
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
Office of Inspections and Evaluations



*A Combination of Legislative Actions and
Increased IRS Capability and Capacity Are
Required to Reduce the Multi-Billion Dollar
U.S. International Tax Gap*

January 27, 2009

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

January 27, 2009

MEMORANDUM FOR COMMISSIONER SHULMAN

FROM: Philip Shropshire 
Director for Inspections and Evaluations

SUBJECT: Final Evaluation Report - A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap
(Project # 200110IE002, Previously Audit #200730027)

This report presents the results of our review of the IRS actions to address the international tax gap. The overall objective of this review was to identify the accuracy and reliability of estimates of the size of the U.S. international tax gap, whether the IRS is planning to develop its own measurement, and the efforts to reduce the international tax gap.

Impact on the Taxpayer

The international tax gap is defined as taxes owed—but not collected on time—from a United States (U.S.) person¹ or foreign person² whose cross-border transactions are subject to U.S. taxation. The IRS has not developed an accurate and reliable estimate of the international tax gap and has no plans to comprehensively measure it, but it is making the reduction of the international tax gap a top priority. Some non-IRS estimates place the international tax gap at

¹ A U.S. person is defined by the Internal Revenue Code (I.R.C.) §7701(a)(30) as a citizen or resident of the United States, domestic partnership, domestic corporation, any estate (not defined as a foreign estate under I.R.C. §7701(a)(31)), and any trust, if administered by a U.S. court or supervised by one or more U.S. persons.

² A foreign person includes a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, and any other person who is not a U.S. person.



A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap

\$100 billion or more annually.³ The result is that compliant taxpayers have additional tax burden when noncompliant taxpayers do not pay their legal obligations.

Synopsis

The IRS estimated that the entire tax gap for Tax Year 2001 was \$345 billion. However, the IRS has not developed an estimate for the international tax gap. Non-IRS estimates of the international tax gap range from \$40 billion to \$123 billion. While there might be overlap between the IRS tax gap estimate and the international tax gap, it is doubtful that the \$345 billion estimate includes the entire international tax gap.

The primary reason for this conclusion is that identifying hidden income within international activity is very difficult and time-consuming.⁴ Furthermore, the IRS did not measure for the international tax gap component in the Individual National Research Project (NRP) estimate for the Tax Year 2001 tax gap. Therefore, it is unlikely that hidden offshore income is comprehensively included in the IRS tax gap estimates. In fact, the IRS's Research, Analysis and Statistics (RAS) organization reasoned that because of cost, staffing, and technical limitations, an NRP type of direct measurement is unfeasible. However, in an attempt to learn more, the IRS has other initiatives underway.

Addressing the international tax gap without the benefit of an NRP type approach is a significant challenge. An important fact to consider is that a prime use of NRP data is to develop algorithms to better identify noncompliant taxpayers and not burden compliant taxpayers. This allows the IRS to make data-driven resource allocation decisions to address patterns of noncompliance. When NRP information is not available, other methods to detect noncompliance are required. As a result, the IRS must allocate its international resources based on factors such as employing previously successful compliance actions, acting on promising initiatives, and sometimes relying on anecdotal evidence.

Consequently, there is less certainty that international tax compliance resources are efficiently allocated to address noncompliance. In fact, the Government Accountability Office determined that about half of offshore examinations resulted in an additional assessment compared to about 70 percent of non-offshore examinations that result in additional assessments.

Nevertheless, over the past few years, the IRS has taken actions to better coordinate international tax compliance issues. First, in September 2007, the Service-wide Approach to International Tax Administration was announced. The approach describes the three strategic goals of 1) improving

³ U.S. Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations. 2008. Tax Haven Banks and U.S. Tax Compliance. Washington D.C. July 17. Accessed online at: http://hsgac.senate.gov/public_files/071708PSIReport.pdf.

⁴ See the GAO audit report *TAX ADMINISTRATION: Additional Time Needed to Complete Offshore Tax Evasion Examinations* (Reference Number GAO-07-237, dated March 2007).



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

taxpayer service, 2) enhancing enforcement and modernizing the IRS for improving voluntary compliance with international tax provisions, and 3) reducing the tax gap attributable to international transactions. The Service-wide Approach to International Tax Administration is supported by detailed tracking plans for the strategic accomplishments and initiatives.

Next, the IRS Commissioner has stated that international issues are a top priority during his tenure. Finally, additional changes were made by modifying organizational structures, changing processes to facilitate improving compliance, investing in human capital and information technology, and increasing cooperation and outreach efforts to foreign governments. Together, these changes should provide the IRS with additional capability and capacity to address international tax compliance.

Beyond the IRS, legislation has been introduced to address tax haven abuse. As with most legislation, it is difficult to determine whether the proposed legislation will become law and whether it would achieve its intended purpose if implemented. Additionally, the Senate Finance Committee and the Senate's Permanent Subcommittee on Investigations both held hearings in July 2008, advocating more tools for the IRS to combat offshore tax evasion. While there is no single solution to addressing the international tax gap, the combination of additional compliance tools and increased IRS capability and capacity promises to improve international tax compliance.

Recommendation

We made no recommendations in this report. However, an advanced copy of the report was shared with key IRS management officials prior to issuance.

Please contact me at (202) 927-7048 or Kevin P. Riley, Inspections and Evaluations, at (972) 249-8355 if you have questions.

Attachment



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Table of Contents

Background	Page 1
Results of Review	Page 3
Accuracy and Reliability of the Estimates of the International Tax Gap	Page 4
IRS Has No Detailed Plans to Comprehensively Measure the International Tax Gap with a National Research Project Effort.....	Page 5
IRS Challenges and Efforts to Reduce the International Tax Gap.....	Page 5
Appendices	
Appendix I – Detailed Objectives, Scope, and Methodology.....	Page 18
Appendix II – Major Contributors to This Report	Page 20
Appendix III – Report Distribution List	Page 21
Appendix IV – Service-wide Approach to International Tax Administration	Page 22
Appendix VI – Selected International Reports	Page 25
Appendix VII – International Tax Gap and Components.....	Page 27



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Abbreviations

BEA	Bureau of Economic Analysis
EDB	Exporter Data Base
GAO	Government Accountability Office
IIF	Industry Issue Focus
IPOC	International Planning and Operations Council
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
JITSIC	Joint International Tax Shelter Information Centre
LMSB	Large and Mid-Size Business
MLAT	Mutual Legal Assistance Treaty
NRP	National Research Project
OECD	Organization for Economic Cooperation and Development
RAS	Research, Analysis, and Statistics
SME	Small and Medium-Sized Enterprise
TECS	Treasury Enforcement Communications System
TIEA	Tax Information Exchange Agreements
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
U.K.	United Kingdom of Great Britain
U.S.	United States of America



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Background

The Permanent Subcommittee on Investigations of the United States (U.S.) Senate Committee on Homeland Security and Governmental Affairs estimates that the international tax gap is \$100 billion or more annually.¹ The international tax gap is defined as taxes owed, but not collected on time, from a U.S. person² or foreign person³ whose cross-border income is subject to U.S. taxation.

The international tax gap is defined as taxes owed, but not collected on time, from a United States (U.S.) person or foreign person when there is cross-border income subject to U.S. taxation.

There are two aspects of international taxation. First, U.S. persons are taxed on their worldwide income. Second, foreign persons are taxed on their U.S. source income when they are effectively connected to a U.S. trade or business.⁴ The international tax gap encompasses all revenue losses resulting from noncompliance with the U.S. tax laws due to international transactions. These include:

- Taxpayer error;
- Conflicting legal interpretations;
- Misinterpretation of the facts; and
- Outright tax evasion.

International taxation reflects the complexity of the global economy. The U.S. international tax laws address a multitude of potentially taxable transactions. These transactions are engaged in

¹ U.S. Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. 2008. Tax Haven Banks and U.S. Tax Compliance. Washington D.C. July 17. Accessed online at: <http://hsgac.senate.gov/public/ files/071708PSIReport.pdf>.

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³ A foreign person includes a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, and any other person who is not a U.S. person.

⁴ Foreign persons not effectively connected with a U.S. trade or business who earn income from passive investment activities in the U.S. are taxed on fixed or determinable income; certain gains from disposal of timber, coal, or domestic iron with a retained economic interest; gains relating to contingent payments received from the sale or exchange of patents, copyrights, and similar intangible property; and sales of interests in U.S. real property. Foreign investors with passive investments as a general rule are not taxed on interest on deposits, portfolio interest, or capital gains on securities or other personal property.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

by millions of entities worldwide, including large multinational enterprises, U.S.-based companies operating internationally, foreign-based companies operating in the U.S., nonresident individual investments in the U.S., individual U.S. investors' international investments, individual U.S. residents residing abroad, and non-resident aliens residing in the U.S. Beyond the tax laws, the U.S. has nearly 60 tax treaties with other nations that can modify and/or change the tax law. The U.S. international tax gap is a critical issue for tax administration because international business and investments in the U.S. has grown from nearly \$188 billion in 1976 to over \$14.5 trillion in 2007, while U.S. business and investment overseas grew from nearly \$368 billion to nearly \$15 trillion over the same period.⁵

This review was performed at the IRS Large and Mid-Size Business (LMSB) Division Headquarters in Washington, D.C., in the Office of the Deputy Commissioner (International) and the Treasury Inspector General for Tax Administration's Los Angeles Office during the period March 2007 through September 2008. We conducted this evaluation in accordance with the President's Council on Integrity and Efficiency Quality Standards for Inspections.⁶ Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁵ See Table 2. *International Investment Position of the United States at Year End, 1976-2007*, U.S. Department of Commerce, Bureau of Economic Analysis (BEA). Accessed online at: <http://www.bea.gov/international/index.htm>

⁶ The evaluation was also performed in accordance with Generally Accepted Government Auditing Standards. These standards require that we plan and perform the project to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions, based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions, based on our evaluation objectives.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Results of Review

The IRS estimated that the entire tax gap for Tax Year 2001 was \$345 billion. However, the IRS has not developed an estimate for the international tax gap. Non-IRS estimates of the international tax gap range from \$40 billion to \$123 billion. While there might be overlap between the IRS tax gap estimate and the international tax gap, it is doubtful that the \$345 billion estimate includes the entire international tax gap. The primary reason for this conclusion is that identifying hidden income within international activity is very difficult and time-consuming.⁷ Furthermore, the IRS did not measure for the international tax gap component in the Individual National Research Project (NRP) estimate for the Tax Year 2001 tax gap. Therefore, it is unlikely that hidden offshore income is comprehensively included in the IRS tax gap estimates.

Nevertheless, over the past few years, the IRS has taken actions to better coordinate international tax compliance issues. First, in September 2007, the Service-wide Approach to International Tax Administration was announced. The approach describes the three strategic goals of 1) improving taxpayer service, 2) enhancing enforcement and modernizing the IRS for improving voluntary compliance with international tax provisions, and 3) reducing the tax gap attributable to international transactions. Next, the IRS Commissioner has stated that international issues are a top priority during his tenure. Finally, additional changes were made by modifying organizational structures, changing processes to facilitate improving compliance, investing in human capital and information technology, and increasing cooperation and outreach efforts to foreign governments. Together, these changes should provide the IRS with additional capability and capacity to address international tax compliance.

Beyond the IRS, legislation has been introduced to address tax haven abuse. As with most legislation, it is difficult to determine whether the proposed legislation will become law and whether it would achieve its intended purpose if implemented. Additionally, the Senate Finance Committee and the Senate's Permanent Subcommittee on Investigations both held hearings in July 2008, advocating more tools for the IRS to combat offshore tax evasion. While there is no single solution to addressing the international tax gap, the combination of additional compliance tools and increased IRS capability and capacity promises to improve international tax compliance.

⁷ See the GAO audit report *TAX ADMINISTRATION: Additional Time Needed to Complete Offshore Tax Evasion Examinations* (Reference Number GAO-07-237, dated March 2007).



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Accuracy and Reliability of the Estimates of the International Tax Gap

The IRS has not developed an accurate and reliable estimate of the international tax gap, based on empirical evidence.⁸ Some non-IRS estimates were developed for different international tax components. More specifically, estimates of the U.S. international tax gap due to tax haven⁹ activity range from \$40 billion to \$70 billion.

Additional revenue losses due to transfer pricing activity range from \$2.8 billion to \$53 billion annually.¹⁰ When these estimates are combined, the total international tax gap ranges from \$40 billion to \$123 billion annually.

No one, including the IRS, has an accurate and reliable estimate of the U.S. international tax gap.

In July 2008, the Permanent Subcommittee on Investigations of the U.S. Senate's Committee on Homeland Security and Governmental Affairs estimated that the international tax gap is \$100 billion or more annually. These estimates are educated guesses based on a few available figures, the estimators' experience, and assumptions—rather than being derived from direct measurement. Added to this, the estimates might not include other international tax gap components, such as abusive tax shelters that include tax havens—which would add billions of dollars to the total—or the compliance of foreign taxpayers with U.S. tax law.

In comparison, the IRS estimates that the overall tax gap for Tax Year (TY) 2001 is \$345 billion. In theory, the IRS tax gap estimate includes the international tax gap numbers. However, based on the broad range of the international tax gap estimate, the \$345 billion estimate is likely not all-inclusive.

The primary reason for this conclusion is that identifying hidden income within international activity is very difficult and time-consuming.¹¹ Furthermore, the IRS did not measure for the international tax gap component in the Individual National Research Program (NRP)¹² estimate

⁸ The IRS has not performed a National Research Project (NRP) on individual or business international taxes. An NRP is a statistical sample of returns that may be examined to determine compliance.

⁹ The Organization for Economic Cooperation and Development (OECD) utilizes four criteria to identify a jurisdiction as a tax haven: 1) no or only nominal taxes (generally or in special circumstances); 2) a lack of transparency; 3) laws or administrative practices that prevent the effective exchange of information for tax purposes; and 4) no requirement that foreign activity be substantial. Although the first criterion is a necessary condition, it is insufficient by itself to identify a jurisdiction as a tax haven. The other criteria reflect conditions that, in conjunction with no or nominal tax, enable a jurisdiction to pursue harmful tax competition and effectively obstruct authorities in other countries from accessing information for tax purposes.

¹⁰ See the TIGTA audit report *Current Trends in the Administration of International Transfer Pricing by the Internal Revenue Service* (Reference Number 2003-30-174, dated September 2003).

¹¹ See the GAO audit report *TAX ADMINISTRATION: Additional Time Needed to Complete Offshore Tax Evasion Examinations* (Reference Number GAO-07-237, dated March 2007).

¹² The National Research Program conducts studies to produce timely, reliable information about the filing of tax returns, the reporting of income, deductions, taxes credits, and payment of tax liabilities. The information is a



A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap

for the Tax Year 2001 tax gap. Therefore, it is unlikely that hidden offshore income is comprehensively included in the IRS tax gap estimates. In fact, the IRS's Research, Analysis and Statistics (RAS) organization reasoned that because of cost, staffing, and technical limitations, an NRP type of direct measurement is not feasible. In an attempt to learn more, the IRS has other initiatives underway.

IRS Has No Detailed Plans to Comprehensively Measure the International Tax Gap with a National Research Project Effort

The IRS's RAS organization has no plans to comprehensively measure the international tax gap. The Director of RAS stated that an NRP direct-measurement type study was currently not technically feasible due to the challenges in identifying returns with offshore activities, because many of the taxpayers are purposely avoiding detection. Other challenges to such a study are costs and limited staffing.

Nevertheless, the IRS has three initiatives underway to learn more about the international tax gap and some of its components. First, the IRS is gathering information about foreign-earned income of U.S. persons. To accomplish this, the new NRP of U.S. Individual Income Tax Returns (Form 1040) will sample 450 returns with a Foreign Earned Income (Form 2555) schedule attached to determine reporting compliance. Second, in September 2007, the LMSB Division announced a plan called the Service-wide Approach to International Tax Administration. The plan included an initiative to collaborate with RAS to identify and develop baselines and measures to better assess the international/U.S. territories tax gap and the progress in reducing it. Third, there is a budget request to match foreign income documents¹³ with nonresident income tax returns.

Together, these initiatives should provide better information about international tax compliance. While these efforts might not lead to a comprehensive international tax gap measurement, they should lead to increasing the capability and capacity of the IRS to focus on significant areas of noncompliance.

The IRS Challenges and Efforts to Reduce the International Tax Gap

International tax administration is highly complex, reflecting the complexity of the global economy. The U.S. international tax law must address a multitude of potentially taxable transactions. These transactions are engaged in by millions of entities worldwide, including large multinational enterprises, U.S.-based companies operating internationally, foreign-based

service-wide resource that will support a variety of user needs, including development of strategic plans and customer-focused programs, products, and services.

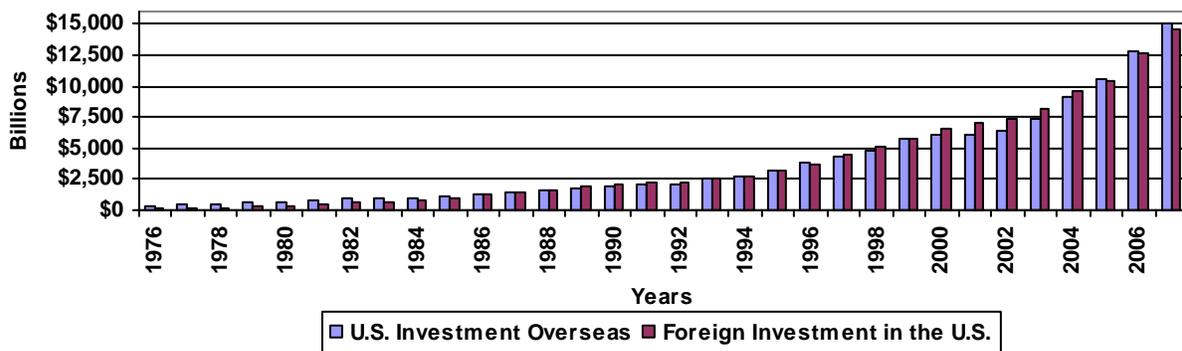
¹³ The foreign information return document is Form 1042-S, and the nonresident tax return is Form 1040NR and Form 1042.



A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap

companies operating in the U.S., nonresident individual investments in the U.S., individual U.S. investors' international investments, individual U.S. residents residing abroad, and non-resident aliens residing in the U.S. Beyond the tax laws, there are nearly 60 tax treaties with other nations that can modify and/or change the tax law. The U.S. international tax gap is a critical issue for tax administration because international business and investments in the U.S. has grown from nearly \$188 billion in 1976 to over \$14.5 trillion in 2007, while U.S. business and investment overseas grew from nearly \$368 billion to nearly \$15 trillion over the same period.¹⁴

Figure 1: U.S. Business and Investment Overseas and Foreign Business and Investment in the U.S., 1976 - 2007



Source: TIGTA Analysis of BEA Data on International Investment Position of the U.S. at Yearend, 1976-2007.¹⁵

Growth in International Activity: The tremendous growth in offshore and international activity is a relatively recent phenomenon, even though corporate and individual use of tax havens started in the 1950s. Since about 1980, the legal and technological barriers to the movement of capital, goods, and services have declined dramatically.¹⁶ Technological advances have provided opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

¹⁴ See footnote 5.

¹⁵ Ibid.

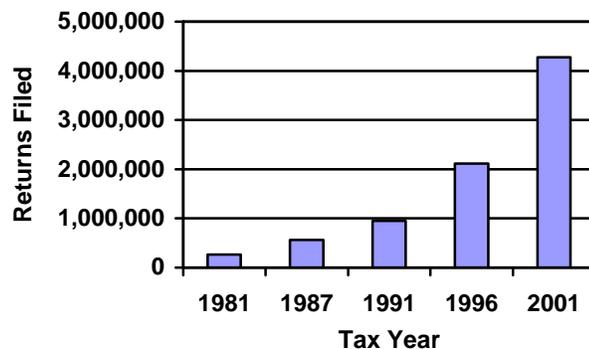
¹⁶ Guttentag, Joseph and Reuven Avi-Yonah. "Chapter 5 - Closing the international tax gap" *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration*. Edited by Max B. Sawicky. Economic Policy Institute. Washington D.C. 2005.



A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap

One indicator of the increasing offshore investment activity is the rise in the number of individual income taxpayers filing the Foreign Tax Credit (Form 1116) (see Figure 2). The Form 1116 is used by taxpayers to compute the amount of allowable foreign tax credit they can offset against their U.S. income taxes for foreign taxes paid on income earned abroad. In 1981, approximately 270,000 individuals filed Form 1116. In 2001, just 20 years later, almost 4.3 million individuals filed a Form 1116. Some other examples of international growth are:

Figure 2: Individual Income Tax Returns Filing Form 1116, Foreign Tax Credit (1981 – 2001)



Source: TIGTA Analysis of IRS RAS Division

- The 20-fold increase in the estimated number of multinational enterprises from 3,000 in 1990 to well over 63,000 in 2007.
- The Commerce Department's Exporter Data Base (EDB)¹⁷ shows that in 2005, the total number of U.S. firms exporting goods stood at 239,094. More specifically, the number of small and medium-sized enterprises¹⁸ (SMEs) that export merchandise more than doubled between 1992 and 2005.¹⁹ The known export revenue of SMEs rose from \$102.8 billion in 1992 to \$228.5 billion in 2005. SMEs were responsible for 29.1 percent of goods exported in 2005.
- The number of filings of Form 1120, U.S. Corporation Income Tax Return containing international features, has increased 87 percent from 2002 to 2007.
- While major multinational companies have traditionally generated cross-border trade, growing industrial globalization enabled by technology, has made it easier for small and mid-market businesses to compete across borders.
- Total income reported for 2005 from active foreign corporations owned by U.S. taxpayers exceeded \$1.8 trillion.

¹⁷ The EDB captures companies exporting merchandise, but not firms that export only services.

¹⁸ A small or medium sized enterprise is defined as a company with fewer than 500 workers.

¹⁹ From about 108,000 firms in 1992 to over 232,000 firms in 2005.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

- U.S.-source income of \$293 billion was sent offshore for tax year 2003; 68.4 percent, or \$200.5 billion, flowed to foreign corporations through both Qualified Intermediaries and U.S. Withholding Agents, with only 1.4 percent or \$3 billion withheld.

Tax policy and administration efforts require a balance regarding what information is needed to enforce tax laws without unduly burdening international business and investments. Achieving this balance is further complicated by taxpayers who intentionally place assets in locations with bank secrecy laws. Due to this, the IRS at times has limited access to information sources concerning taxpayers in these jurisdictions. While the IRS has the capability to obtain significant amounts of information from many of these jurisdictions, it is handicapped by time-consuming requirements on a case-by-case basis to specifically identify the taxpayers under investigation. The time and access limitations encountered in international tax administration create significant differences between the domestic and international tax administration environments.

Therefore, the IRS has developed international compliance programs with different resource allocation approaches by using various compliance case identification information sources. Examples of these information sources are referrals from informants, criminal investigations, the Joint International Tax Shelter Information Centre (JITSIC), and other tax treaty and bilateral exchanges of information agreements. Other compliance cases are also identified through tax return data analysis and other information reporting regimes such as the Qualified Intermediary and U.S. Withholding Agent Programs. However, using these case identification sources presents challenges in measuring the wider compliance effect. Several major international tax compliance issues have come to the public's attention from investigations and the media reports:

- In 2000, Enron Corporation established 441 special-purpose offshore entities in the Cayman Islands.
- In 2002, the IRS estimated that there might be as many as 1 million U.S. taxpayers who have signature authority or control a foreign bank account and might be required to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts, although it received only 177,151 reports in 2001.
- In 2003, the IRS estimated that 500,000 U.S. taxpayers had offshore bank accounts and were accessing the funds with offshore credit cards.
- In 2004, data from the Department of Commerce's Bureau of Economic Analysis (BEA) reported that profits of foreign subsidiaries of U.S. corporations based in 18 tax haven countries grew 70 percent from \$88 billion in 1999 to \$149 billion in 2002. The \$149 billion reported in 2002 in the 18 tax haven countries accounts for 58 percent (\$149 billion / \$255 billion) of profits of foreign subsidiaries of U.S. corporations worldwide.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

- In 2005, the Tax Justice Network estimated that assets held offshore by Americans of high net worth exceeded \$1 trillion.
- In February 2008, published reports identified a global tax scandal after a former employee of LGT Bank in Liechtenstein sold customer information to the German authorities that identified about 1,400 persons who were using accounts at the bank to evade taxes.
- In May 2008, published reports identified a second global tax scandal when the U.S. arrested a private banker formerly employed by UBS AG on charges of having conspired with a U.S. citizen and a business associate to defraud the IRS of \$7.2 million in taxes on \$200 million of assets hidden in offshore accounts in Switzerland and Liechtenstein.
- In July 2008, the GAO reported that a five-story building in the Cayman Islands, Uglund House, had 18,857 business tenants. The estimate is that about 9,000 of those entities were U.S.-related.

The IRS recognizes that globalization presents challenges for tax administration. The IRS is addressing these challenges by establishing international tax compliance as a strategic priority, modifying organizational structures, changing processes to facilitate improving compliance, investing in human capital and information technology, and increasing cooperation and outreach efforts with foreign governments.

Establishing International Tax Compliance as a Strategic Priority

The IRS is establishing international tax compliance as a strategic priority, based on several actions that have been taken. First, IRS Commissioner Douglas Shulman is making reducing the international tax gap a top priority. In testimony before the Senate's Permanent Subcommittee on Investigation, Commissioner Shulman stated:

I have made international issues a top priority for the IRS for my five-year tenure as Commissioner. There are a number of activities and initiatives underway, and more in the works, at the IRS to help ensure we are adapting to the global economy. In some cases, this involves proactive dialogue with foreign tax administrators and multinational enterprises.²⁰

Prior to appearing before the subcommittee, the Commissioner had emphasized the importance of international issues to the IRS in speeches before the American Bar Association and the Federation of Tax Administrators.

²⁰ *Written Testimony of Douglas Shulman, Commissioner of Internal Revenue, Before the Senate Committee on Homeland Security and Government Affairs' Permanent Subcommittee on Investigations Hearing on Tax Haven Financial Institutions: Their Formation and Administration of Offshore Entities and Accounts for Use by U.S. Clients, July 17, 2008, page 1.*



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Second, from a strategic perspective, in August 2007, the Department of Treasury, Office of Tax Policy, announced a revised tax gap reduction strategy²¹ that included six initiatives focused on improving international and offshore compliance, along with 24 milestones. The six initiatives are:

1. Enhance the ability to identify and address tax schemes of businesses and individuals involving offshore activity, address illegitimate use of tax havens to shelter income, and increase information matching and examination activity for individuals abroad.
2. Improve the alignment and allocation of service-wide resources to identify, develop, and resolve challenges better in the global taxation arena.
3. Improve tax administration to deal more effectively with increased emphasis on globalization by all corporation and individual taxpayers.
4. Increase industry and global issue focus by aligning resources to cases and issues with the highest compliance risk.
5. Leverage the efforts of examiners as well as external partnerships with foreign tax administrations to identify and address emerging issues of significant compliance risk.
6. Address offshore and cross-border compliance risks through enforcement and by issuing published guidance.

Modifying Organizational Structures

The Commissioner's statements represent the latest in a series of actions over the past several years culminating in greater prominence and coordination of international issues across the IRS. In June 2006, the IRS created the position of Deputy Commissioner, International, in the LMSB Division. The IRS describes the purpose of the position: "To improve oversight and focus on global taxation issues." The position is responsible for international service and compliance activities across the entire IRS and serves as the U.S. Competent Authority responsible for tax treaty administration.

Another step in the process was the announcement on September 16, 2007, of the Service-wide Approach to International Tax Administration (see Appendix IV). The approach describes goals for improving voluntary compliance with international tax provisions of the Internal Revenue Code and reducing the tax gap attributable to international transactions. The new approach envisions using cross-functional cooperation in addressing emerging international tax issues and using tools and authorities already granted. The approach describes a three-pronged strategy, consistent with the strategies described in the IRS strategic plan, of:

- Strategic Goal 1: Improving Taxpayer Service.

²¹ *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance*. IRS. Washington, D.C. August 2, 2007.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

- Strategic Goal 2: Enhancing Enforcement of Tax Laws.
- Strategic Goal 3: Modernizing the IRS through its People, Processes, and Technology.

To achieve cross-functional cooperation envisioned in the Service-wide approach to International Tax Administration, the International Planning and Operations Council (IPOC) was established. The IPOC is chaired by the Deputy Commissioner, International, with executive participation from the Small Business/Self-Employed Division, Wage and Investment Division, Tax-Exempt Government Entities Division, Criminal Investigations Division, Office of Appeals, and Office of Chief Counsel. The IPOC serves as the forum to develop and coordinate the Service-wide strategy for dealing with international tax administration operational issues and significant international tax transactions, both internally and externally, and reports to the Deputy Commissioner for Service and Enforcement. The Council ensures that resource and operational support issues are properly coordinated to maintain accountability of the international enforcement and customer service strategies and initiatives. The responsibilities of the Council are:

- Annual review of the Service-wide international strategy and international enforcement and service initiatives;
- Resolution of cross-business division policy and resource issues related to international activities and initiatives;
- Oversight for Service-wide international enforcement initiative; and
- Provide periodic reporting to the Enforcement Committee.

Changing Processes to Facilitate Improving Compliance

In addition to addressing international income tax issues through income tax examinations, the Service-wide Approach to International Tax Administration is using other forums to resolve tax disputes. For example, the IRS recently completed its first pre-filing agreement on international partnerships and is working on a pre-filing agreement regarding permanent establishments. The IRS is also piloting the process of resolving international tax issue disputes within its Compliance Assurance Process (CAP).

On the examination front, the IRS recently introduced the Industry Issue Focus (IIF) approach to strengthen the industry focus within the LMSB Division by strategically concentrating on high-risk tax issues through the use of coordinating guidance and compliance activities on emerging tax issues. The IIF approach accomplishes these results by identifying, prioritizing, analyzing, and addressing significant compliance issues in one of three tiers. International tax issues compose one-sixth of the 60 Tier I and Tier II issues so far identified. The IRS has also implemented compliance activities dealing with Offshore Private Banking, Offshore Merchant Accounts, and international compliance of Entertainers and Athletes.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Investing in Human Capital

The IRS has implemented 5 initiatives that are leveraging its international human capital. First, the IRS realigned its LMSB Division by changing international examiner groups from being managed as specialty groups to being supervised by line managers so there would be greater flexibility to employ international examiner skills. Second, managers at all levels are being trained on the basics of international tax so that international examiner skills can be better employed. Third, the LMSB Division is training domestic agents to examine less complex international issues so that international examiners can focus on more complex issues. Fourth, the LMSB Division has just-in-time training resources that can be delivered to assist tax examiners with an international tax issue they are currently or will shortly be working on. Finally, the Appeals Division has been restructured into two teams of International Specialists and Economists to provide technical support to help ensure timely and consistent resolution by appeals of international tax issues.

Investing in Information Technology

The IRS is taking several technology initiatives to address all aspects of the international tax program. One compliance initiative is to develop a system to automatically match third party payment information for offshore investors with income tax return information. Another multi-purpose initiative is a proposal to bring together all the international data the IRS receives into a single database. The database would be used for research, strategic planning, resource allocation, and examination case selection. Several taxpayer service initiatives are focusing on upgrading service to taxpayers with international issues. These include exploring options to provide low/no-cost telephone services to U.S. taxpayers living abroad, maintaining and improving the content of the IRS's international websites on irs.gov, continuing development of the online International Technical Digest, and making improvements to the Treasury Enforcement Communications System (TECS) for information regarding passports and U.S. border entries and exits.

Increasing Cooperation and Outreach Efforts to Foreign Governments: Outreach and cooperation with U.S. treaty partners and other governments is an integral part of the Service-wide Approach to International Tax Administration. The IRS participates in Organization for Economic Co-operation and Development (OECD) working groups concerning a broad spectrum of issues, such as the model tax treaty, international transfer pricing, and tax avoidance and evasion. The IRS also regularly participates in the Leeds Castle Group²² discussions as well as being a participant in the JITSIC with Australia, Canada, Japan, and the U.K. JITSIC has allowed participants to cooperatively identify and challenge abusive tax schemes and transactions.

²² The Leeds Castle Group consists of the tax administrators of Australia, Canada, China, France, Germany, India, Japan, South Korea, the United Kingdom (U.K.), and the U.S.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

In addition to these activities, the U.S. has numerous Tax Information Exchange Agreements (TIEAs) and Mutual Legal Assistance Treaties (MLATs) and tax treaties. The U.S. has 20 TIEAs that allow information exchanges between nations. This form of agreement was started in 1983 with low or no-tax jurisdictions for a time when a comprehensive tax treaty addressing issues of double taxation would be unnecessary. TIEAs provide for exchange of information in both civil and criminal actions only when one government formally asks another government for particular information regarding a specific taxpayer. The U.S. also has 60 MLATs that are bilateral treaties for criminal matters that seek to improve the effectiveness of judicial assistance and to regularize and facilitate procedures. Because most U.S. tax matters are handled in civil rather than criminal proceedings, this approach severely restricts tax information exchanges between the two countries. Finally, the U.S. has nearly 60 Tax Treaties²³ in force with foreign countries.

Taken together, these initiatives should increase the capacity and capability to address the international tax gap. However, more tax administration tools are needed to leverage these efforts. In recent years, various Congressional committees held hearings and developed legislative proposals that would benefit the IRS's efforts to reduce the international tax gap.

Congressional Hearings and Legislative Proposals: Congressional hearing and legislative proposals regarding U.S. international taxation in recent years consisted of two focuses. One focus stressed fundamental reform of the U.S. tax system to encourage long-term U.S. global competitiveness. The other focus sought solutions for closing loopholes in the current international tax system to eliminate abuses and reduce the international tax gap. A summary of the hearings and proposals follows.

On June 22, 2006, the Subcommittee on Select Revenues of the House Ways and Means Committee held a hearing on the *Impact of International Tax Reform on U.S. Competitiveness*. Then-Chairman Congressman Dave Camp (R-MI) stated:

*The current U.S. international tax system has been characterized as one that distorts business decisions and inhibits the competitiveness of U.S. business abroad. This hearing will provide us the opportunity to understand how the current international tax system impacts the competitiveness of U.S. companies operating abroad and to evaluate how this system can be reformed and to stimulate job creation at home.*²⁴

²³ Under these treaties, residents of foreign countries are taxed at a reduced rate or are exempt from U.S. taxes on certain types of income they receive from sources within the U.S. Under these same treaties, residents or citizens of the U.S. are taxed at a reduced rate, or are exempt from foreign taxes on certain items of income they receive from sources within foreign countries. U.S. tax treaties also contain provisions for information exchange, and many contain provisions for automatic exchange of information in the form of sharing income information.

²⁴ U.S. House of Representatives Committee on Ways and Means, Subcommittee on Select Revenue Measures. 2006. Hearing on the Impact of International Tax Reform on U.S. Competitiveness. Washington, D.C. June 22. Accessed online at: <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=5303>



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

The hearing collected testimony from witnesses describing the obstacles the current U.S. tax system creates for U.S. international business competitiveness in the global economy and how the system should be reformed.

On August 1, 2006, the Senate's Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs held a hearing on *Tax Haven Abuses: The Enablers, The Tools and Secrecy* and released its staff's report.²⁵ Through a series of case histories, the hearing explored the role of financial professionals, tax attorneys, accountants, bankers, brokers, corporate service providers, and trust administrators in aggressively promoting offshore tax haven use to U.S. citizens as a means to avoid taxes and creditors. The case histories illustrated the use and operation of offshore trusts and corporations to circumvent U.S. tax, securities, and anti-money laundering laws.

As a direct result of the hearing, in February 2007, the Committee on Homeland Security and Governmental Affairs referred the Stop Tax Haven Abuse Act (S. 681) to the Senate Finance Committee to reduce the international tax gap, improve compliance, and reduce the abuses associated with tax havens. The proposed legislation would:

- Close loopholes by establishing legal presumptions against the validity of transactions involving offshore secrecy jurisdictions;
- Impose restrictions on foreign jurisdictions, financial institutions, or international transactions that are of primarily money laundering concerns or that impede U.S. tax enforcement;
- Increase the period for the IRS review of tax returns involving offshore secrecy jurisdictions;
- Require tax withholding agents and financial institutions to report certain information about beneficial owners of foreign-owned financial accounts and accounts established in offshore secrecy jurisdictions; and
- Disallow tax advisor opinions validating in offshore secrecy jurisdictions.

On June 17, 2008, The Heroes Earnings Assistance and Relief Tax Act of 2008²⁶ became law. It contained a new expatriation tax that applies to individuals who expatriate from the U.S. on or after enactment. The Senate Finance Committee intended to tighten the rules so that certain high net worth individuals cannot renounce their U.S. citizenship or terminate their long-term U.S. residency in order to avoid U.S. taxes. Congress expects that the new expatriation rules will raise \$411 million over the next 10 years.

²⁵ U.S. Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. 2006. *Tax Haven Abuse: The Enablers, The Tools and Secrecy*. Washington D.C. August 1. Accessed online at: <http://hsgac.senate.gov/public/files/TAXHAVENABUSESREPORT8106FINAL107.pdf>

²⁶ P.L. 110-245 (2008).



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

On June 26, 2008, the Senate Finance Committee explored how the U. S. taxes foreign direct investment in the U.S. and U.S. direct investment overseas under the current tax system and possible alternatives for reform. The hearing examined the advantages and disadvantages of different types of tax regimes along with the impact of international transfer pricing. Also distributed at the hearing was a July 25, 2008, analysis by the Joint Committee on Taxation.²⁷

Additionally, the Senate's Permanent Subcommittee on Investigations and the Senate Finance Committee both held hearings in July 2008 advocating more tools for the IRS to combat offshore tax evasion. On July 17, 2008, the Senate's Permanent Subcommittee on Investigations held a hearing on *Tax Haven Banks and U.S. Tax Compliance*. The hearing examined how financial institutions located in offshore tax havens facilitated the movement of funds offshore from the U.S. that, in some instances, resulted in tax evasion and or other misconduct by U.S. clients. The hearing also explored how U.S. domestic and international tax enforcement efforts could be strengthened.

On July 24, 2008, the Senate Finance Committee held hearings on *The Cayman Islands and Offshore Tax Issues*. At the hearing, the GAO released a report²⁸ on its investigation, focused on Uglad House in the Cayman Islands, whose sole physical occupant is the international law firm Maples and Calder, but which serves as a registered address for 18,857 business entities. During the hearing, Senate Finance Committee Chairman Senator Max Baucus (D-MT) announced that he and Senator Charles Grassley (R-IA) planned to introduce six new measures to curb offshore tax evasion that included:

1. Lengthening the statute of limitations for prosecuting individuals who fail to report foreign bank accounts.
2. Giving the IRS more authority to enforce reporting requirements.
3. Clarifying information that must be reported.
4. Requiring the reports to be filed with individual and corporate tax returns.
5. Revising the definition of ownership to include beneficial ownership of a corporation.
6. Including the reports under a tax code section ensuring that when taxpayers do file the information, the statute of limitations will not expire until three years afterward.

²⁷ See the Joint Committee on Taxation analysis *Economic Efficiency and Structural Analysis of Alternative U.S. Tax Policies for Foreign Direct Investment*, (Reference Number, JCX-55-08, June 25, 2008).

²⁸ See the GAO audit report *CAYMAN ISLANDS: Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist*, (Reference Number GAO-08-778, July 2008).



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Also distributed at the hearing was a July 23, 2008, analysis prepared by the Joint Committee on Taxation.²⁹

On September 11, 2008, the Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations held a hearing on *Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock Dividends*. The hearing examined how U.S. financial institutions designed, marketed, and implemented transactions that repeatedly enabled foreign taxpayers, including offshore hedge funds, to evade millions of dollars of U.S. withholding taxes on U.S. stock dividends. The report accompanying the hearing recommended:³⁰

- **End offshore Dividend Tax Abuse.** Congress should end offshore dividend tax abuse by enacting legislation to make it clear that non-U.S. persons cannot avoid U.S. dividend taxes by using a swap or stock loan to disguise dividend payments.
- **Take Enforcement Action.** The IRS should complete its review of dividend-related transactions and take civil enforcement actions against taxpayers and U.S. financial institutions that knowingly participated in abusive transactions aimed at dodging U.S. taxes on stock dividends.
- **Strengthen Regulations on Equity Swaps.** To stop misuse of equity swap transactions to dodge U.S. dividend taxes, the IRS should issue a new regulation to make dividend payments under equity swap transactions taxable to the same extent as U.S. stock dividends.
- **Strengthen Stock Loan Regulations.** To stop misuse of stock loan transactions to dodge U.S. dividend taxes, the IRS should immediately meet its 1997 commitments to issue a new regulation on the tax treatment of substitute dividend payments between foreign parties to make clear that inserting an offshore entity into a stock loan transaction does not eliminate U.S. tax withholding obligations.

Conclusion

The IRS has not developed an estimate of the international tax gap, nor is there any intention to develop an NRP type estimate. However, the IRS is making international tax compliance a strategic priority. Many actions have been planned or implemented that should increase the IRS' capability and capacity to enhance international tax administration. Beyond the IRS' efforts, the Congress is identifying ways to balance a fundamental reform of the U.S. tax system to

²⁹ See the Joint Committee on Taxation analysis *Selected Issues Relating to Tax Compliance With Respect to Offshore Accounts and Entities*, (Reference Number, JCX-65-08, July 23, 2008).

³⁰ *Dividends*, U.S. Senate, Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. 2008. *Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock*. Washington, D.C. September 11. Accessed online at:

<http://hsgac.senate.gov/public/ files/REPORTDividendTaxAbuseFINAL910080.pdf>



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

encourage long-term U.S. global competitiveness and to find solutions for closing loopholes in the current international tax system to eliminate abuses and reduce the international tax gap. A combination of increased IRS capability and capacity and legislative solutions should help to reduce the international tax gap. We have no recommendations for the findings presented in this report.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objective of this review was to evaluate the accuracy and reliability of estimates of the size of the U.S. international tax gap, determine whether the IRS is planning to develop its own measurement, and identify the efforts the IRS has underway to reduce it.

To accomplish our objective, we relied extensively on interviews, information studies, and internal reports from the IRS. To accomplish our objective, we:

- I. Identified estimates of the potential size of the U.S. international tax gap.
 - A. Interviewed IRS officials regarding the IRS estimate of the \$40 billion international tax gap described in Commissioner Rossotti's letter to Senators Grassley and Baucus on March 22, 2002, the information used, and how it was derived.
 - B. Interviewed attorney Jack Blum regarding his estimate of a \$70 billion international tax gap, the information used, and how it was derived.
 - C. Interviewed Professor Reuven Avi-Yonah regarding an estimate of the \$50 billion international tax gap, the information used, and how it was derived.
 - D. Interviewed IRS officials in the Research, Analysis, and Statistics Division regarding the lack of a periodic estimate of the international tax gap.
- II. Determined what actions and resources the IRS is applying in its efforts to reduce the international tax gap.
 - A. Determined what action the IRS is taking as part of the Service-wide Approach to International Tax Administration through review of IRS internal monitoring reports.
 - B. Interviewed IRS officials from the Office of the Deputy Commissioner, International, regarding actions completed and underway as part of the IRS Service-wide Approach to International Tax Administration.
 - C. Determined the number of Tax Information Exchange Agreements (TIEAs) made from FY 2001 through FY 2007.
 - D. Determined what accomplishments the Joint International Tax Shelter Information Centre (JITSIC) has publicized since its creation in FY 2004.
 - E. Determined what actions the IRS is initiating to address the U.S. international tax gap as part of its August 2, 2007 plan, *Reducing the Federal Tax Gap: A Report on*



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Improving Voluntary Compliance, in response to Congressional pressure regarding the overall tax gap.

- F. Determined what actions were proposed by the Congress to address the problems of tax havens and the U.S. international tax gap.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix II

Major Contributors to This Report

Phil Shropshire, Director
Earl Charles Burney, Lead Auditor
Amanda Fila, Economist



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix III

Report Distribution List

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*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix IV

Service-wide Approach to International Tax Administration

The IRS will improve tax administration to deal more effectively with the increase of globalization of individual and business taxpayers. This will be accomplished through Service-wide cross-functional cooperation in addressing emerging international issues. The priority will be to improve voluntary compliance with the international tax provisions and to reduce the tax gap attributable to international transactions. Our approach to international tax administration includes the following components:

Strategic Goal 1: Improve Taxpayer Service

International tax law is extremely complex. Providing international taxpayers and taxpayers in the U.S. territories (American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands) with assistance and clear and accurate information before they file their tax returns helps avoid unintentional errors and reduces unnecessary contacts afterwards. To achieve this, we will improve service options for international/U.S. territories taxpayers, enhance outreach, provide tools for earlier certainty on complex issues, and strive for burden reduction in the international/U.S. territories tax law arena.

Strategic Initiatives:

- A. Enhance customer service options for international/U.S. territories taxpayers to encourage voluntary compliance with complex international/U.S. territories tax laws.**
- B. Deliver targeted education and outreach to taxpayers with international/U.S. territories transactions and enhance our partnerships with tax practitioners involved in the preparation of international/U.S. territories returns.**
- C. Explore opportunities for expanded e-filing of international/U.S. territories forms.**
- D. Identify opportunities for burden reduction through forms revisions, legislative proposals, and procedural changes.**
- E. Provide earlier certainty to taxpayers on international/U.S. territories tax issues through pre-filing tools and achieving greater currency of audits.**
- F. Contribute to identifying and developing guidance on priority international issues.**



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Strategic Goal 2: Enhance Enforcement of Tax Laws

As globalization continues, tax planning is increasingly focused on minimizing the worldwide effective tax rate. In this context, international/U.S. territories' non-compliance is a significant area of concern and focus. We are challenged by a lack of information reporting on many cross-border transactions. The ease of utilizing complex international structures and cross-border transactions results in constantly evolving compliance issues. To properly identify, address, and pursue such emerging issues, we will strengthen reporting requirements; enhance IRS access to international data; ensure adherence to professional standards by tax professionals; and increase industry and global issue focus by aligning resources to cases and issues with the highest compliance risk.

Strategic Initiatives:

- A. Improve examination coverage, identify emerging compliance issues, and increase issue specialization to address complex transactions.**
- B. Strengthen our information reporting and withholding systems to ensure that we receive the appropriate information and use it effectively in our compliance and withholding tax efforts.**
- C. Improve cooperation with treaty partners to identify and address inappropriate tax arbitrage and abusive schemes, achieve greater transparency on cross-border transactions, and identify and address process improvements in the mutual agreement program.**
- D. Encourage tax professionals to adhere to professional standards and provide effective oversight to ensure accountability of professional responsibilities.**
- E. Detect and deter financial criminal activity and abusive transactions that involve offshore entities and cross-border transactions.**

Strategic Goal 3: Modernize the IRS through its People, Processes, and Technology

As the flow of trade and capital moves more easily across borders, the global marketplace is developing at an ever increasing rate. The fast pace of change in the global economy requires an equally fast pace of change within our organization. We must strategically manage resources, associated business processes, and technology systems to effectively and efficiently meet international service and enforcement missions. To achieve this, we will improve our resource capabilities to leverage international expertise throughout the IRS and modernize information systems to improve service and enforcement.

Strategic Initiatives:

- A. Identify workforce skills needed to address emerging international/U.S. territories issues and develop a training plan to address the needed skills.**



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

- B. Provide IRS employees the tools needed to respond accurately and in a timely manner to taxpayer inquiries.**
- C. Improve the systems for capturing and utilizing information reported by treaty partners to enhance compliance of U.S. taxpayers.**
- D. Identify opportunities to improve international/U.S. territories' forms and the related processing systems to ensure that appropriate information is available for risk assessment and issue identification.**
- E. Assess systems and resources devoted to referrals of international/U.S. territories issues to ensure that high risk issues are addressed in a timely manner.**
- F. Identify and develop baselines and measures to better assess the international/U.S. territories' tax gap and our progress in reducing it.**



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix V

Selected International Reports

Domestic and Foreign Controlled Corporations

Tax Administration: Comparison of the Reported Tax Liabilities of Foreign and U.S.-Controlled Corporations, GAO, Reference Number GAO-08-957, July 2008.

International Taxation: Taxes of Foreign- and U.S.-Controlled Corporations, GAO, Reference Number GAO/GGD-93-112FS, June 1993.

Information Returns

Automating the Penalty-Setting Process for Information Returns Related to Foreign Operations and Transactions Shows Promise, but More Work Is Needed, TIGTA, Reference Number 2006-30-075, May 2006.

Compliance Opportunities Exist for the Internal Revenue Service to Use Foreign Source Income Data, TIGTA, Reference Number 2005-30-101, July 2005.

Controls Over the Identification and Selection of Foreign Controlled Corporations for Examination Need Improvement, TIGTA, Reference Number 2001-30-119, July 2001.

Program Improvements Are Needed to Encourage Taxpayer Compliance in Reporting Foreign Sourced Income, TIGTA, Reference Number 2001-30-052, March 2001.

Review of Service Efforts to Ensure Compliance of Taxpayers Receiving Foreign Source Income, IRS Internal Audit,¹ Reference Number 072208, April 2, 1997.

International Compliance Activities

Dividend Tax Abuse: How Offshore Entities Dodge Taxes on U.S. Stock, U.S. Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations. Washington D.C. September 11, 2008.

Selected Issues Relating to Tax Compliance With Respect to Offshore Accounts And Entities, Joint Committee on Taxation, Reference Number JCX-65-08, July 23, 2008.

Economic Efficiency and Structural Analysis of Alternative U.S. Tax Policies for Foreign Direct Investment, Joint Committee on Taxation, Reference Number JCX-55-08, June 25, 2008.

¹ As a consequence of the IRS Restructuring and Reform Act of 1998, the IRS Office of Audit became the Office of Audit of the Treasury Inspector General for Tax Administration (TIGTA) on January 18, 1999.



A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap

Actions Are Needed to Control Risks With International Transactions Reported on Corporate Income Tax Returns, TIGTA, Reference Number 2008-30-114, May 30, 2008.

Opportunities Exist to Enhance the International Field Assistance Specialization Program, TIGTA, Reference Number 2000-30-130, September 2000.

Tax Administration: Information on IRS's International Tax Compliance Activities, GAO, Reference Number GAO/GDD-94-96FS, June 1994.

International Transfer Pricing

The Controls for Examination Processes for Industry Cases With International Transfer Pricing Issues Can Be Improved, TIGTA Reference Number 2004-30-133, September 2004.

Current Trends in the Administration of International Transfer Pricing by the Internal Revenue Service, TIGTA, Reference Number 2003-30-174, September 2003.

International Taxation: Transfer Pricing and Nonpayment of Tax, GAO, Reference Number GAO/GGD-95-101, April 1995.

International Taxation: Problems Persist in Determining Effects of Intercompany Prices, GAO, Reference Number GAO/GGD-92-89, June 1992.

Tax Havens

Cayman Islands: Business and Tax Advantages Attract U.S. Persons and Enforcement Challenges Exist, GAO, Reference Number GAO-08-778, July 2008.

Tax Haven Banks and U.S. Tax Compliance, Permanent Subcommittee on Investigations, U.S. Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations, Washington D.C. July 17, 2008.

Additional Actions Are Needed to Effectively Address the Tax Gap, TIGTA, Reference Number 2008-30-094, April 23, 2008.

Tax Administration: Additional Time Needed to Complete Offshore Tax Evasion, GAO, Reference Number GAO-07-237, March 2007.

Tax Haven Abuse: The Enablers, The Tools and Secrecy, U.S. Senate Committee on Homeland Security and Government Affairs, Permanent Subcommittee on Investigations. Washington D.C. August 1, 2006

International Taxation: Tax Haven Companies Were More Likely to Have a Tax Cost Advantage in Federal Contracting, GAO, Reference Number GAO-04-856, June 2004.



*A Combination of Legislative Actions and Increased IRS
Capability and Capacity Are Required to Reduce the Multi-Billion
Dollar U.S. International Tax Gap*

Appendix VI

International Tax Gap and Components

Component	Low Estimate	High Estimate
International Transfer Pricing	\$2.8 billion ¹	\$53.0 billion ²
Offshore Noncompliance of U.S. Taxpayers	\$40.0 billion ³	\$70.0 billion ⁴
Noncompliance of Foreign Taxpayers with Income from an Effectively Connected Trade or Business in the U.S.	Unknown	Unknown
Noncompliance of Foreign Taxpayers with Passive Investment Activities in the U.S.	Unknown	Unknown
Tax Shelters with Tax Haven Components	Unknown	Unknown
Total International Tax Gap	UNKNOWN	UNKNOWN
Known Estimates of Total International Tax Gap	\$42.8 billion	\$123.0 billion

Source: TIGTA Analysis of Likely Components of the International Tax Gap with Available Estimates.

¹ U.S. Department of the Treasury, IRS, *Report on the Application and Administration of Section 482*; 1999.

² *U.S. Trade with the World: An Estimate of 2001 Lost U.S. Federal Income Tax Revenues Due to Over-Invoiced and Under-Invoiced Exports*, by Professors Simon J. Pak, Ph.D. of Penn State University – Great Valley, and John S. Zdanowicz, Ph.D. of Florida International University.

³ Rossotti, Charles O. 2004. Letter to Senators Charles Grassley and Max Baucus. March 22.

⁴ Sullivan, Martin A. 2004. U.S. citizens hide hundreds of billions in Cayman accounts. *Tax Notes*. Vol. 103, p.956