIHC. As stated in the IRM, it is responsible for maintaining the LIHC database, including transcribing data from submitted forms, correcting errors, and preparing analyses of documents as required under I.R.C. § 42.<sup>24</sup> The LIHC unit is also responsible for maintaining the expatriate database, including transcribing data from Form 8854 for purposes of I.R.C. § 6039G. However, we observed that the LIHC unit does not transcribe from Form 8854 the following significant fields for purposes of enforcing I.R.C. § 877A:

- Part IV, Section B, *Property Owned on Date of Expatriation*, Line 8, which computes gain or loss on the deemed sale of property.
- Part V, Schedule A, *Balance Sheet*, includes assets and liabilities to compute net worth.
- Part V, Schedule B, *Income Statement*, which is used to verify income from the final tax return for expatriates.

This information is needed for either the LIHC unit and/or the IRS to analyze and determine if the expatriate is meeting requirements under I.R.C. § 877A and paying income tax (exit tax) on the net unrealized gain for the deemed sale of worldwide assets.

When we discussed these concerns with IRS management, (i) they restated that the LIHC unit is not involved with tax compliance activities; (ii) they do not want to add additional data fields to the expatriate database until they evaluate the campaign results and the data fields that were used from the Form 8854 to compute the exit tax and/or tax adjustments for the examinations; and (iii) if it is determined additional data fields from the Form 8854 are needed for tax compliance purposes, then they will determine who will be responsible to collect and capture these data. As discussed later, the IRS recently announced a compliance campaign for taxpayers who expatriated and plans to conduct \*\*2\*\* examinations.

<sup>24</sup> IRM 4.19.11.2.19 (June 22, 2016).



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We also observed that the expatriate database and the Form 8854 included:

- No annual Form 8854 filed from expatriates who elected to defer exit taxes. If an expatriate elects a tax deferral, the taxpayer has to submit a bond or a letter of credit for “collateral” that is deemed acceptable by the IRS and conditioned upon payment of the amount of tax due. When we inquired with the IRS if any expatriates elected a tax deferral, it stated that only three were received over the years and that the requests were denied.
- The data fields based on the AJCA and Form 8854 lines for TY 2007. Based on a review of the expatriate database, the data fields match the outdated job aid (Expatriate Database – Job Aid, last updated July 7, 2006) and the Form 8854 lines for TY 2007, which are based on the AJCA. For example, the Form 8854 for TY 2007, Line 7 (see Appendix V) states “Enter your net worth on the date of your expatriation for tax purposes” whereas this request is listed on Part IV, Line 2, for TY 2018 (see Appendix VI), and the expatriate database data field states “Line 7 Net Worth.” When we asked IRS management why the Job Aid and the expatriate database data fields as used by the LIHC unit have not been updated for the HEART Act or TY 2018 Form 8854 lines, they said that IRS Office of Chief Counsel agreed that updates to the expatriate database were not necessary for purposes of I.R.C. § 6039G. The IRS should consider revisions to the expatriate database, based on the HEART Act and items required for enforcement of I.R.C. § 877A.

Form 8854 LIHC unit, or a unit as determined by the IRS responsible for tax compliance of expatriates, procedures along with the expatriate database need to be updated so the IRS can properly transcribe Form 8854 and the expatriate database can be analyzed for compliance purposes to enforce I.R.C. § 877A.

### **The LIHC unit does not have procedures for correcting errors with Form 8854**

We previously stated that the LIHC unit is responsible for correcting errors related to the LIHC but does not have the same procedures for correcting errors with the Form 8854. Based on a review of the expatriate database, we found:

- In 8,619 (36 percent) of the 24,260 records in which a Form 8854 was received by the Philadelphia Campus, the average five-year tax liability was zero. Since in all five years tax liabilities were zero, it appears that the expatriates did not self-report prior year tax liabilities, and the LIHC unit did not research prior tax liabilities for these expatriates.
- In 1,534 (6 percent) of the 24,260 records in which a Form 8854 was received by the IRS, the taxpayers’ net worth was zero; the LIHC unit does not have procedures to correspond with expatriates to obtain missing information.

The IRS needs to develop procedures for correcting and obtaining specific Form 8854 data when the information is found to be incomplete or missing. Without this information, the IRS is unable to determine if the expatriate is a covered expatriate subject to income tax (exit tax) under I.R.C. § 877A.



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### The Commissioner, LB&I Division, should:

**Recommendation 3:** Evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriate database to ensure tax compliance of taxpayers who expatriate, *e.g.*, Form 8854, *Part IV, Section B, Property Owned on Date of Expatriation*.

**Management's Response:** IRS management agreed with this recommendation and will evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriate database to best evaluate the tax compliance of taxpayers who expatriate while taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

**Recommendation 4:** Develop IRM procedures for transcribing Form 8854 data, correct Form 8854 data when information as filed by expatriates is missing or incomplete, and prepare analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under I.R.C. § 877A.

**Management's Response:** IRS management agreed with this recommendation. They will develop IRM or other procedures for inputting and correcting certain Form 8854 data when information as filed by expatriates is missing or incomplete, as appropriate, and prepare an analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under I.R.C. § 877A following the initial assessment of the Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

## Some Expatriates With High Net Worth Appear to Not Be Paying Their Exit Tax

Filing Form 8854 only satisfies the expatriate's information reporting obligations under I.R.C. § 6039G. Expatriates must still compute any tax due (including I.R.C. § 877A exit tax, if applicable) and file applicable Federal income tax returns. We determined that the IRS \*\*\*\*2\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\* Figure 2 showed that 59 percent of the expatriates filed a Form 8854 with the Philadelphia Campus. Specifically, 24,260 expatriates filed a Form 8854 with the Philadelphia Campus to report their five prior income tax liabilities and net worth from June 18, 2008, through December 31, 2018.

For the 24,260 who filed a Form 8854:<sup>25</sup>

- 712 (3 percent) were covered expatriates based on the tax liability rule, of which 68 expatriated during the period from January 1, 2017, through December 31, 2018, with average income tax liability for the five preceding taxable years ending before expatriation date over \$570,000. Of the 68 taxpayers, we selected 26 cases reporting a combined net worth of \$925 million, capital gains of over \$126.3 million, and over \$584,000 in five-year average tax liability.
- 2,222 (9 percent) were covered expatriates based on net worth over \$2 million, of which 347 expatriated in the period from January 1, 2017, through December 31, 2018. The

<sup>25</sup> These populations are not mutually exclusive of each other as it is possible for an individual to be included in each of the two categories. For example, a person can average a taxable net income of \$165,000 or more for the five years preceding taxable years before expatriation and have a self-reported net worth of \$2,000,000 or greater.



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total net worth of these expatriates was over \$4 billion. Of the 347, we selected 35 cases reporting a combined net worth of \$289 million and capital gains of nearly \$3.3 million.

We reviewed these 61 cases for compliance with I.R.C. § 887A deemed sale of worldwide assets and potential tax noncompliance issues, such as nonfiling, underreporting, and/or payment issues. As we previously stated, Form 8854, Part IV, Section B, Line 8, includes the expatriate's calculation of the gain or loss on the deemed sale. Further, the information on Form 8854, Part IV, is not transcribed on the expatriate database. We used information return documents for actual sales and compared to the expatriate's Form 1040 or Form 1040-NR last tax return. These taxpayers reported a combined net worth of \$1.2 billion on Form 8854 and capital gains of \$129.6 million, which were identified from either Form 1040 or Form 1040-NR as follows:

- Capital Gain or Loss – Line 14.
- Other Gains or Losses – Line 15.

Without an examination of the expatriates' last tax return or their calculation of the gain or loss on the deemed sale from the Form 8854, we cannot determine with certainty whether the taxpayers who reported capital gains or losses on Form 1040 or Form 1040-NR are in compliance under I.R.C. § 877A. For the 61 cases, we determined that 39 cases reported gains or losses and 22 cases did not report any gain or loss. Specifically, for the 26 tax liability cases:

- In 12 cases, the expatriates reported combined net worth of nearly \$852 million and capital gains of \$126 million, or 15 percent in capital gains compared to net worth.
- In 14 cases, the expatriates either did not report any gain on Form 1040 or Form 1040-NR yet reported a combined net worth over \$73 million (an average of over \$5 million) on their respective Form 8854 or did not file a tax return.

For the 35 net worth cases:

- In 29 cases, the expatriates reported combined net worth of nearly \$224 million and capital gains of nearly \$3.3 million, or nearly 1 percent in capital gains compared to net worth.
- In six cases, the expatriates did not report any gain on Form 1040 or Form 1040-NR yet reported a combined net worth over \$65 million (an average of nearly \$10 million) on their respective Form 8854.

However, the capital gains reported were based on actual sales of assets and not from the deemed sale provisions of I.R.C. § 877A. Given the high net worth of these 61 covered expatriates with combined net worth of \$1.2 billion, it appears that these taxpayers failed to pay the required exit tax. The expatriate is also allowed to reduce net gain by a specified amount (\$711,000 for TY 2018) that is adjusted for inflation but not below zero. At a minimum, the 20 of 61 taxpayers who failed to report any gains or losses (14 tax liability and six net worth cases) are not in compliance with I.R.C. § 877A and may have owed exit tax. It is critical that the IRS establish an effective strategy to strengthen enforcement efforts pertaining to the exit tax by actively identifying individuals who relinquish citizenship or terminate residency.

Similar to prior CLN sample results, we also found instances of potential nonfiling and underreporting when a Form 8854 was received by the Philadelphia Campus. Specifically, we found that, in 19 cases of the 61 cases, the expatriate did not report taxable income and/or did not file a subsequent year tax return. The potential unreported income is based on information return documents, *e.g.*, interest, dividends, capital gains, filed with the IRS. When discussed



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these cases with IRS executives, they had concerns with four cases that included real estate sale transactions. Specifically, that real estate sale transaction information returns do not include the cost basis and that taxpayers who used the property as a personal residence may qualify to exclude up to \$250,000 or \$500,000 for married filing jointly. After using an aggregate threshold of \$25,000 for the information return documents, and excluding cases with real estate sales transactions of nearly \$5 million, we determined that 15 of 61 cases had potential unreported income over \$17 million of which seven had an unfiled return in the subsequent tax year. These cases were not identified because the expatriate database information is not used to identify potential unreported income or nonfilers, and \*\*\*\*\*2\*\*\*\*\*  
\*\*\*\*\*2\*\*\*\*\*

**Management Action:** The IRS recognizes that some U.S. citizens and long-term lawful residents may have expatriated without complying with the expatriation tax rules or may not be aware of their Federal tax obligations upon expatriation. On July 19, 2019, IRS LB&I Division management announced a new compliance campaign focusing on U.S. citizens and long-term residents (lawful permanent residents in eight out of the last 15 taxable years) who expatriated on or after June 17, 2008, and did not meet their filing requirements or tax obligations with the IRS.<sup>26</sup> Under the Expatriation Campaign, IRS LB&I Division management states that they are selecting varying degrees of covered expatriates through different treatment streams consisting of soft letters, outreach and education, and examinations.<sup>27</sup>

The LB&I Division plans to use a two-pronged approach in developing cases. First, the LB&I Division will use soft letters sent to expatriates who do not have a Form 8854 on file with the IRS. The IRS plans to send out \*2\* soft letters.

Second, the campaign will use examinations of expatriates' tax returns to address potential underreporting of income or nonfiling of income tax returns. The campaign will conduct \*2\* examinations derived from campaign-developed filters. These filters use Individual Master File (income tax returns) and expatriate database (Forms 8854) information to identify cases for classification and assignment to international examiners for examination. We were provided a status of the campaign plans in June 2020 and were advised that:

- The soft letter (Letter 6272) has been finalized and is listed in the IRS catalog. The letters are expected to be issued during the week of July 12, 2020, depending upon resource availability and organizational priorities.
- As of the end of May, there are four returns under examination in the field for the Expatriation Campaign. Additional cases will be sent to the field during the week of July 12, 2020, depending upon resource availability and organizational priorities

We believe that the information from the expatriate database and any data that the LB&I Division's compliance campaign compiles from case classification, case building, and assignment to international examiners for examination can and should be leveraged to develop

<sup>26</sup> The LB&I Division has announced 65 campaigns. Campaigns are part of the LB&I Division's efforts to move towards more issue-based examinations, and they involve analysis of data to support the identification and evaluation of a compliance issue; a more deliberate consideration of potential treatment streams; decisions about the resources to be deployed; and identification of training, mentoring, networking, and tools needed as well as a robust feedback mechanism to ensure that all elements of a campaign are continuously improved.

<sup>27</sup> A soft letter is correspondence directed at a particular filing position taken by a taxpayer and seeks information or suggests a course of action.



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an effective compliance program that identifies and addresses expatriates who have not complied with their income tax requirements under I.R.C. § 877A.

### Examination Rate of Expatriate Last Tax Returns Is Low

IRS examinations of expatriates are tracked on the Audit Information Management System using a special project code of 0504. Using this special project code, we identified closed examinations of expatriate cases for Fiscal Year (FY) 2015 through FY 2018. As Figure 4 shows, 18,790 citizens expatriated from CY 2015 through CY 2018, while 63 expatriation examinations were closed, with \*1\* expatriation examinations resulting in additional tax adjustments from FY 2015 through FY 2018.<sup>28</sup>

**Figure 4: Closed Examinations of Special Project Code 0504 Cases**

Year	Number of Expatriates Published in the Federal Register	Year	Number of Closed Expatriate Examinations	Those Closed With Tax Adjustments	Change Rate <sup>29</sup>	Average Adjustment Amount
CY 2015	4,279	FY 2015	20	3	15%	\$4,803
CY 2016	5,405	FY 2016	17	*1*	12%	\$35,371
CY 2017	5,132	FY 2017	14	5	36%	\$70,809
CY 2018	3,974	FY 2018	12	3	25%	\$156,803
-	<b>18,790</b>	-	<b>63</b>	<b>*1*</b>		

*Source: Federal Register CY 2015 through CY 2018 and Audit Information Management System for FYs 2015 to 2018.*

Though the number of returns examined is small, the IRS had some success examining the expatriate tax returns; however, some of these returns examined were not identified from the expatriate database or as part of any special expatriation examination program. The examination numbers in Figure 4 are of expatriates who attached their Form 8854 to their Forms 1040-NR. Specifically, we determined 48 of 63 closed expatriation examinations and \*1\* \*\*1\*\* closed cases with additional tax adjustments had an Audit Code K. Expatriates attaching Form 8854 to their Form 1040-NR filed for the year of their expatriation are edited during processing with an Audit Code K. The information from the Form 8854 is not transcribed, that only occurs if an expatriate mails a Form 8854 to the Philadelphia Campus. As previously stated, there also is no match of this information to the expatriate database maintained in the Philadelphia Campus or reconciliation between these data and expatriate database data in which a CLN was received but no Form 8854 was received. As a result, expatriates who do not file Form 8854 are also not identified or pursued by the Austin Campus.

We determined that, for Processing Years 2017 through 2019, 8,861 Forms 1040-NR were coded with an Audit Code K. As previously stated, the IRS does not transcribe the Form 8854 when attached to a paper Form 1040-NR or attached as a Portable Document Format file to an

<sup>28</sup> Special Project Code 0504 is used on examinations of expatriation taxpayers. Examination records are for FY 2015 through FY 2018. We notified the IRS of our audit in June 2019.

<sup>29</sup> Change rate represents the percentage of cases examined that had an adjustment.



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electronically filed return. The Audit Code K does not identify expatriates attaching Form 8854 to their Form 1040. Returns with an Audit Code K are automatically established on the Audit Information Management System and routed to Philadelphia Centralized Files and Scheduling, Campus Examination.

Centralized Files and Scheduling at the campus assembles the case file, updates Audit Information Management System controls, and suspends processing the return until the LB&I Division classifies it. From this population, we determined that 5,810 returns had a Transaction Code 420 (return has been referred for examination) for TY 2016 through TY 2018, and that most of these returns (97 percent) were ultimately surveyed (with a Transaction Code 421) within an average of 43 days.<sup>30</sup> The returns are also systemically surveyed if the LB&I Division does not classify them. However, expatriates who do not \*\*\*\*\*2\*\*\*\*\* or do not \*\*\*\*\*2\*\*\*\*\* with the Philadelphia Campus, or \*\*\*\*\*2\*\*\*\*\* are not reviewed for examination potential. As a result, thousands of taxpayers expatriating annually have largely gone unchecked. Overall, we found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules. Without a centralized compliance effort, Congress's attempts to create disincentives to expatriate via I.R.C. § 877A will not be effective until the IRS strengthens its enforcement efforts.

### The Commissioner, LB&I Division, should:

**Recommendation 5:** Establish a process to compile information on all expatriates whether they filed Form 8854 with their Form 1040-NR or filed Form 8854 with the LIHC unit and use this information to identify the highest risk expatriate returns for tax compliance.

**Management's Response:** IRS management agreed with this recommendation and stated that the Expatriation Campaign was established to compile information on all expatriates, whether they filed Form 8854 with their Form 1040-NR or filed Form 8854 with the LIHC unit, and they will use this information to identify expatriate returns with high risk of noncompliance.

<sup>30</sup> To "Survey" a return is to not initiate an examination. Most (91 percent) of the 61 sample cases we reviewed were surveyed with a Disposal Code 35, which is "Surveyed-Excess Inventory – Return has audit potential but time prohibits starting the examination."



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# Appendix I

### Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the effectiveness of the IRS's efforts in ensuring compliance with the expatriation tax provisions under I.R.C. Sections (§§) 877 and 877A and related efforts to reduce taxpayer burden. To accomplish our objective, we:

- Obtained an extract of the expatriate database to assess its reliability. We accomplished this by analyzing our extract of the database to determine whether the information is complete, accurate, and usable with regards to:
  - Critical information reported on Form 8854 and the CLNs.
  - Procedures in place to update the information when applicable.
  - Identification of taxpayers not in compliance with the provisions established for expatriating.
- Determined that the expatriate database and its Job Aid were not updated to match the current Form 8854 and I.R.C § 877A provisions. We reviewed current IRMs, Job Aids, I.R.C. sections, and other guidance to ensure that procedures were in place to collect information for input into the expatriate database. We interviewed personnel who review and input taxpayer data into the expatriate database to assess what is involved in the process of receiving and entering information into the expatriate database and any timeliness standards or rules pertaining to the receipt and entering information into the database. We assessed any controls or procedures in place to ensure that the information input is complete and accurate.
- Determined whether the expatriate database is used for compliance activities that ensure that expatriates are compliant with I.R.C. § 877A. We assessed the effectiveness and/or limitations of the database's reporting capabilities and any procedures in place that verify/ensure that the information reported by expatriating taxpayers is complete and accurate. We assessed procedures in place that use the database to actively monitor expatriating taxpayers' compliance with the rules for expatriation.
  - Judgmentally selected a sample of 61 expatriates from a population of 415 expatriates who met the tax liability and net worth rules and expatriated during the period from January 1, 2017, through December 31, 2018.<sup>1</sup>
  - Identified 55 expatriates who met the tax liability rule from June 18, 2008, through December 31, 2018, for which LIHC unit tax examiners researched the Individual Master File and recorded in the expatriate database one or more prior tax liabilities (expatriates are required to provide five prior years). We judgmentally selected the 26 expatriates who expatriated from CY 2016 through CY 2018.
- Determined the scope and status of the expatriation tax campaign and assessed the progress of the implementation of the campaign.

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<sup>1</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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### Performance of This Review

This review was performed at the SB/SE Division Philadelphia Campus in Philadelphia, Pennsylvania, and with information obtained from the LB&I Division Headquarters in Washington, D.C., during the period October 2019 through June 2020. 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.

Major contributors to the report were Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Christina Dreyer, Director; Robert Jenness, Acting Director; Timothy Greiner, Audit Manager; Charles Nall, Lead Auditor; and Victor Taylor, Senior Auditor.

### Validity and Reliability of Data From Computer-Based Systems

During this review, we relied on expatriate data extracted from an Access database maintained at the Philadelphia Campus. Before relying on these data, we ensured that the file contained the specific data elements we requested. In addition, we tested a randomly selected sample of 101 records with a CLN date, expatriation date, and no Form 8854 received date. We reconciled this information with the physical case files also maintained at the Philadelphia Campus. In all 101 cases, the CLN information and expatriation date matched the information in the expatriate database. In addition, none of the 101 case files contained a Form 8854, which supported the fact that no Form 8854 received date was entered to the database. Further, as part of our fieldwork, we reviewed samples from the database and verified relevant data fields recorded against the IRS Individual Master File using the Integrated Data Retrieval System. We determined that the data were sufficiently reliable for purposes of this audit.

### Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: controls over the processing of CLN documents and Forms 8854 and the processing of Forms 1040-NR with Form 8854 attached. We evaluated these controls by interviewing key personnel, analyzing data from the LIHC unit at the Philadelphia Campus, and performing analysis of tax return data from the Individual Returns Transaction File located on the Treasury Inspector General for Tax Administration Data Center Warehouse.



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# Appendix II

## 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:**

- Reliability of Information – Potential; information for 16,798 expatriates in the expatriate database is incomplete (see Recommendations 1 and 2).

### **Methodology Used to Measure the Reported Benefit:**

Pursuant to I.R.C. Section 6039G, individuals who expatriate are required to send a statement to the IRS (Form 8854) detailing the individual's income, assets, and liabilities. Expatriates use Form 8854 to certify compliance with tax obligations in the five years before expatriation. Expatriates file Form 8854 with the Philadelphia Campus, where the information is entered to the expatriate database.

We obtained an extract of this expatriate database on August 30, 2019, which contained 41,058 records for expatriates who expatriated from June 18, 2008, through December 31, 2018. Form 8854 is critical in determining whether the expatriate is a covered expatriate who is required to comply with I.R.C. § 877A. However, 16,798 of the 41,058 expatriates failed to file a Form 8854 with the Philadelphia Campus to report their prior income tax liabilities and net worth and to certify compliance. We identified these expatriates in the expatriate database via the data field "DATE CLN REC'D," which is the date the Form DS-4083 (CLN) was received by the IRS from the State Department. Because these taxpayers did not certify their tax compliance as required, they are also considered a covered expatriate under the law.

### **Type and Value of Outcome Measure:**

- Increased Revenue – Potential; \$6 million in unreported income pertaining to five expatriates (see Recommendations 3 and 4).

### **Methodology Used to Measure the Reported Benefit:**

LIHC unit tax examiners sometimes research for the expatriate's SSN using the Individual Master File, and LIHC unit tax examiners did not identify an SSN in 9,463 (56 percent) of 16,798 records in which only a CLN was received. For the 7,335 records for which the LIHC unit researched the Individual Master File and identified an SSN, we found that LIHC unit tax examiners researched and recorded one or more prior tax liabilities (when expatriates are required to provide five prior years) using the Individual Master File in the expatriate database for 3,315 (45 percent) of 7,335 expatriates.

Based on this research, 55 records met the tax liability rule, with average five-year tax liabilities more than the specified amount that is annually adjusted for inflation (\$165,000 for TY 2018), as a covered expatriate from June 18, 2008, through December 31, 2018. We selected 26 of the



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55 cases that were from CY 2016 through CY 2018 for further analysis. We researched information return documents filed with the IRS and the Individual Master File for these 26 cases to determine if receipt of the SSN would help the IRS to identify instances of potential tax compliance (nonfiling, underreporting, and/or nonpayment) issues. We determined that five of the 26 cases had potential unreported income of \$6,674,546.

### Type and Value of Outcome Measure:

- Increased Revenue – Actual; nearly \$17 million in unreported income pertaining to 15 expatriates (see Recommendation 5).

### Methodology Used to Measure the Reported Benefit:

We determined that 24,260 expatriates filed a Form 8854 with the Philadelphia Campus to report their prior income tax liabilities and net worth and/or certify compliance, from June 18, 2008, through December 31, 2018. From the 24,260 expatriates:

- 68 expatriated during the period from January 1, 2017, through December 31, 2018, with average income tax liability for the five preceding taxable years ending before expatriation date of over \$570,000. Of the 68 taxpayers, we randomly selected 26 cases reporting a combined net worth of \$925 million, capital gains of over \$126.3 million, and over \$584,000 in five-year average tax liability.
- 347 expatriated in the period from January 1, 2017, through December 31, 2018, and the total net worth of these expatriates was over \$4 billion. Of the 347, we randomly selected 35 cases reporting a combined net worth of \$289 million and capital gains of nearly \$3.3 million.

We reviewed these 61 cases for tax compliance and determined that 19 of the 61 expatriates did not report taxable income. We identified the potential unreported income using third-party information documents, *e.g.*, interest, dividends, capital gains, filed with the IRS. When we discussed these cases with IRS executives, they had concerns with four cases that included real estate sale transactions. After using an aggregate threshold of \$25,000 for the information return documents, and excluding cases with real estate sales transactions of nearly \$5 million, we determined that the 15 expatriates did not report \$17,502,462 in income.



## Appendix III

### Tax Liability and Exclusion Amounts by Tax Year

**Figure 1: Tax Liability Amounts by Tax Year**

Tax Year	Amount
2008	\$139,000
2009	\$145,000
2010	\$145,000
2011	\$147,000
2012	\$151,000
2013	\$155,000
2014	\$157,000
2015	\$160,000
2016	\$161,000
2017	\$162,000
2018	\$165,000
2019	\$168,000

Source: Instructions for Form 8854 for TYs 2008 through 2019.

**Figure 2: Net Gain Exclusion Amounts by Tax Year**

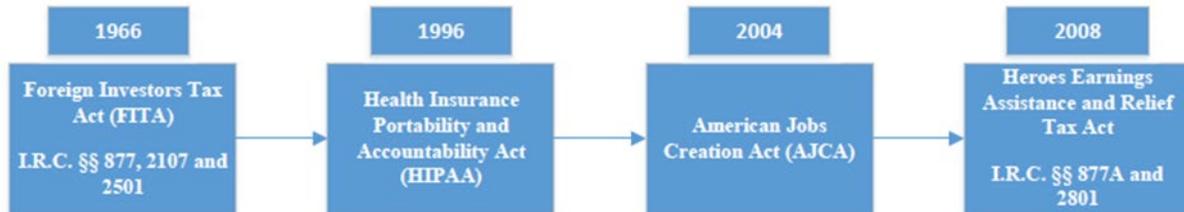
Tax Year	Amount
2008	\$600,000
2009	\$626,000
2010	\$627,000
2011	\$636,000
2012	\$651,000
2013	\$668,000
2014	\$680,000
2015	\$690,000
2016	\$693,000
2017	\$699,000
2018	\$711,000
2019	\$725,000

Source: Instructions for Form 8854 for TYs 2008 through 2019.



## Appendix IV

### U.S. Tax Expatriation – Timeline of Tax Law Changes



Source: Pub. L. Nos. 89-809 (1966), 104-191 (1996), 108-357 (2004), 110-245 (2008).

The Foreign Investors Tax Act of 1966 established a 10-year "alternative tax" regime on U.S. source income for expatriates.<sup>1</sup> Over the next four decades, the alternative tax regime was modified twice, first by the Health Insurance Portability and Accountability Act of 1996 and then by the AJCA. The Joint Committee on Taxation reviewed the effectiveness of the changes made by the Health Insurance Portability and Accountability Act of 1996. The Joint Committee on Taxation reported that there had been little, if any, enforcement of the expatriation rules by the responsible agencies, principally the IRS.<sup>2</sup> The Joint Committee on Taxation Report made a number of specific recommendations within the framework of the existing regime that were generally intended to make the rules easier to administer and enforce. The AJCA generally adopted recommendations made by the Joint Committee on Taxation.

The AJCA left the 10-year alternative tax regime on U.S. source income in place while making a number of important changes. For example, the AJCA removed the requirement that an individual have a tax avoidance purpose, eliminated the ruling procedure, and established the income tax liability test threshold to "greater than" \$124,000, indexed annually beginning in CY 2005. The net worth test standard increased to \$2,000,000, not indexed.<sup>3</sup> The AJCA added a third test which asked that an expatriate certify that they had fully complied with all U.S. tax requirements for the five years preceding expatriation.<sup>4</sup> Exceptions to the provision were limited to certain dual nationals at birth having no "substantial contacts" with the United States and minors expatriating before age 18½ who were born in the United State to noncitizen parents and who have not been in the United States more than 30 days in any of the 10 years preceding expatriation.<sup>5</sup>

<sup>1</sup> These rules were contained principally in I.R.C. §§ 877, 2107, and 2501.

<sup>2</sup> Joint Committee on Taxation, *Review of the Present-Law Tax and Immigration Treatment of Relinquishment of Citizenship and Termination of Long-Term Residency* (JCS-2-03) (Feb. 2003).

<sup>3</sup> AJCA I.R.C. § 804(a)(1), amending I.R.C. § 877(a)(2).

<sup>4</sup> AJCA I.R.C. § 804(a)(1), adding new I.R.C. § 877(a)(2)(C).

<sup>5</sup> Under the new I.R.C. § 877(c)(2)(B), added by AJCA I.R.C § 804(a)(1), an individual will be considered to have "substantial contacts" with the United States if he or she ever held a U.S. passport, was a U.S. tax resident within the meaning of I.R.C. § 7701(b), or spent more than 30 days in the United States in any of the 10 years preceding expatriation. This exception is available only to individuals who were dual citizens at birth and remain a citizen of the other country.



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Appendix V

Form 8854 - Tax Year 2007

Form 8854 Initial and Annual Expatriation Information Statement. Department of the Treasury Internal Revenue Service. OMB No. 1545-0074. 2007 Attachment Sequence No. 112. Name, Date of birth, Tax Year.

Initial or Annual Information Statement. Check the box that applies.

- Initial Information Statement. Complete Parts I, II, and III, and Schedules A and B.
Annual Information Statement. Complete Parts I and III and Schedules A and B. Skip Part II (see instructions).

Part I General Information. All filers must complete Part I. See instructions.

- 1 Identifying number
2 Mailing address and telephone number where you can be reached after expatriation
3 Address of principal foreign residence
4 Country of tax residence
5 Date of notification of expatriating act, termination of residency, or claim of treaty benefits.
a Citizen. Date notification given to Department of State
b Long-term resident. Date notification given to Homeland Security
c Long-term resident with dual residency in a treaty country.

Part II Initial Expatriation or Termination Information Statement

- 6 Enter your U.S. income tax liability (after foreign tax credits) for the 5 tax years ending before the date of expatriation.
7 Enter your net worth on the date of your expatriation for tax purposes
8 Did you become at birth a U.S. citizen and a citizen of another country, and do you continue to be a citizen of that other country?
9 Do you have substantial contacts with the United States?
10 Are you a minor described in section 877(c)(3)?
11 Do you certify under penalty of perjury that you have complied with all of your tax obligations for the 5 preceding tax years?

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## Part III Annual Information Reporting under Section 6039G

**Do not** complete this part if:

- Your average annual net income tax liability for years 1-5 (line 6) was not more than the limit listed under *Taxation Under Section 877* on page 1 of the instructions and your net worth on line 7 was under \$2,000,000, and you checked "Yes" to line 11, or
- You checked "Yes" to line 8 and "No" to line 9, and you checked "Yes" to line 11, or
- You checked "Yes" to line 10, and you checked "Yes" to line 11.

**12** List all countries (other than the United States) of which you are a citizen.

**a** Name of country .....

**b** How you became a citizen .....

**c** Date you became a citizen .....

**13** Number of days you were physically present in the United States during the current year. If you were present in the United States more than 60 days, skip line 14 . . . . .

**14** Were you physically present in the United States for more than 30 days but not more than 60 days during the tax year? . . . . .  **Yes**  **No**

**a** Were you performing services for an unrelated employer? . . . . .  **Yes**  **No**

**b** If you checked "Yes" to line 14a, are you a citizen or resident, fully liable for income tax, in the country in which you were born, your spouse was born, or either of your parents were born? .  **Yes**  **No**

<b>Sign Here</b>	Under penalties of perjury, I declare that I have examined this form, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than filer) is based on all information of which preparer has any knowledge.	
	Your signature	Date
	Preparer's signature	Date

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**Schedule A Balance Sheet**

- If this is an initial information statement, list in U.S. dollars the fair market value (column (a)) and the U.S. adjusted basis (column (b)) of your assets and liabilities as of the date of your expatriation for tax purposes.
  - If this is an annual information statement, list in U.S. dollars the fair market value (column (a)) and the U.S. adjusted basis (column (b)) of your assets and liabilities as of the end of the tax year for which you are filing this form.
  - If you are a former U.S. long-term resident (LTR), it may benefit you to complete column (d). Only former LTRs should do so.
- For more details, see the separate instructions.

Assets	(a) Fair Market Value (FMV)	(b) U.S. adjusted basis	(c) Gain or (Loss). Subtract column (b) from column (a)	(d) FMV on beginning date of U.S. residency (optional, for LTRs only)
<b>1</b> Cash, including bank deposits . . . . .				
<b>2</b> Marketable stock and securities issued by U.S. companies . . . . .				
<b>3</b> Marketable stock and securities issued by foreign companies . . . . .				
<b>4</b> Nonmarketable stock and securities issued by U.S. companies . . . . .				
<b>5</b> Nonmarketable stock and securities issued by foreign companies . . . . .				
<b>a</b> Separately state stock issued by foreign companies that would be controlled foreign corporations if you were still a U.S. citizen or permanent resident (see instructions) . . . . .				
<b>b</b> Provide the name, address, and EIN, if any, of any such company _____				
<b>6</b> Pensions from services performed in the United States . . . . .				
<b>7</b> Pensions from services performed outside the United States . . . . .				
<b>8</b> Partnership interests (see instructions) . . . . .				
<b>9</b> Assets held by trusts you own under sections 671-679 (see instructions) . . . . .				
<b>10</b> Beneficial interests in nongrantor trusts (see instructions) . . . . .				
<b>11</b> Intangibles used in the United States . . . . .				
<b>12</b> Intangibles used outside the United States . . . . .				
<b>13</b> Loans to U.S. persons . . . . .				
<b>14</b> Loans to foreign persons . . . . .				
<b>15</b> Real property located in the United States . . . . .				
<b>16</b> Real property located outside the United States . . . . .				
<b>17</b> Business property located in the United States . . . . .				
<b>18</b> Business property located outside the United States . . . . .				
<b>19</b> Other assets (see instructions) . . . . .				
<b>20</b> Total assets. Add lines 1 through 5 and lines 6 through 19. Do not include amounts on line 5a in this total . . . . .				
<b>Liabilities</b>	<b>Amount</b>			
<b>21</b> Installment obligations . . . . .				
<b>22</b> Mortgages, etc. . . . .				
<b>23</b> Other liabilities (see instructions) . . . . .				
<b>24</b> Total liabilities. Add lines 21 through 23 . . . . .				
<b>25</b> <b>Net worth.</b> Subtract line 24 from line 20, column (a) . . . . .				

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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**Schedule B Income Statement**

- If this is an initial information statement, provide income information for that portion of the year that ends on the date of your expatriation for tax purposes.
- If this is an annual information statement, provide income information for the tax year for which you are filing the form.

<b>1</b>	U.S. source gross income not effectively connected with the conduct of a U.S. trade or business.				
	<b>a</b> Interest . . . . .	<b>1a</b>			
	<b>b</b> Dividends . . . . .	<b>1b</b>			
	<b>c</b> Royalties . . . . .	<b>1c</b>			
	<b>d</b> Pension distributions . . . . .	<b>1d</b>			
	<b>e</b> Other . . . . .	<b>1e</b>			
	<b>f Total.</b> Add lines a through e . . . . .			<b>1f</b>	
<b>2</b>	Gross income that is effectively connected with the conduct of a U.S. trade or business . . . . .			<b>2</b>	
<b>3</b>	Income from the performance of services in the United States . . . . .			<b>3</b>	
<b>4</b>	Gains from the sale or exchange of:				
	<b>a</b> Property (other than stock or debt obligations) located in the United States . . . . .	<b>4a</b>			
	<b>b</b> Stock issued by a U.S. domestic corporation . . . . .	<b>4b</b>			
	<b>c</b> Debt obligations of U.S. persons or of the United States, a state or political subdivision thereof, or the District of Columbia . . . . .	<b>4c</b>			
	<b>d Total.</b> Add lines a through c . . . . .			<b>4d</b>	
<b>5</b>	Income or gain derived from certain foreign corporations to the extent of your share of earnings and profits earned or accumulated before the date of expatriation (see instructions), . . . . .			<b>5</b>	
<b>6</b>	Gains on certain exchanges of property that would ordinarily not be recognized (see instructions)			<b>6</b>	
<b>7</b>	Income received or accrued by certain foreign corporations (see instructions) . . . . .			<b>7</b>	
<b>8</b>	Add lines 1f, 2, 3, 4d, 5, 6, and 7 . . . . .			<b>8</b>	
<b>9</b>	Gross income from all other sources . . . . .			<b>9</b>	
<b>10</b>	<b>Total.</b> Add lines 8 and 9 . . . . .			<b>10</b>	

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Appendix VI

Form 8854 - Tax Year 2018

Form 8854 Initial and Annual Expatriation Statement. Department of the Treasury Internal Revenue Service. OMB No. 1545-0074. 2018 Attachment Sequence No. 112.

Part I General Information. For all filers.

1 Mailing address and telephone number where you can be reached after expatriation:
2 Address of principal foreign residence (if different from line 1):
3 Country of tax residence (if different from line 2):
4 Expatriation date. Check the box that applies (see instructions).
5 Date of notification of expatriating act, termination of residency, or claim of treaty benefits (see instructions).
6 Number of days you were physically present in the United States in the current year:
7 List all countries (other than the United States) of which you are a citizen.
8 How you became a U.S. citizen: By birth By naturalization

Part II For Persons Who Expatriated After June 3, 2004, and Before June 17, 2008

1 Did you complete Form 8854 for any period after June 3, 2004, and before June 17, 2008?
2 Were you physically present in the United States for more than 30 days but not more than 60 days during the tax year?
a If you checked "Yes" to line 2, were you performing services for an unrelated employer?
b If you checked "Yes" to line 2a, are you a citizen or resident, fully liable for income tax, in the country in which you were born, your spouse was born, or either of your parents was born?



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**Part III For Persons Who Expatriated After June 16, 2008, and Before January 1, 2018**

- If you made an election to defer the payment of tax, complete line 1.
- If you have an item of eligible deferred compensation, complete line 2.
- If you have an interest in a nongrantor trust, complete line 3.

**1** Complete columns (a), (b), and (c) for all property on which you deferred tax on a prior year Form 8854. Complete column (d) for any property you disposed of in 2018 and see the instructions for Part III.

(a) Description of property	(b) Amount of mark-to-market gain or (loss) reported on prior year Form 8854	(c) Amount of tax deferred on prior year Form 8854	(d) Date of disposition (if any)

- 2** Did you receive any distributions of eligible deferred compensation items for 2018?  Yes  No  
 If "Yes," Amount of distribution: \_\_\_\_\_ Amount withheld at source, if any: \_\_\_\_\_
- 3** Did you receive any distributions from a nongrantor trust for 2018?  Yes  No  
 If "Yes," Amount of distribution: \_\_\_\_\_ Amount withheld at source, if any: \_\_\_\_\_

**Part IV For Persons Who Expatriated During 2018**

**Section A Expatriation Information**

- 1** Enter your U.S. income tax liability (after foreign tax credits) for the 5 tax years ending before the date of expatriation.
- |                                 |                                 |                                 |                                 |                                 |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| 1st Year<br>Before Expatriation | 2nd Year<br>Before Expatriation | 3rd Year<br>Before Expatriation | 4th Year<br>Before Expatriation | 5th Year<br>Before Expatriation |
| \$ _____                        | \$ _____                        | \$ _____                        | \$ _____                        | \$ _____                        |
- 2** Enter your net worth on the date of your expatriation for tax purposes . . . . . \$ \_\_\_\_\_
- 3** Did you become at birth a U.S. citizen and a citizen of another country, and do you continue to be a citizen of, and taxed as a resident of, that other country? . . . . .  Yes  No
- 4** If you answered "Yes" to question 3, have you been a resident of the United States for not more than 10 of the last 15 tax years? . . . . .  Yes  No
- 5** Were you under age 18½ on the date you expatriated and have you been a U.S. resident for not more than 10 years? . . . . .  Yes  No
- 6** Do you certify under penalties of perjury that you have complied with all of your tax obligations for the 5 preceding tax years (see instructions)? . . . . .  Yes  No

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**Section B** **Property Owned on Date of Expatriation**

**Don't** complete Section B if:

- Your average net income tax liability for the 5 tax years immediately before expatriation (see line 1 in Section A) wasn't more than \$165,000, your net worth (see line 2 in Section A) was under \$2 million, and you checked "Yes" on line 6 in Section A;
- In Section A, you checked "Yes" on lines 3, 4, and 6; or
- In Section A, you checked "Yes" on lines 5 and 6.

**7a** Do you have any **eligible deferred compensation items**? Checking the "Yes" box is an irrevocable waiver of any right to claim any reduction in withholding for such eligible deferred compensation item under any treaty with the United States . . . . .  **Yes**  **No**

**b** Do you have any **ineligible deferred compensation items**? If "Yes," you must include in income the present value of your account on the day before your expatriation date . . . . .  **Yes**  **No**

**c** Do you have any **specified tax deferred accounts**? If "Yes," you must include in income the entire account balance on the day before your expatriation date . . . . .  **Yes**  **No**

**d** Do you have an interest in a **nongrantor trust**? Checking the "Yes" box is a waiver of any right to claim any reduction in withholding on any distribution from such trust under any treaty with the United States unless you make the election below . . . . .  **Yes**  **No**

Check this box to elect under section 877A(f)(4)(B) to be treated as having received the value of your entire interest in the trust (as determined for purposes of section 877A) as of the day before your expatriation date. Attach a copy of your valuation letter ruling issued by the IRS (see instructions).

**8** Recognition of gain or loss on the deemed sale of mark-to-market property. **Caution:** Don't include in column (a) any property described on line 7a, 7b, 7c, or 7d.

Complete column (g) only if you are deferring tax on gain from any property listed in column (a).

(a) Description of property	(b) Fair market value on day before date of expatriation	(c) Cost or other basis*	(d) Gain or (loss). Subtract (c) from (b)	(e) Gain after allocation of the exclusion amount (see instructions)	(f) Form or Schedule on which gain or loss is reported	(g) Amount of tax deferred (attach computations)
<b>9 Total.</b> Add the amounts in column (d) and column (e) . . . . .						
<b>10 Total tax deferred.</b> Add the amounts in column (g). Enter here and on line 15 . . . . .						

\*You must identify as "(h)(2)" any property for which you are making the special basis election under section 877A(h)(2). This election is irrevocable. See the instructions for Part IV, Section B, line 8, column (c).

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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**Section C**    **Deferral of Tax**

**Election to defer tax.** *You can defer tax only if you have provided adequate security. Adequate security is described in the instructions.*

- 11** Are you electing to defer tax under section 877A(b)?  
 Checking the "Yes" box is an irrevocable waiver of any right under any treaty of the United States that would prevent assessment or collection of any tax imposed because of section 877A.       **Yes**     **No**

If you checked the "Yes" box, continue to line 12. Otherwise, don't complete lines 12 through 15.

<b>12</b>	Enter the total tax you would have reported on Form 1040, line 15, for the part of the year including the day before the expatriation date absent the deferral election . . . . .	<b>12</b>	
<b>13</b>	Enter the total tax for the same part of the tax year determined without regard to the amounts attributable to section 877A(a). Attach computation . . . . .	<b>13</b>	
<b>14</b>	Subtract line 13 from line 12. <b>This is the amount of tax eligible for deferral</b> . . . . .	<b>14</b>	
<b>15</b>	Enter the total tax deferred from line 10, column (g) . . . . .	<b>15</b>	
	<ul style="list-style-type: none"> <li>• If you are filing Form 1040, enter this amount in brackets to the left of the entry space for line 15. Identify as "EXP."</li> <li>• If you are filing Form 1040NR, enter this amount in brackets to the left of the entry space for line 61. Identify as "EXP."</li> </ul>		

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**Part V Balance Sheet and Income Statement**

**Schedule A Balance Sheet**

List in U.S. dollars the fair market value (column (a)) and the U.S. adjusted basis (column (b)) of your assets and liabilities as of the following date.

- Part II filers—the end of the tax year for which you are filing the form.
- Part IV filers—your expatriation date. **Note:** Part IV filers don't complete column (d).

For more details, see the separate instructions.

Assets	(a) Fair market value (FMV)	(b) U.S. adjusted basis	(c) Gain or (loss). Subtract column (b) from column (a)	(d) FMV on beginning date of U.S. residency (optional, for long-term residents only)
<b>1</b> Cash, including bank deposits . . . . .				
<b>2</b> Marketable stock and securities issued by U.S. companies . . . . .				
<b>3</b> Marketable stock and securities issued by foreign companies . . . . .				
<b>4</b> Nonmarketable stock and securities issued by U.S. companies . . . . .				
<b>5</b> Nonmarketable stock and securities issued by foreign companies . . . . .				
<b>a</b> Separately state stock issued by foreign companies that would be controlled foreign corporations if you were still a U.S. citizen or permanent resident (see instructions) . . . . .				
<b>b</b> Provide the name, address, and EIN, if any, of any such company _____				
<b>6</b> Pensions from services performed in the United States . . . . .				
<b>7</b> Pensions from services performed outside the United States . . . . .				
<b>8</b> Partnership interests (see instructions) . . . . .				
<b>9</b> Assets held by trusts you own under sections 671 through 679 (see instructions)				
<b>10</b> Beneficial interests in nongrantor trusts (see instructions) . . . . .				
<b>11</b> Intangibles used in the United States . . . . .				
<b>12</b> Intangibles used outside the United States . . . . .				
<b>13</b> Loans to U.S. persons . . . . .				
<b>14</b> Loans to foreign persons . . . . .				
<b>15</b> Real property located in the United States . . . . .				
<b>16</b> Real property located outside the United States . . . . .				
<b>17</b> Business property located in the United States . . . . .				
<b>18</b> Business property located outside the United States . . . . .				
<b>19</b> Other assets (see instructions) . . . . .				
<b>20</b> Total assets. Add lines 1 through 5 and lines 6 through 19. Don't include amounts on line 5a in this total . . . . .				
<b>Liabilities</b>	<b>Amount</b>			
<b>21</b> Installment obligations . . . . .				
<b>22</b> Mortgages, etc. . . . .				
<b>23</b> Other liabilities (see instructions) . . . . .				
<b>24</b> Total liabilities. Add lines 21 through 23 . . . . .				
<b>25</b> <b>Net worth.</b> Subtract line 24 from line 20, column (a). . . . .				

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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**Schedule B Income Statement**

Provide income information for the following period.

- Part II filers—the tax year for which you are filing the form.
- Part IV filers—the part of the tax year that ends with the day before your expatriation date; but enter -0- for lines 5 through 7.

<b>1</b> U.S. source gross income not effectively connected with the conduct of a U.S. trade or business.				
<b>a</b> Interest	<b>1a</b>			
<b>b</b> Dividends	<b>1b</b>			
<b>c</b> Royalties	<b>1c</b>			
<b>d</b> Pension distributions	<b>1d</b>			
<b>e</b> Other	<b>1e</b>			
<b>f Total.</b> Add lines 1a through 1e			<b>1f</b>	
<b>2</b> Gross income that is effectively connected with the conduct of a U.S. trade or business			<b>2</b>	
<b>3</b> Income from the performance of services in the United States			<b>3</b>	
<b>4</b> Gains from the sale or exchange of:				
<b>a</b> Property (other than stock or debt obligations) located in the United States	<b>4a</b>			
<b>b</b> Stock issued by a U.S. domestic corporation	<b>4b</b>			
<b>c</b> Debt obligations of U.S. persons or of the United States, a state or political subdivision thereof, or the District of Columbia	<b>4c</b>			
<b>d Total.</b> Add lines 4a through 4c			<b>4d</b>	
<b>5</b> Income or gain derived from certain foreign corporations to the extent of your share of earnings and profits earned or accumulated before the date of expatriation (see instructions)			<b>5</b>	
<b>6</b> Gains on certain exchanges of property that ordinarily wouldn't be recognized (see instructions)			<b>6</b>	
<b>7</b> Income received or accrued by certain foreign corporations (see instructions)			<b>7</b>	
<b>8</b> Add lines 1f, 2, 3, 4d, 5, 6, and 7			<b>8</b>	
<b>9</b> Gross income from all other sources			<b>9</b>	
<b>10 Total.</b> Add lines 8 and 9			<b>10</b>	

**Sign Here**

Under penalties of perjury, I declare that I have examined this form, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than filer) is based on all information of which preparer has any knowledge.

Your signature \_\_\_\_\_ Date \_\_\_\_\_

---

<b>Paid Preparer Use Only</b>	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶				Firm's EIN ▶
	Firm's address ▶				Phone no.

Form **8854** (2018)



More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

Appendix VII

Certificate of Loss of Nationality of the United States

U.S. Department of State

BUREAU OF CONSULAR AFFAIRS

CERTIFICATE OF LOSS OF NATIONALITY OF THE UNITED STATES

This form is prescribed by the Secretary of State pursuant to Section 501 of the Act of October 14, 1940 (54 Stat. 1171) and Section 358 of the Act of June 27, 1952 (66 Stat. 272).



DEPARTMENT USE ONLY

1. Embassy/Consulate \_\_\_\_\_ of the United States of America
2. at \_\_\_\_\_ ss:
3. I, \_\_\_\_\_ Name
hereby certify that, to the best of my knowledge and belief,
4. \_\_\_\_\_ Name
5. was born at \_\_\_\_\_ Town or City, \_\_\_\_\_ Province or County
6. \_\_\_\_\_ State or Country, on \_\_\_\_\_ Date (mm-dd-yyyy)
7. That: he/she resided/never resided\* in the United States (Dates) \_\_\_\_\_;
8. That: he/she resides at \_\_\_\_\_;
9. That: he/she acquired the nationality of the United States by virtue of \_\_\_\_\_;
10. That: he/she acquired the nationality of \_\_\_\_\_ by virtue of \_\_\_\_\_;
11. \_\_\_\_\_;
12. That: he/she (The action causing expatriation should be set forth succinctly.) \_\_\_\_\_;
13. That: said expatriating act was performed voluntarily with the intent to relinquish United States citizenship;
14. That: he/she thereby expatriated \_\_\_\_\_ self on (Date) \_\_\_\_\_ (mm-dd-yyyy) under the provisions of
15. Section \_\_\_\_\_ of The Nationality Act of 1940; The Immigration and Nationality Act of 1952, as amended.\*
16. That the evidence of such action consists of the following: \_\_\_\_\_;
17. That attached to and made a part of this certificate are the following documents or copies thereof: \_\_\_\_\_;
18. In testimony whereof, I have hereunto subscribed by name and affixed my office seal this \_\_\_\_\_ day of \_\_\_\_\_ (Month), \_\_\_\_\_ (Year).
[SEAL] Signature
Title
\* Strikeout inapplicable item



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Appendix VIII

Letter 2399C - Failure to File Initial Form 8854

Department of the Treasury | Transmittal Number | Date of Issue | 06-08 | 08/07/2006 | Originating Office | Form Number | SE:S:SP:IN:IP | 2399C

IDRS CORRESPONDEX

Internal Revenue Service

Title: Failure to File Initial Form 8854 - Post AJCA Notification Letter

Number of Copies | Distribution to: | Former Letter | Original | 1 to TP

OMB Clearance Number | Expires | IMF | -

Letters Considered in Revision:

Drop Point: [01 4V] Person to Contact: [02 30V] Badge Number: [03 10V] Contact Phone Number: [04 23V]

Dear [-30V]

WHY WE ARE CONTACTING YOU

You are receiving this letter because our records show that you have lost your U.S. citizenship but have not properly given notice to the Internal Revenue Service. Such notice is given by filing an initial Form 8854, Initial and Annual Expatriation Information Statement. We [05 50V] initial Form 8854.

You are receiving this letter because our records show that you have terminated your lawful permanent resident status, having been a lawful permanent resident for 8 of the last 15 years (long term resident), but have not properly given notice to the Internal Revenue Service. Such notice is given by filing an initial Form 8854, Initial and Annual Expatriation Information Statement. We [06 50V] initial Form 8854.

Specifically, information is missing from [07 91V]

[08 385V]



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### WHAT DOES THE LAW REQUIRE

Internal Revenue Code (IRC) section 7701(n) requires that a citizen or long-term resident of the U.S. who otherwise stops being a citizen or resident will continue to be treated as such for federal tax purposes. The law requires this individual to be treated as a citizen or resident until the individual (1) gives notice of an expatriating act or termination of residency (with the required intent to relinquish citizenship or terminate such status) to the State Department or the Department of Homeland Security and (2) provides a statement to the IRS based on the revised requirements of IRC section 6039G, which can be done by filing a complete initial Form 8854. Until you comply with both 1 and 2 above, notification and information reporting requirements, you will continue to be treated as a citizen or resident of the United States for federal income tax purposes regardless of your status under U.S. immigration laws.

If IRC section 877 applies to you, IRC 6039G also states that you must file an annual Form 8854 for 10 tax years following the date of your expatriation, whether you owe taxes under IRC section 877 for each tax year or not. The first annual Form 8854 you file must include the date of your expatriation or termination of long-term resident status. This annual form will be due by the same due date of filing a Form 1040-NR (generally by June 15) or, if you are present in the United States following your expatriation and are subject to tax as a U.S. citizen or resident, by the due date of filing a Form 1040 (generally by April 15).

### WHAT YOU NEED TO DO

If you want to establish that you are no longer to be treated as a U.S. citizen or resident for federal tax purposes and you have never submitted the initial Form 8854, please do so now. You will continue to be treated as a U.S. citizen or resident for federal tax purposes until the date you file your completed initial Form 8854 with us. The postmark date will be considered your date of expatriation for federal tax purposes. For your convenience, we have included a Form 8854 and the related instructions with this letter and ask that you complete all of the pertinent sections and return to the address at the top of this letter.

If you submitted an incomplete initial Form 8854, you will need to complete another one and mail it to the address at the top of this letter. You will continue to be treated as a U.S. citizen or resident for federal tax purposes until the date you file your completed initial Form 8854 with us. The postmark date will be considered your date of expatriation for federal tax purposes. For your convenience, we have included a Form 8854 and the related instructions with this letter and ask that you complete all of the pertinent sections and return to the address at the top of this letter.

If you are required to file an annual Form 8854 but fail to do so, do not include all of the information required by the form, or the form includes incorrect information, you could be assessed a penalty



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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of \$10,000 for each tax year that a required annual Form 8854 is not filed, unless you can show that your failure to file the form was due to reasonable cause and not willful neglect.

It is important to note! Filing an initial Form 8854 only satisfies your information reporting obligations resulting from your expatriation for tax purposes. You are still required to:

- File an annual Form 8854 for the 10 tax years following the date of your expatriation for tax purposes, if:
  - \* Your net worth as of the date of your expatriation is \$2 million or more;
  - \* Your annual net income tax liability for the 5 years ending before the date of your expatriation is greater than \$[09 12\$]; or
  - \* You fail or are not able to certify on Form 8854, under penalty of perjury, that you met your tax obligations for the 5 years ending before the date of your expatriation.
- Compute any tax due, if applicable, under IRC section 877.

### HOW TO CONTACT US

If you have any questions, please call the contact person whose name and telephone number are shown at the top of this letter or refer to "The American Jobs Creation Act" information on our IRS.gov web site at <http://www.irs.gov/businesses/small/international/index.html>.

Sincerely yours,

[10 35S]

[11 35S]

Enclosures:  
Form 8854  
Instructions for Form 8854  
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NOTE: Use Sel. A for lost citizenship or use Sel. B for termination of permanent resident status.

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

# 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

September 8, 2020

MEMORANDUM FOR MICHAEL E. McKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

Digitally signed by Douglas W.  
Odonnell  
Date: 2020.09.09 11:08:06 -04'00'

SUBJECT: Draft Audit Report # 2019-30-016, More Enforcement and A  
Centralized Compliance Effort Are Required for Expatriation  
Provisions

Thank you for the opportunity to review and comment on the draft report referenced above. Historically, IRS audits of expatriates focused on noncompliance with expatriation tax law and high risk expatriates who filed Form 8854, Initial and Annual Repatriation Statement; soft letters were transmitted to certain expatriates who failed to file Form 8854. More recently, in July 2019, the IRS announced a campaign to enhance these earlier efforts to ensure tax compliance of covered expatriates. This campaign evaluates filings of Forms 8854 and 1040-NR, U.S. Nonresident Alien Income Tax Return, utilizing numerous filters to identify those areas of potential risk for noncompliance. This has led to issuance of soft letters to expatriates who have not filed a required Form 8854 and examinations of covered expatriates with a high risk of expatriation tax noncompliance. We are assessing, and will continue to assess, initial campaign results, compliance risks, available resources, and organizational priorities to determine what modifications should be made to the campaign, to the Expatriation Database and/or to the Form 8854, as well as when to request additional information regarding missing or incomplete Forms 8854.

We have also begun assessing potential enhancements to the Expatriation Database that would expand the breadth and usability of the data; and strengthen our data analytics capabilities for identifying noncompliance in this area.

The attachment provides a response outlining our corrective actions for the recommendations. While the forms you reviewed included some reporting discrepancies, it does not necessarily follow that an examination of the relevant taxpayers will result in an increase of revenue.

Please contact me if you have any questions, or members of your staff may contact Deborah T. Palacheck, Director, Withholding & International Individual Compliance Practice Area at (202) 317-8451.

Attachment



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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### Attachment I

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

#### **RECOMMENDATION 1:**

Contact the Department of State, via the Federal Intergovernmental Program, for the Social Security number data field to be added to the Certificate of Loss of Nationality of the United States Form DS-4083 and explore the feasibility of obtaining the CLN electronically.

#### **CORRECTIVE ACTIONS:**

We will contact the Department of State, via the Federal Intergovernmental Program, to request the Social Security number data field be added to the Certificate of Loss of Nationality of the United States, Form DS-4083, and explore the feasibility of obtaining the CLN electronically.

#### **IMPLEMENTATION DATE:**

March 31, 2021

#### **RESPONSIBLE OFFICIAL(S):**

Deborah Palacheck, Director, Withholding & International Individual Compliance Practice Area

#### **CORRECTIVE ACTION(S) MONITORING PLAN:**

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

#### **RECOMMENDATION 2:**

Update the Letter 2399C and Letter 4135C for compliance under HEART Act of 2008 and develop IRM procedures to use these letters to obtain Form 8854 when a Certificate of Loss of Nationality is received and no Form 8854.

#### **CORRECTIVE ACTIONS:**

We will update letters 2399C and 4135C to include the requirements of I.R.C. § 877A and remove any language no longer applicable under the HEART Act of 2008. We will also develop IRM or other procedures on how, and when appropriate, to obtain Form 8854 when a Certificate of Loss of Nationality but no Form 8854 is received, taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

#### **IMPLEMENTATION DATE:**

December 31, 2021

#### **RESPONSIBLE OFFICIAL(S):**

Deborah Palacheck, Director, Withholding & International Individual Compliance Practice Area



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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**CORRECTIVE ACTION(S) MONITORING PLAN:**

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

**RECOMMENDATION 3:**

Evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriation database to ensure tax compliance of taxpayers that expatriate (e.g. Form 8854, *Part IV, Schedule B, Property Owned on Date of Expatriation*).

**CORRECTIVE ACTIONS:**

We will evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriation database to best evaluate the tax compliance of taxpayers that expatriate, taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

**IMPLEMENTATION DATE:**

December 31, 2021

**RESPONSIBLE OFFICIAL(S):**

Deborah Palacheck, Director, Withholding & International Individual Compliance Practice Area

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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

**RECOMMENDATION 4:**

Develop IRM procedures for transcribing Form 8854 data, correcting Form 8854 data when information as filed by expatriates is missing or incomplete and prepare analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under I.R.C. § 877A.

**CORRECTIVE ACTIONS:**

Following the initial assessment of the Expatriation Campaign results, compliance risks, resource availability, and organizational priorities, we will develop IRM or other procedures for inputting and correcting certain Form 8854 data when information as filed by expatriates is missing or incomplete, as appropriate, and prepare an analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under I.R.C. § 877A.

**IMPLEMENTATION DATE:**

December 31, 2021



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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**RESPONSIBLE OFFICIAL(S):**

Deborah Palacheck, Director, Withholding & International Individual Compliance Practice Area

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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

**RECOMMENDATION 5:**

Establish a process to compile information on all expatriates whether they filed Form 8854 with their Form 1040-NR or filed Form 8854 with the LIHC unit and use this information to identify the highest risk expatriate returns for tax compliance.

**CORRECTIVE ACTIONS:**

The Expatriation Campaign is the process established to compile information on all expatriates, whether they filed Form 8854 with their Form 1040-NR or filed Form 8854 with the LIHC unit, and we will use this information to identify expatriate returns with high risk of noncompliance.

**IMPLEMENTATION DATE:**

Implemented

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION(S) MONITORING PLAN:**

N/A



## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

# Appendix X

## Glossary of Terms

Term	Definition
Audit Information Management System	The Audit Information Management System is a computer system used by the Small Business/Self-Employed Division Examination Operations function and others to control returns, input assessments/adjustments to the Master File, and provide management reports.
Calendar Year	The 12-consecutive-month period ending on December 31.
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.
Classification	The process of determining whether a return should be selected for audit, the initial issues to be audited, and who should conduct the audit.
Data Center Warehouse	Provides data and data access services and a centralized storage, security, and administration of files. Also develops uniform and user-friendly interfaces for users to access data.
Disposal Code	Two digit code used to indicate the disposition of an examination. The codes are assigned by the Examination function.
Expatriate Database	IRS database used to collect information on expatriates.
Federal Register	The official daily publication for rules, proposed rules, and notices of Federal agencies and organizations, as well as executive orders and other presidential documents.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Individual Returns Transaction File	Contains data transcribed from initial input of the original individual tax returns during return processing.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
IRS Catalog	Provides electronic and printed products and services that enable America's taxpayers to understand and meet their tax responsibilities and IRS employees to effectively and fairly administer the tax laws.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.



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Tax Modules	Part of a taxpayer's account which reflects tax data for one tax class and one tax period.
Tax Year	The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Taxpayer Identification Number	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the Taxpayer Identification Number is an Employer Identification Number, an SSN, or an Individual Taxpayer Identification Number.
Transaction Code	A three-digit code used to identify actions being taken on a taxpayer's account.

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## More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions

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### Appendix XI

#### Abbreviations

AJCA	American Jobs Creation Act of 2004
CLN	Certificate of Loss of Nationality of the United States
CY	Calendar Year
FY	Fiscal Year
HEART Act	The Heroes Earnings Assistance and Relief Tax Act of 2008
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LB&I	Large Business and International
LIHC	Low-Income Housing Credit
SB/SE	Small Business/Self-Employed
SSN	Social Security Number
TY	Tax Year