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TaxForum

| 2017

Advocating for Your Client in
Issues Flowing from the Foreign
Account Tax Compliance Act
(FATCA)



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Specifically the presentation will be addressing refund issues associated with nonresident alien withholding on payments of U.S. source income reported on Form 1042-S.



Learning Objectives

- After completing this course, you will be able to:
 - Better understand current IRS practice regarding refunds of withholding reported on Forms 1042-S;
 - More effectively advocate for taxpayers whose Form 1042-S refund claims have been frozen by the IRS; and
 - Anticipate future developments in this area that impact taxpayers you represent.



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Refund Issues of Nonresidents

- Problems receiving Form 1040NR refunds associated with Forms 1042-S
- IRS approach to reviewing claims and how to advocate
- Impact of FATCA



Chapter 3

- IRC §§ 1441-1446, 1461-1465 (Chapter 3)
- Requires payers to withhold on fixed, determinable, annual, and periodic (FDAP) income
- FDAP includes fellowships, compensation for personal services, dividends, and royalties



Chapter 3, continued

- Withholding agents remit amounts to IRS
- They also submit applicable documentation:
 - Aggregate Form 1042 to the IRS
 - Individual Forms 1042-S to the IRS and taxpayers



Chapter 3, continued

- Taxpayers seek refund by:
 - Filing Form 1040NR requesting refund
 - Attaching Form 1042-S showing amounts that have been withheld
- IRS wants taxpayer's copy of Form 1042-S to match withholding agent's copy of Form 1042-S



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FATCA Represented a Game Changer

- Congress enacted FATCA to compel reporting of offshore accounts
- Has a withholding component, but usually not necessary
- Most significant because it signals shift to enforcement orientation

FATCA's Intersection With Chapter 3

- FATCA generally adopts Chapter 3's rules regarding withholding and refunds
- As it implemented FATCA, IRS's approach to Chapter 3 changed substantially





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Prior Chapter 3 Refund Practice

- Chapter 3 refunds were issued quickly; sometimes audited later
- Approach mirrored that regarding withholding of domestic employment taxes
- Fraud concerns led IRS to alter its Chapter 3 practices
- Now demands precise matching and denies right to credit or refund unless amounts actually remitted



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Chapter 3 Refund Freezes

- Systemic refund freezes
- No refund until Forms 1042-S matched
- Refunds subject to renewable six month freeze
- Over 100,000 taxpayers had refunds frozen



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Chapter 3 Refund Freezes, continued

- Reliance on semi-automated matching tool
- Significant error rates and long delays
- Remaining freezes generally released in June 2016



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Evolving Landscape

- Since lifting the refund freezes, the IRS has published incremental guidance
- Different IRMs govern different periods
- IRS working toward permanent policy for the future



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Current Refund Practices

- Now, some, but not all, refund claims are frozen
- After freeze, IRS manually matches Form 1040NR against Form 1042-S items



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Current Refund Practices, continued

- Any freeze will result in manual review
- This review can lead to larger audit
- Ensure that information on Form 1040NR and Form 1042-S matches up and is accurate



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Form 1042-S Review Process

- After freeze is established, the Form 1042-S review process is initiated
- Taxpayers notified of preliminary action (Letter 3064C or 5887C)
 - No action required at this stage
 - Initial time allocated for review is six months from later of date return filed or due



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Form 1042-S Review Process, continued

- During freeze, IRS compares fields
- Taxpayer's Form 1040NR must match withholding agent's Form 1042-S
- If all fields match, refund released
- Potential for audit via referral or regular Compliance procedures



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Results of Mismatch

- If mismatch:
 - Withholding credit on Taxpayer's Form 1040NR reduced or eliminated
 - Taxpayer notified of preliminary disallowance (Letter 5904C)
 - Taxpayer must contact withholding agent to correct inconsistencies that are not the result of taxpayer error



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“False Positive”

- If taxpayer contacts withholding agent and no inconsistencies discovered:
 - Theoretically, IRS should remedy false positive and release refund
- If IRS provides neither relief nor path to resolution regarding the mismatch:
 - Contact TAS



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Addressing Mismatches

- Most Form 1042-S issues will be resolved through withholding agent contact
- Withholding agent must:
 - File amended Form 1042-S with IRS
 - Issue amended Form 1042-S to taxpayer



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Addressing Mismatches, continued

- Mismatches may result from withholding agent or taxpayer error
- Refund released after withholding agent and/or taxpayer correct errors
- Taxpayer may need to file amended Form 1040NR if mismatch resulted from error on original Form 1040NR



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Potential Problems

- Potential for problems if:
 - Withholding agent and taxpayer cannot identify mismatches
 - Withholding agent unresponsive
- IRS should consider possibility of “false positive” mismatches where no inconsistencies apparent



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Follow-Up and Appeal Rights

- Without taxpayer follow-up regarding disallowances, statute of limitations on refund will eventually expire
- Taxpayer ideally should be able to contest refund disallowance determination within the IRS, including at Appeals
- Taxpayers will have the right to judicial review



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TAS Advocacy

- National Taxpayer Advocate has advocated for impacted taxpayers:
 - Preliminary disallowance letters improved via greater specificity
 - Seeking guaranteed appeal rights for taxpayers with denied refund claims associated with withholding on Forms 1042-S
 - Recommending allowance of Form 1042-S refunds if taxpayer can prove withholding occurred (IRS has declined)



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Intended Regulations

- Intended regulations would allow credits and refunds only if withholding agents have remitted amounts to IRS
- Pro rata refunds for individuals based on extent of withholding agents' partial deposits
- No exception contemplated for taxpayers who have had all taxes withheld, but not remitted by withholding agent to IRS

Coming Soon...

- Fast developing area, so stay tuned
- TAS continues to:
 - Monitor IRS policy on this subject
 - Advocate for affected taxpayers



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- www.TaxpayerAdvocate.irs.gov
- www.youtube.com/tasnta
- www.facebook.com/YourVoiceAtIRS
- Call 877.777.4778
- twitter.com/YourVoiceatIRS
- File Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance order)



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Contact TAS

Michael Baillif, Attorney Advisor

Michael.E.Baillif@irs.gov