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4 rue de Chevreuse
75006 Paris, France
Tel: +33 (0)1 4720 2415
Website: www.aaro.org
Email: aaronews@aaro.org

Treasury Inspector General for Tax Administration Audit of FATCA Compliance

Comments from AARO

The audit of FATCA compliance released on April 7 by the Treasury Inspector General for Tax Administration (TIGTA) has attracted considerable attention[1]. It seems to be the first report on this subject since 2018 (which informed both the GAO report on FATCA's impact [GAO 2019-19-180] and AARO's OAW meetings in 2019).

It is a dense report (32 pages, many numbers), generally critical of IRS for its lack of action, contains new information, makes six recommendations to strengthen FATCA compliance and includes IRS management responses and commentary.

Brief summary of the report's main points; concerns; take-aways.

The information gathering took place between October 2020 and June 2021, which means most information stops in 2019 or before, i.e. it is old. Almost nothing is from 2021.

Notably, it repeats a longstanding IRS position that it has no reliable estimate of the revenue loss due to offshore non-compliance. At the same time, it ignores the IRS report released as an NBER Working Paper[2] in March 2021 which provided highly publicized estimates for "sophisticated evasion" that put the offshore figure at $15 billion (in 2012 $).

Discussion and analysis are too simplistic. Amounts reported on FATCA forms are repeatedly described as "bank accounts", but reported financial positions include more complex instruments and positions. We are not dealing with just passbook accounts.

Similarly, TIGTA calculated that IRS identified 330,000 US taxpayers who could have been penalized $3.3 billion or more for failure to file Form 8938 (i.e. the FATCA report that individuals file as part of tax returns) from 2016 to 2019. IRS management dismissed this as “grossly overstated” for various good reasons, using words like “inaccurate” and “erroneous”.

Finally, key numbers for FATCA filings, by both individuals (Form 8938) and foreign financial institutions, or FFIs (Form 8966), do not appear to match with IRS statements about the same numbers. We are trying to get clarification from IRS.

12 years after passage, FATCA has generated virtually no money

TIGTA’s summary of FATCA’s impact is: “[in 11 years] IRS has not made significant measurable progress toward ensuring compliance.” (p.21).

No identifiable tax revenues attributable to FATCA are cited, although FATCA withholding from FFIs has been rising and amounted cumulatively to $1.5 billion through 2018. In addition, cumulative penalties for non-reporting reached $14 million by 2019, $1 million of which was abated. This adds to only a small fraction of the cumulative $8.7 billion by 2020 envisaged in the legislative budget scoring for FATCA when it was passed in 2010.

Implementation costs continue to rise. The $380 million already spent by 2018 had grown by the end of 2020 to $574 million (mostly for IT).

TIGTA targets fines and penalties as if they were general revenues

The report is almost devoid of anything about actual tax revenues. It focuses on information reporting and the fines and penalties to which misreporting can be subjected. Indeed, IRS management’s response to the report notes:

“TIGTA’s report largely fails to recognize the … impact…FATCA … has on its filing population, which should be the largest source of the regime’s revenue generation.”

TIGTA pressure on IRS to go for financial penalties is evident in its recommendations to use penalty assessments (i) as part of additional compliance actions for under-reporting on Form 8938 and (ii) to establish procedures to identify non-filers of this form. IRS agreed and claims to have already implemented these recommendations.

The focus on Form 8938 is fairly new. It is also a misdirection of Treasury efforts to identify evasion, since taxable income reported by FFIs on Form 8966 can be matched directly to Form 1040.

We may see a stream of large Form 8938 penalty cases, similar to what we have seen for FBARS, in the near future.

Small businesses will increasingly be targeted

Organizationally, international tax issues at IRS are handled by the Large Business section, presumably because of the high profile of multi-national enterprises. As a result, FATCA compliance within IRS has been handled by this section. But the "FATCA Compliance Roadmap" has always envisaged wider use of FATCA-related information and TIGTA has pushed for the Small Business division to focus on international tax issues as well. TIGTA Recommendation 6 calls for action in this regard and IRS management has indicated that this has already been implemented.

Separately, we can recall that the March 2021 IRS report, noted above, highlighted alleged "sophisticated evasion" associated with "offshore" and "passthrough" businesses. (A "Passthrough" business is pretty much any business that is not a C-corporation.) Many expat small businesses are both offshore and passthrough.

There is considerable risk that we will see enhanced enforcement efforts directed at expat small businesses.

TINs and the Accidentals

The problems faced by Accidentals seem likely to get worse.

IRS' problem of having no TINs to match FATCA reports from banks (Form 8966) with actual taxpayers persists, as, even as late as 2019, fewer than half of these forms contain a valid TIN. TIGTA and IRS continue to see this as a problem of FFI non-compliance, rather than a problem made in Washington that FFIs can do little about. IRS plans to reinforce compliance actions already being directed at 34 FFIs. Pressure on banks to cut expats off is likely to increase.

It is difficult to see the point in harassing Accidentals for lack of TINs. IRS has had some success developing programs to allow it to match FFI accounts reported by filers on Form 8938 with those filed by the FFIs on Form 8966, even without TINs. The success rate amounted to 76% of all FFIs identified by taxpayers filing Form 8938 in both 2016 and 2017 and 70% and 83% of all FFIs filing Form 8966 in 2016 and 2017, respectively. So the share of unmatched reporting seems fairly small, in the 15-30% range.

No suggestion of large-scale offshore evasion emerges from the data

The TIGTA audit contains the first substantial summary information we have seen about FFI Form 8966 reporting. Once these data are properly analyzed and filtered for duplicate reporting it should provide accurate and comprehensive data about offshore financial investments by individuals. What has been reported so far is partial and any analysis of it should be taken as suggestive and not authoritative. But with more than 80% of the information reported on Form 8966 matched to individual taxpayers it is a large step forward compared to the guesswork that has served to date as a basis for most estimates of revenues lost due to offshore evasion.

TIGTA reports too many numbers, with too many qualifications, to filter, analyze and summarize here. But one figure of interest is $171.2 billion, reported by TIGTA as “potential under-reported bank values" in 2018. This appears to cover all of the 83% of reported accounts that could be matched with taxpayer filings.

Using standard methodology and reasonable parameters for rates of taxable returns and effective taxation, this could suggest lost tax revenues of the order of $1.3 billion. We can only guess how representative this is of the remaining 17% of accounts that have not been matched—a similar distribution of under-reporting would suggest raising this figure to close to $1.6 billion. But even without adjusting for factors tending to overstate the true amount, the total looks likely to be small fractions of the various estimates (e.g. $40 billion; $70 billion; $40-123 billion; $15 billion) that have nourished policy discussion in Washington.

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[1] “Additional Actions Are Needed to Address Non-Filing and Non-Reporting Compliance Under the Foreign Account Tax Compliance Act”, *TIGTA Report Number* 2022-30-019.
[2] Guyton, John; Patrick Langetieg; Daniel reck; Max Risch; and Gabriel Zucman; “Tax Evasion at the Top of the Income Distribution”, *NBER Working Paper* 28542, March 2021.

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