Improvements Are Needed to Verify Taxpayer Claims for Exemption From United States Social Security Taxes Under Totalization Agreements

July 17, 2015

Reference Number: 2015-30-056

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2 = Risk Circumvention of Agency Regulation or Statute

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IMPROVEMENTS ARE NEEDED TO VERIFY TAXPAYER CLAIMS FOR EXEMPTION FROM UNITED STATES SOCIAL SECURITY TAXES UNDER TOTALIZATION AGREEMENTS

Highlights

Final Report issued on July 17, 2015

Highlights of Reference Number: 2015-30-056 to the Internal Revenue Service Commissioner for the Large Business and International Division.

IMPACT ON TAXPAYERS

In an effort to eliminate dual taxation with respect to social security taxes, the United States entered into international agreements, called Totalization Agreements, with 24 foreign countries. These agreements coordinated the social security coverage and taxation of American citizens and resident aliens who are employed in those foreign countries, as well as resident aliens in the United States that may be subject to U.S. Social Security and Medicare taxes. Internal Revenue Code Section 3101(c) provides relief from U.S. Social Security and Medicare taxes in cases covered by an international agreement.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the IRS's efforts to identify taxpayers affected by Totalization Agreements and ensure that their U.S. Social Security taxes are properly paid in accordance with these international agreements.

WHAT TIGTA FOUND

The IRS cannot readily identify American citizens and resident aliens working in a foreign country, as well as resident aliens working in the United States, who may have improperly claimed exemption from U.S. Social Security taxes under a Totalization Agreement. TIGTA selected a stratified statistical sample of 160 taxpayers who did not pay U.S. Social Security taxes. Based on this sample, TIGTA found 29 taxpayers who appeared to not have met the Totalization Agreement criteria for exemption from U.S. Social Security taxes. This included American citizens or resident aliens who worked overseas during Tax Year 2012, but did not appear to have met the five-year period for coverage by a foreign country's social security system; and resident aliens who worked in the United States during Tax Year 2012, but appeared to have exceeded the five-year period for coverage by a foreign country's social security system. As a result, TIGTA identified that these taxpayers potentially owe $822,367 in U.S. Social Security and Medicare taxes, or $16.9 million when the sample is projected to the population.

TIGTA also identified 23 resident aliens who appeared to either work for an American-based employer or were hired by a foreign employer while living in the United States. These taxpayers potentially owe $51,008 in U.S. Social Security and Medicare taxes, or $4.3 million when the sample is projected to the population.

Also, TIGTA determined that the Social Security Administration receives Certificates of Coverage from foreign countries, but the IRS does not have formalized procedures to obtain these certificates to identify noncompliant taxpayers.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS coordinate with the Social Security Administration to periodically acquire Certificate of Coverage data, as well as request from Totalization Agreement countries data related to foreign social security taxes paid. TIGTA also recommended that the IRS use the data obtained to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

In their response to the report, IRS officials agreed with our recommendations. The IRS plans to work with the Social Security Administration to periodically obtain Certificate of Coverage data and to request data from countries with Totalization Agreements related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers. The IRS plans to explore the use of the data obtained to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

July 17, 2015

MEMORANDUM FOR COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements Are Needed to Verify Taxpayer Claims for Exemption From United States Social Security Taxes Under Totalization Agreements (Audit # 201330023)

This report presents the results of our review to evaluate the Internal Revenue Service's (IRS) efforts to identify taxpayers affected by Totalization Agreements and ensure that their U.S. Social Security taxes are properly paid in accordance with these international agreements. This audit is included in the Treasury Inspector General for Tax Administration's Fiscal Year 2015 Annual Audit Plan and addresses the major management challenges of Globalization and Tax Compliance Initiatives.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations.

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

Table of Contents

Abbreviations

FICA	Federal Insurance Contributions Act
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States

Background

In an effort to eliminate dual taxation with respect to social security taxes, the United States entered into international agreements, called Totalization Agreements,[1] with 24 foreign countries.[2] These agreements coordinate the social security coverage and taxation of American citizens and resident aliens who are employed in those foreign countries, as well as resident aliens in the United States that may be subject to U.S. Social Security and Medicare taxes.

Dual social security tax liabilities result when American citizens and resident aliens working in a foreign country are expected to pay into both the United States' and a foreign country's social security systems.

Social Security benefits were created under Title II of the *Social Security Act of 1935*[3] and its related taxing provisions were provided for under Title VIII. In 1939, the Title VIII taxing provisions were placed under the Internal Revenue Code (I.R.C.) by the *Federal Insurance Contributions Act* (FICA).[4] The FICA provides for a Social Security tax to pay for benefits under the old age, survivors, and disability insurance portion of I.R.C. Section (§) 3101(a), while the hospital insurance portion is financed by the Medicare tax under I.R.C. § 3101(b). These are known as "employment taxes." Employment taxes include Federal income tax withholding, Social Security, and Medicare taxes. I.R.C. § 3101(c) provides relief from U.S. Social Security and Medicare taxes in cases covered by these international agreements. The Internal Revenue Service (IRS) has the primary responsibility for ensuring taxpayer and employer compliance with employment taxes.

If an American citizen or resident alien received wages for employment from an American employer, regardless of whether the services are performed in the United States or in a foreign country, they are generally required to pay into the U.S. Social Security and Medicare system. Additionally, many foreign affiliates of American companies provide U.S. Social Security and Medicare coverage for American citizens and resident aliens they employ.

However, many foreign countries also require workers who perform services within their geographical territory to pay a social security tax. Dual social security tax liabilities result when American citizens or resident aliens working in a foreign country are expected to pay into *both* the United States' and the foreign country's social security systems.

If an American employer sends an American citizen or resident alien to work in a foreign country that does not have a Totalization Agreement with the United States, the American

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[1] See Appendix VI for a glossary of terms.
[2] Appendix V includes a list of the 24 foreign countries and the effective dates of their Totalization Agreements.
[3] Pub.L. 74–271, 49 Stat. 620.
[4] 26 U.S.C. §§ 3101-3128.

employer and the employee are generally liable to pay social security taxes to *both* countries. However, when an American employer sends an American citizen or resident alien to work in a foreign country with which the United States has a Totalization Agreement, relief from dual social security taxes is provided. In general, the Totalization Agreements state:

1. If an American citizen or resident alien is <u>sent</u> to a foreign country for less than five years to work for the <u>same</u> American-based employer, he or she would generally remain covered by the U.S. Social Security system.
2. If the same taxpayer was <u>sent</u> abroad for longer than five years, he or she would pay social security taxes to the foreign country.
3. If the taxpayer is employed by a foreign employer or was hired by an American-based employer while living overseas, he or she would pay social security taxes to the foreign country.

Conversely, if a resident alien is working in the United States the same principles would generally apply.

1. If the resident alien is sent by a foreign employer to work in the United States for less than five years, he or she would generally remain covered by the foreign country's social security system.
2. If the resident alien worked for an American-based employer or was hired by a foreign employer while living in the United States, he or she would pay U.S. Social Security taxes.

To substantiate his or her exemption from the FICA under the terms of a Totalization Agreement, the American citizen or resident alien or his or her employer generally requests a Certificate of Coverage from either the country in which the employee is employed or the country of residence.

This review was performed at the Large Business and International Division Headquarters in Washington, D.C., with information obtained from the Social Security Administration (SSA), Office of International Programs and the Small Business/Self-Employed Division during the period March 2014 through January 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Some Taxpayers May Be Improperly Claiming Exemption From United States Social Security Taxes Under Totalization Agreements

For American citizens and resident aliens working in a foreign country, and resident aliens working in the United States, the IRS is unable to readily identify those taxpayers who may have improperly claimed exemption from U.S. Social Security taxes under a Totalization Agreement. We analyzed the IRS's Individual Return Transaction File and Form W-2, *Wage and Tax Statement*, data for Processing Year 2013 and identified 46,670 individual taxpayers who filed a Tax Year 2012 Form 1040, *U.S. Individual Income Tax Return*, with either a foreign address from a Totalization Agreement country or a U.S. domestic address[5] with a foreign country code from a Totalization Agreement country.

From this population, we identified 8,807 individual taxpayers[6] who filed a Tax Year 2012 Form 1040 claiming earned wages of $966.5 million with the following characteristics:

- Received wages from an American employer.
- The American employer did not withhold any U.S. Social Security taxes from the employee's wages.

From the 8,807 individual taxpayers, we selected a statistically valid sample of 160 taxpayers from three stratified subpopulations[7] to determine if these taxpayers were properly exempted from paying U.S. Social Security taxes.[8] For each sampled taxpayer, we reviewed information from the IRS's Integrated Data Retrieval System to determine the length of time the taxpayer was living overseas or in the United States, and if he or she would or would not be subject to U.S. Social Security taxes. This included reviewing each taxpayer's Tax Year 2012 Form 1040 tax return and filing address history, as well as tax return and Form W-2 information from prior and subsequent years.

[5] Some taxpayers maintain a U.S. domestic address for tax purposes, even though they physically reside and work in a foreign country.
[6] We selected only those taxpayers with wages greater than $200.
[7] These statistical strata were based on the amount of wages earned during Tax Year 2012. Since IRS computer systems cannot readily identify American citizens and resident aliens working in a foreign country or resident aliens working in the United States who claim an exemption from U.S. Social Security taxes under a Totalization Agreement, the population could not be stratified beyond the amount of wages earned during Tax Year 2012.
[8] Appendix IV contains a detailed breakdown of the population and sample sizes from the three stratified subpopulations.

Our analysis found that 76 of the 160 sampled American citizens and resident aliens were compliant with U.S. Social Security tax laws. Specifically, we identified:

- 26 of the 76 taxpayers were not required to pay U.S. Social Security taxes or the taxes were actually paid. Some of the more prevalent examples include:
  - Students who worked for their college or university and were exempt.
  - Disability payments that were exempted.
  - Missionaries or ministers who paid self-employment taxes.[9]
- 50 of the 76 taxpayers working overseas appeared to have met the criteria to be covered by a foreign country's social security system and would be exempted from U.S. Social Security taxes. These included:
  - Taxpayers working for more than five years in a foreign country.
  - Taxpayers who appear to have been hired by an American employer while living in a foreign country.
  - Taxpayers who were employed by a foreign affiliate of an American employer while working overseas. These foreign affiliates appear to not have elected to extend U.S. Social Security coverage to the American citizens and resident aliens working for them.

Our analysis also found that 52 of the 160 sampled American citizens and resident aliens appeared to be noncompliant with U.S. Social Security tax laws. Specifically, our review of the sampled taxpayers determined that:

- 29 of the 52 noncompliant taxpayers did not meet the Totalization Agreement criteria for exemption from U.S. Social Security taxes. These included:
  - American citizens or resident aliens who worked overseas during Tax Year 2012 but appeared not to have met the five-year period for coverage by a foreign country's social security system.
  - Resident aliens[10] who worked in the United States during Tax Year 2012 but appeared to exceed the five-year period for coverage by a foreign country's social security system.

[9] Missionaries and ministers report all taxable compensation as wages in Box 1 on Form W-2. While these earnings are not subject to Federal, Social Security or Medicare withholding taxes by their employer, the earnings reported on the missionary's or minister's Form 1040 are subject to self-employment and Federal income tax.

[10] We concluded that these taxpayers were resident aliens earning wages in the United States based on one or more of the following characteristics: had a limited filing history, the Tax Year 2013 return filed was a Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, State and local taxes were paid, or had rental income from a residence in a foreign country.

The wages for these 29 individuals totaled $21,060,581, but due to the Social Security wage base limit, only $2,480,017 would be subject to U.S. Social Security taxes. As a result, the taxpayers potentially owe $108,313 and their American-based employers potentially owe $139,113 in U.S. Social Security taxes.[11] In addition, these taxpayers and their American-based employers potentially owe a combined total of $574,941 in Medicare taxes.[12] This results in a total of $822,367 in FICA taxes or a weighted average of $1,916 per case.[13] When we project the results of these 29 exceptions to the population, 1,427 individual taxpayers[14] would potentially owe $16.9 million in FICA taxes.[15] When the results are forecast over five years, we estimate that 7,135 individual taxpayers who did not satisfy the Totalization Agreement criteria for exclusion would potentially owe approximately $84.4 million in FICA taxes.[16]

- Of the 52 noncompliant taxpayers, 23 were resident aliens who appeared to either work for an American-based employer or were hired by a foreign employer while living in the United States. These taxpayers had wages totaling $411,549, but due to the Social Security wage base limit, only $393,941 would be subject to U.S. Social Security taxes. As a result, they would potentially owe $16,546 and their employers would potentially owe $24,424 in U.S. Social Security taxes. In addition, these taxpayers and their employers would potentially owe a combined total of $10,038 in Medicare taxes. This results in a total of $51,008 in FICA taxes, or a weighted average of $490 per case.[17] When we project the result of these 23 exceptions to the population, 1,947 individual taxpayers[18] potentially owe $4.3 million in FICA taxes.[19] When the results are forecast over five years, we estimate that 9,735 individual taxpayers who did not satisfy the

[11] For Tax Year 2012, the Social Security tax rate was 6.2 percent for the American employer and 4.2 percent for the employee with a Social Security wage base limit of $110,100. See Appendix IV for the computation of these taxes.
[12] For Tax Year 2012, the Medicare tax rate was 1.45 percent for the American employer and 1.45 percent for the employee. There is no wage base limit for Medicare taxes as all covered wages are subject to Medicare taxes. See Appendix IV for the computation of these taxes.
[13] This is the total weighted average per case based on the stratified sample calculations as shown in Appendix IV.
[14] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 819 and 2,036.
[15] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $8 million and $25 million.
[16] The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.
[17] This is the total weighted average per case based on the stratified sample calculations as shown in Appendix IV.
[18] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 1,250 and 2,645.
[19] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $1 million and $7 million.

Totalization Agreement criteria for exclusion would potentially owe approximately $21.5 million in FICA taxes.[20]

For the remaining 32 of the 160 sampled taxpayers, we could not verify their compliance without additional information that would prove exemption from U.S. Social Security taxes, such as a valid Certificate of Coverage from a Totalization Agreement country. These taxpayers had wages totaling $12,574,544, but due to the Social Security wage base limit, only $2,953,552 would be subject to U.S. Social Security taxes, if applicable. Specifically, our review of the sampled taxpayers determined that:

- Of the 32 taxpayers, 29 were resident aliens who appeared to have been sent to the United States by a foreign employer for less than five years. As a result, they would owe social security taxes to a foreign country. However, if these taxpayers do not have a valid Certificate of Coverage from a Totalization Agreement country, they would potentially owe $110,177 and their employers would potentially owe $162,642 in U.S. Social Security taxes. In addition, these taxpayers and their employers would potentially owe a combined total of $317,998 in Medicare taxes, resulting in a total of $590,817 in FICA taxes owed.
- For three of the 32 taxpayers, we could not make a reasonable determination if they would be subject to U.S. Social Security taxes based on the information available to us. If it is determined that these three taxpayers would be liable for U.S. Social Security taxes based on the Totalization Agreements, the three taxpayers would potentially owe $13,873 and their employers would potentially owe $20,479 in U.S. Social Security taxes. In addition, these taxpayers and their employers would potentially owe a combined total of $46,664 in Medicare taxes, resulting in a total of $81,016 in FICA taxes owed.

Acquiring information from external sources would help improve the IRS's ability to ensure compliance with U.S. Social Security taxes in accordance with Totalization Agreements

The Large Business and International Division's Exchange of Information function is responsible for administering the exchange of information provisions of U.S. tax treaties and tax information exchange agreements. Specifically, the Exchange of Information function:

- Helps IRS field personnel obtain information from foreign countries.
- Works with IRS field personnel to provide information to certain foreign countries.
- Coordinates the Mutual Collection Assistance provisions of certain treaties.

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

The IRS routinely exchanges information with treaty partners that includes data on wages, interest, dividends, and other forms of income. IRS examiners can request some foreign social security tax information from the SSA on a case-by-case basis; however, there is currently no systemic exchange of information related to the maintenance of Totalization Agreements and the payments of social security taxes. When we discussed this issue with Large Business and International Division management, they indicated that they have little involvement in the administration of Totalization Agreements, emphasizing that the SSA is the competent authority of the Totalization Agreement area.

Since the IRS is responsible for enforcing compliance with U.S. Social Security taxes, obtaining systemic social security information from the Totalization Agreement countries would help verify which American citizens and resident aliens are covered by a foreign country's social security system and, therefore, exempt from paying U.S. Social Security taxes. Without systemic information related to the payment of social security taxes by American citizens or resident aliens to countries with which the United States has a Totalization Agreement, the IRS cannot properly ensure that all taxpayers are meeting their U.S. FICA tax obligations.

Obtaining Certificates of Coverage from the SSA would enhance the IRS's ability to determine whether taxpayers are exempt from paying U.S. Social Security taxes

IRS guidance provided to taxpayers and employers on its website (*e.g.*, IRS.gov) states that if a taxpayer was permanently working in a foreign country with which the United States has a social security agreement, and under the Totalization Agreement, the taxpayer's pay is exempt from U.S. Social Security tax. The taxpayer or the employer should get a statement from the authorized official or agency of the foreign country verifying that his or her pay is subject to social security coverage in that country. The statement should be maintained by the employer because it establishes that the taxpayer's pay is exempt from U.S. Social Security tax.

The SSA receives copies of Certificates of Coverage issued by other foreign countries. However, the SSA only uses this data to record the number of Certificates of Coverage approved by other Totalization Agreement countries and then destroys the documents. The IRS does not have any formalized procedures to obtain information from the SSA related to Certificates of Coverage received from other countries. Obtaining this information periodically from the SSA would not only help verify that American citizens and resident aliens permanently working in a country with a Totalization Agreement were covered by that country's social security system, but would also help verify if resident aliens working in the United States are required to pay U.S. Social Security taxes.

In addition, the SSA issues Certificates of Coverage to American Citizens and resident aliens temporarily working in countries with which the United States has Totalization Agreements. However, the IRS does not have procedures to periodically obtain information related to Certificates of Coverage issued by the SSA to American citizens and resident aliens, which would help the IRS determine if they were covered by the U.S. Social Security system. **2***

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************************2*********************. For several years, the SSA has maintained an automated program of all Certificates of Coverage requests made by American citizens and resident aliens working in countries with which the United States has Totalization Agreements. Periodically obtaining this information from the SSA would assist the IRS in determining if American citizens or resident aliens are exempt from paying U.S. Social Security taxes.

Recommendations

Recommendation 1: The Commissioner, Large Business and International Division, should use existing procedures to work with the SSA on establishing a process to periodically acquire Certificate of Coverage data. This includes obtaining copies of Certificates of Coverage issued by the SSA, as well as copies that were received by the SSA from Totalization Agreement countries indicating that American citizens and resident aliens were covered under a foreign country's social security system.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS will use existing procedures to work with the SSA on establishing a process to periodically acquire Certificate of Coverage data. This includes obtaining copies of Certificates of Coverage issued by the SSA, as well as copies that were received by the SSA from Totalization Agreement countries indicating that American citizens and resident aliens were covered under a foreign country's social security system.

Recommendation 2: The Commissioner, Large Business and International Division, should coordinate with the SSA Competent Authority to request data from countries with which the United States has Totalization Agreements related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers that would help the IRS ensure compliance with the U.S. Social Security tax laws.

> ***Management's Response:*** The IRS agreed with this recommendation. The Large Business and International Division will coordinate with the SSA Competent Authority to request data from countries with Totalization Agreements related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers that would help the IRS ensure compliance with the U.S. Social Security tax laws.

Recommendation 3: The Commissioner, Large Business and International Division, and the Commissioner, Small Business/Self-Employed Division, should use the data obtained from the other Totalization Agreement countries and the SSA to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

Management's Response: The IRS agreed with this recommendation. The Large Business and International Division will explore the use of data obtained from the SSA and the other Totalization Agreement countries to identify noncompliance with payment of U.S. Social Security and Medicare taxes. If the results of pilot Form 1040 examinations identify a pattern of noncompliance, the Large Business and International Division will review the use of the data received from the SSA and other Totalization Agreement countries pursuant to Recommendations 1 and 2.

The Small Business/Self-Employed Division will explore the use of data obtained from the SSA and the other Totalization Agreement countries to identify noncompliance with payment of U.S. Social Security and Medicare taxes. If the results of pilot Form 1040 examinations identify a pattern of noncompliance, the Small Business/Self-Employed Division will review the use of the data received from the SSA and other Totalization Agreement countries pursuant to Recommendations 1 and 2. If the data are determined to be in a usable format and human capital and information technology resources are available, it will explore the use of the data to identify employer behaviors pertaining to quarterly Federal employee tax reporting requirements and identify noncompliance with payment of U.S. Social Security and Medicare taxes. Commensurate with available human capital and information technology resources and in coordination with other priority work, the Small Business/Self-Employed Division will consider developing treatments, education, and communication, and conduct examinations on the most noncompliant employers.

While the IRS agreed that outcome measures should be computed for this audit, the IRS did not agree with the methodology we used in calculating these outcomes. The IRS believed that a single random sample did not consider the distinctions within the sample, specifically, different taxpayer populations and respective noncompliance issues. Finally, the IRS indicated the single and five-year projections are not accompanied by confidence intervals, which they believe would provide additional perspective.

Office of Audit Comment: We selected our sample from a population of Tax Year 2012 Forms 1040 filed with either a foreign address from a Totalization Agreement country or a U.S. domestic address with a foreign country code from a Totalization Agreement country and reporting wages in Tax Year 2012 from an American employer and the American employer did not withhold Social Security taxes from the employee's wages. It was not possible for us to readily differentiate between American citizens and resident aliens working in a foreign country and resident aliens working in the United States that may have improperly claimed exemption from U.S. Social Security taxes under a Totalization Agreement. The differentiation between the two only became apparent after we reviewed the sampled cases and identified the types of noncompliance. We projected the results only on the sample cases that appeared to be noncompliant with U.S. Social Security tax laws. We believe that the outcome measures accurately demonstrate the potential impact of our recommendations. Appendix IV of the report contains the confidence intervals for the single year projections. The five-year forecasts are based on a point estimate.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to evaluate the IRS's efforts to identify taxpayers affected by Totalization Agreements[1] and ensure that their U.S. Social Security taxes are properly paid in accordance with these international agreements. To accomplish our objective, we:

I. Determined whether the IRS has a compliance program to identify taxpayers working in Totalization Agreement countries who are noncompliant with paying their U.S. Social Security taxes.

   A. Interviewed Small Business/Self-Employed Division personnel and determined how the IRS identifies taxpayers working in Totalization Agreement countries that were noncompliant with paying their U.S. Social Security taxes.

   B. Interviewed the Large Business and International Division's Exchange of Information management, researched the IRS's Intranet website, and determined whether the IRS receives information related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers from foreign countries that have a Totalization Agreement with the United States.

   C. Interviewed the SSA's Office of International Operations management and obtained an understanding of the Totalization Agreement process, the issuance and use of Certificates of Coverage, and foreign social security data provided to the IRS related to taxpayers working in Totalization Agreement countries.

   D. Researched the SSA's Internet website to identify information about the Totalization Agreement process, Certificates of Coverage, and guidance provided to taxpayers impacted by Totalization Agreements.

II. Determined if American citizens and resident aliens are properly classified as exempt from U.S. Social Security taxes as a result of a Totalization Agreement.

   A. Analyzed the IRS's Individual Return Transaction File and Form W-2, *Wage and Tax Statement*, data from TIGTA's Data Center Warehouse and identified a total of 8,807 taxpayers with wages of $966.5 million who filed a Form 1040, *U.S. Individual Income Tax Return*, during Tax Year 2012 with a foreign address from a Totalization Agreement country or a U.S. domestic address with a foreign country code for a

[1] See Appendix VI for a glossary of terms.

Totalization Agreement country,[2] received wages from an American employer, and did not have U.S. Social Security taxes withheld by the American employer.

B. Selected a statistical stratified random sample[3] of 160 taxpayers and analyzed the taxpayer's Tax Year 2012 Form 1040 data from the Integrated Data Retrieval System and Certificate of Coverage information obtained from the SSA and determined whether the taxpayer was exempt from paying U.S. Social Security taxes. We selected the sample using a confidence level of 95 percent, a precision rate of ±5 percent, and an error rate of 10 percent. A statistical sample was taken because we wanted to estimate and project the amount of U.S. Social Security and Medicare taxes that may be owed. We shared our sampling methodology with our contracted statistician, who confirmed the accuracy of our methodology. The contracted statistician assisted with reviewing our sampling plans and developing our projections.

Data validation methodology

During this review, we relied on data extracts from the IRS's Individual Return Transaction File and Form W-2 data located at TIGTA's Data Center Warehouse. We relied on data validation tests conducted by the TIGTA Office of Investigations' Strategic Data Services for the accuracy of the data. We also used the Integrated Data Retrieval System to verify the accuracy of data for 10 sampled taxpayers from the population of wage earners with no Social Security taxes withheld by their American employers by comparing information identified from the Individual Return Transaction File maintained at TIGTA's Data Center Warehouse to the Individual Master File tax accounts of the taxpayers working in Totalization Agreement countries. We determined that the data obtained were sufficiently reliable.

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: the IRS's processes and procedures for ensuring that all American citizens and resident aliens working in Totalization Agreement countries, as well as resident aliens working in the United States, are compliant in paying U.S. Social Security and Medicare taxes. We evaluated these controls by interviewing

[2] Some taxpayers maintain a U.S. domestic address for tax purposes, even though they physically reside and work in a foreign country.

[3] These 160 taxpayers were selected from three stratified subpopulations based on the amount of wages earned during Tax Year 2012. A total of 100 was selected from Strata 1 of those taxpayers with wages at least $201, but not more than $499,999. A total of 30 was selected from Strata 2 of those taxpayers with wages of at least $500,000, but not more than $999,999. A total of 30 was selected from Strata 3 of those taxpayers with wages of at least $1,000,000. The sample selections were made prior to our testing based on the Form W-2 information.

key personnel with the IRS and the SSA, analyzing data, and reviewing SSA policies and procedures.

Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

Increased Revenue – Potential; $16.9 million in FICA[1] taxes for 1,427 individual taxpayers (*e.g.*, American citizens and resident aliens) who did not satisfy the criteria for exclusion from paying U.S. Social Security taxes during Tax Year 2012, or $84.4 million for 7,135 individual taxpayers when the sample is forecast over five years (see page 3).

Methodology Used to Measure the Reported Benefit:

We analyzed the Individual Return Transaction File and the Form W-2, *Wage and Tax Statement*, data and identified a total of 8,807 individual taxpayers with earned wages of $966.5 million who filed a Tax Year 2012 Form 1040, *U.S. Individual Income Tax Return*, that received wages from an American-based employer and the American-based employer did not withhold U.S. Social Security taxes from the wages received. From the 8,807 individual taxpayers, we selected a statistically valid random sample of 160 taxpayers from three stratified subpopulations[2] to determine if these taxpayers were properly exempt from paying U.S. Social Security taxes. Figure 1 identifies the stratified populations and sample data.

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[1] See Appendix VI for a glossary of terms.
[2] These statistical strata were based on the amount of wages earned during Tax Year 2012. Since IRS computer systems cannot readily identify American citizens and resident aliens working in a foreign country or resident aliens working in the United States who claim an exemption from U.S. Social Security taxes under a Totalization Agreement, the population could not be stratified beyond the amount of wages earned during Tax Year 2012.

Figure 1: Population and Sample Data for Taxpayers Who Did Not Pay U.S. Social Security Taxes Under a Totalization Agreement (Wages in Thousands)

	Wage Strata			
	STRATUM 1: $201 to $499,999	**STRATUM 2: $500,000 to $999,999**	**STRATUM 3: $1,000,000 or greater**	**Total**
Population Data:				
Number of Accounts	8,468	195	144	8,807
Population Percentage	96.15%	2.21%	1.64%	100.00%
Population Wages	$511,392	$133,881	$321,207	$966,481
Sample Data:				
Sample Cases	100	30	30	160
Sample Wages	$6,760	$19,282	$61,483	$87,525

Source: TIGTA analysis of the Individual Return Transaction File and the Form W-2 data for Tax Year 2012 Forms 1040 filed with a foreign address and where no Social Security taxes were withheld by employers.

We found that 29 of the 160 taxpayers may not be in compliance with the FICA. The wages for these 29 individuals totaled $21,060,581, but due to the Social Security wage base limit, only $2,480,017 would be subject to U.S. Social Security taxes. For these 29 exceptions, $247,426 in U.S. Social Security[3] and $574,941 in Medicare[4] taxes (for a total of $822,367 in FICA taxes) may be due because it appears that the taxpayers did not satisfy the criteria for exclusion from U.S. Social Security taxes. For these 29 exceptions, we calculated the error rate for each stratum by multiplying the stratum number of errors by the stratum sample cases. This computes error rates of 16 percent (16 / 100) for Stratum 1, 20 percent (6 / 30) for Stratum 2, and 23 percent (7 / 30) for Stratum 3. We then calculated a percentage weighted average for each stratum by multiplying the stratum population percentage to the stratum error rate. This computed weighted error rates of 15.38 percent (0.16 x 0.9615) for Stratum 1, 0.44 percent (0.20 x 0.0221) for Stratum 2, and 0.38 percent (0.23 x 0.0164) for Stratum 3, for a total sample weighted average of 16.20 percent. We then applied this sample weighted average to the population of 8,807 wage earners who worked for an American-based employer or were hired by a foreign employer while living in the United States, and who did not pay U.S. Social Security taxes. Based on these

[3] For Tax Year 2012, the Social Security tax rate was 6.2 percent for the American employer and 4.2 percent for the employee with a Social Security wage base limit of $110,100.
[4] For Tax Year 2012, the Medicare tax rate was 1.45 percent for the American employer and 1.45 percent for the employee. There is no wage base limit for Medicare taxes, as all covered wages are subject to Medicare taxes.

parameters, 1,427 (8,807 x 0.1620) wage earners[5] did not meet the Totalization Agreement criteria for exemption from FICA taxes, or 7,135 individual taxpayers[6] when forecast over the next five years.

To compute the dollars for these 29 exceptions, we calculated the error dollars for each stratum by multiplying the stratum total FICA taxes by the stratum sample cases. This computed dollar rates of $1,582 ($158,193 / 100) for Stratum 1, $5,762 ($172,870 / 30) for Stratum 2, and $16,377 ($491,304 / 30) for Stratum 3. We then calculated a dollar weighted average for each stratum by multiplying the stratum population percentage to the stratum dollar rate. This computed weighted dollar rates of $1,521 ($1,582 x 0.9615) for Stratum 1, $127 ($5,762 x 0.0221) for Stratum 2, and $269 ($16,377 x 0.0164) for Stratum 3, for a total sample dollar weighted average of $1,917. We then applied this sample weighted average to the population of 8,807 wage earners who did not pay U.S. Social Security taxes. Based on these parameters, $16.9 million[7] (8,807 x $1,917) in FICA taxes may be due since the wage earners did not meet the Totalization Agreement criteria for exemption, or $84.4 million[8] in FICA taxes may be due when forecast over the next five years. Figure 2 identifies the sample results for the 29 cases.

[5] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 819 and 2,036.
[6] The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.
[7] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $8 million and $25 million.
[8] The five-year forecast is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change.

Figure 2: Sample Results for Taxpayers Who Did Not Pay U.S. Social Security Taxes Under a Totalization Agreement

Exception Case Results:	**STRATUM 1**	**STRATUM 2**	**STRATUM 3**	**TOTAL**
Number of Exception Cases	16	6	7	29
Exception Wages	$1,710,193	$3,591,992	$15,758,416	$21,060,581
Social Security Wage Limit	$1,048,717	$660,600	$770,700	$2,480,017
Employer Social Security Taxes	$56,629	$40,957	$41,526	$139,112
Employee Social Security Taxes	$52,437	$27,745	$28,131	$108,313
Total Social Security Taxes	**$109,067**	**$68,702**	**$69,657**	**$247,426**
Medicare Taxes	**$49,126**	**$104,168**	**$421,647**	**$574,941**
Total FICA Taxes	**$158,193**	**$172,870**	**$491,304**	**$822,367**
Error and Dollar Rates:				
Error Rate per Stratum	16%	20%	23%	
Stratum Weighted Average	15.38%	0.44%	0.38%	16.20%
Dollar Rate per Stratum	$1,582	$5,762	$16,377	
Dollar Weighted Average	$1,521	$127	$269	$1,917
Project Rates to Population:	One Year	Five Year		
Number of Cases	1,427	7,135		
Total FICA Taxes	$16,883,019	$84,415,095		

Source: TIGTA sample results for taxpayers affected by Totalization Agreements.

Type and Value of Outcome Measure:

Increased Revenue – Potential; $4.3 million in FICA taxes for 1,947 individual taxpayers (*e.g.*, resident aliens) who appear to either work for an American-based employer or were hired by a foreign employer while living in the United States and may not qualify for relief from paying U.S. Social Security taxes during Tax Year 2012, or $21.6 million in FICA taxes for 9,735 individual taxpayers when the sample is forecast over five years (see page 3).

Methodology Used to Measure the Reported Benefit:

We found that 23 of the 160 taxpayers may not be in compliance with the FICA. The wages for these 23 individuals totaled $411,549 but due to the Social Security wage base limit, only $393,941 would be subject to U.S. Social Security taxes. For these 23 exceptions, $40,970 in U.S. Social Security[9] and $10,038 in Medicare[10] taxes for a total of $51,008 in FICA taxes may be due because it appears that the taxpayer did not satisfy the criteria for exclusion from paying U.S. Social Security taxes. For these 23 exceptions, we calculated the error rate for each stratum by multiplying the stratum number of errors by the stratum sample cases. This computes error rates of 23 percent (23 / 100) for Stratum 1, 0 percent (0 / 30) for Stratum 2, and 0 percent (0 / 30) for Stratum 3. We then calculated a percentage weighted average for each stratum by multiplying the stratum population percentage to the stratum error rate. This computed weighted error rates of 22.11 percent (0.23 x 0.9615) for Stratum 1, 0 percent (0.00 x 0.0221) for Stratum 2, and 0 percent (0.00 x 0.0164) for Stratum 3, for a total sample weighted average of 22.11 percent. We then applied this sample weighted average to the population of 8,807 wage earners who worked for an American-based employer or were hired by a foreign employer while living in the United States, and who did not pay U.S. Social Security taxes. Based on these parameters, 1,947 (8,807 x 0.2211) wage earners[11] did not meet the Totalization Agreement criteria for exemption from FICA taxes, or 9,735 individual taxpayers[12] when forecast over the next five years.

To compute the dollars for these 23 exceptions, we calculated the error dollars for each stratum by multiplying the stratum total FICA taxes by the stratum sample cases. This computed dollar rates of $510 ($51,008 / 100) for Stratum 1, $0 ($0 / 30) for Stratum 2, and $0 ($0 / 30) for Stratum 3. We then calculated a dollar weighted average for each stratum by multiplying the stratum population percentage to the stratum dollar rate. This computed weighted dollar rates of $490 ($510 x 0.9615) for Stratum 1, $0 ($0 x 0.0221) for Stratum 2, and $0 ($0 x 0.0164) for Stratum 3, for a total sample dollar weighted average of $490. We then applied this sample weighted average to the population of 8,807 wage earners who did not pay U.S. Social Security taxes. Based on these parameters, $4.3 million[13] (8,807 x $490) in FICA taxes may be due since the wage earners did not meet the Totalization Agreement criteria for exemption, or $21.6

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[9] For Tax Year 2012, the Social Security tax rate was 6.2 percent for the American employer and 4.2 percent for the employee with a Social Security wage base limit of $110,100.

[10] For Tax Year 2012, the Medicare tax rate was 1.45 percent for the American employer and 1.45 percent for the employee. There is no wage base limit for Medicare taxes, as all covered wages are subject to Medicare taxes.

[11] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 1,250 and 2,645.

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

[13] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between $1 million and $7 million.

million[14] in FICA taxes may be due when forecast over the next five years. Figure 3 identifies the sample results for the 23 cases.

Figure 3: Sample Results for Taxpayers Who Did Not Pay U.S. Social Security Taxes Under a Totalization Agreement While Living in the United States

Exception Case Results:	**STRATUM 1**	**STRATUM 2**	**STRATUM 3**	**TOTAL**
Number of Exception Cases	23	0	0	23
Exception Wages	$411,549	$0	$0	$411,549
Social Security Wage Limit	$393,941	$0	$0	$393,941
Employer Social Security Taxes	$24,424	$0	$0	$24,424
Employee Social Security Taxes	$16,546	$0	$0	$16,546
Total Social Security Taxes	**$40,970**	**$0**	**$0**	**$40,970**
Medicare Taxes	**$10,038**	**$0**	**$0**	**$10,038**
Total FICA Taxes	**$51,008**	**$0**	**$0**	**$51,008**
Error and Dollar Rates:				
Error Rate per Stratum	23%	0%	0%	
Stratum Weighted Average	22.11%	0%	0%	22.11%
Dollar Rate per Stratum	$510	$0	$0	
Dollar Weighted Average	$490	$0	$0	$490
Project Rates to Population:	One Year	Five Year		
Number of Cases	1,947	9,735		
Total FICA Taxes	$4,315,430	$21,577,150		

Source: TIGTA sample results for taxpayers affected by Totalization Agreements.

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

Appendix V

Listing of Foreign Countries With Which the United States Has Bilateral Social Security Agreements

Since the late 1970s, the United States began entering into bilateral social security agreements with foreign countries,[1] called Totalization Agreements,[2] which coordinate social security coverage and taxation of workers who are employed in those countries. The following 24 countries have entered into Totalization Agreements with the United States (shown in order by effective date).

Country	Effective Date	Country	Effective Date
Italy	November 1, 1978	Austria	November 1, 1991
Germany	December 1, 1979	Finland	November 1, 1992
Switzerland	November 1, 1980	Ireland	September 1, 1993
Belgium	July 1, 1984	Luxembourg	November 1, 1993
Norway	July 1, 1984	Greece	September 1, 1994
Canada	August 1, 1984	South Korea	April 1, 2001
United Kingdom	January 1, 1985	Chile	December 1, 2001
Sweden	January 1, 1987	Australia	October 1, 2002
Spain	April 1, 1988	Japan	October 1, 2005
France	July 1, 1988	Denmark	October 1, 2008
Portugal	August 1, 1989	Czech Republic	January 1, 2009
Netherlands	November 1, 1990	Poland	March 1, 2009

[1] U.S. bilateral social security agreements with foreign countries as of December 31, 2013.
[2] See Appendix VI for a glossary of terms.

Appendix VI

Glossary of Terms

Term	Definition
Certificate of Coverage	A certificate from a foreign country or the SSA that serves as proof that the employee and employer are exempt from the payment of Social Security taxes to the foreign country or the United States.
Data Center Warehouse	A collection of IRS databases containing various types of taxpayer accounts and IRS and TIGTA employee information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.
Dual Taxation	For the purpose of this report, dual taxation is when a citizen from one country works in another country and is required to pay Social Security taxes to both countries on the same earnings.
Exchange of Information Office	IRS office within the Competent Authority and the International Coordination function in the Office of the Deputy Commissioner (International), Large Business and International Division. It administers and coordinates all exchange of information programs arising out of U.S. tax treaties and tax information exchange agreements. This includes specific requests to and from foreign governments, and spontaneous and routine exchanges of information.
Federal Insurance Contributions Act	Provides for a Federal system of old-age, survivors, disability, and hospital insurance tax imposed on the wage income of every individual with respect to their employment.
Form W-2 Data	The Form W-2, *Wage and Tax Statement*, data from the Data Center Warehouse is an extract of Form W-2 information filed by employers obtained from the Information Returns Master File.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Individual Return Transaction File	Contains data transcribed from initial input of the original individual tax returns during return processing.

Term	Definition
Information Returns Master File	The IRS database that contains the current tax year information returns and maintains access to nine prior years.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating information. It works in conjunction with a taxpayer's account records.
Internal Revenue Code	Federal tax law begins with the I.R.C., enacted by Congress in Title 26 of the U.S. Code. It is the main body of domestic statutory tax law of the United States organized topically, including laws covering the income tax, payroll taxes, gift taxes, estate taxes, and statutory excise taxes. Its implementing agency is the IRS.
Medicare Taxes	A tax deducted from employees' paychecks that goes to pay for medical benefits for people over 65 years of age. Medicare tax is paid by both the employee and employer.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Social Security Administration	An independent agency of the U.S. Federal Government that assigns Social Security Numbers; administers the retirement, survivors, and disability insurance programs known as Social Security; and administers the Supplemental Security Income program for the aged, blind, and disabled.
Social Security Taxes	The tax levied on both employers and employees used to fund Social Security programs. Social Security taxes are usually collected in the form of payroll taxes or self-employment taxes.
Strategic Data Services Division	The organization within TIGTA that uses computer code to extract data from IRS systems not readily available to auditors.
Tax Year	A 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.
Totalization Agreement	Agreements between nations with the purpose of avoiding dual taxation of income with respect to Social Security taxes.

Appendix VII

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

COMMISSIONER
LARGE BUSINESS AND
INTERNATIONAL DIVISION

June 25, 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Heather C. Maloy
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report – Improvements Are Needed to Verify Taxpayer Claims for Exemption From United States Social Security Taxes Under Totalization Agreements

Thank you for the opportunity to review and comment on the subject draft report. The IRS has primary responsibility for ensuring both taxpayer and employer compliance with employment taxes which include Federal income tax withholding, Social Security and Medicare taxes. To eliminate double taxation of income with respect to Social Security and Medicare taxes, the United States entered into Totalization Agreements with twenty-four foreign countries. These international agreements help ensure these taxes are only paid to one country when American citizens or resident aliens working in a foreign country are expected to pay social security taxes on the same earnings in both countries. To substantiate exemption from social security taxes under the terms of a Totalization Agreement, a Certificate of Coverage is generally requested from either the country in which the employee is employed or the country of residence. In the United States, the Certificates of Coverage are received from foreign countries by the Social Security Administration (SSA).

The IRS agrees with the recommendations in the report and will work with SSA to develop a process to periodically acquire data that can be analyzed within our systems to increase employment tax compliance by both employers and individuals. We note that our limited compliance resources must be broadly allocated to provide balanced support to overall tax administration, and we must evaluate the priority of these recommended improvements relative to our other risk-based compliance needs and improvements.

The IRS does not agree with the outcome measures as stated. The methodology utilized does not accurately reflect the differences between taxpayer populations and their respective compliance issues

Attached is a detailed response outlining the corrective actions the IRS will take to address the recommendations in the report. If you have any questions, please contact me or members of your staff may contact David W. Horton, Director, International Individual Compliance, at 630-493-5937.

Attachments

Attachment I

RECOMMENDATION 1:

The Commissioner, Large Business and International Division should use existing procedures to work with SSA on establishing a process to periodically acquire Certificate of Coverage data. This includes obtaining copies of Certificates of Coverage issued by the SSA, as well as copies that were received by the SSA from Totalization Agreement countries indicating that American citizens and resident aliens were covered under a foreign country's social security system.

CORRECTIVE ACTIONS:

We agree with this recommendation, and will use existing procedures to work with SSA on establishing a process to periodically acquire Certificate of Coverage data. This includes obtaining copies of Certificates of Coverage issued by the SSA, as well as copies that were received by the SSA from Totalization Agreement countries indicating that American citizens and resident aliens were covered under a foreign country's social security system.

IMPLEMENTATION DATE:

March 30, 2016

RESPONSIBLE OFFICIAL(S):

Director, International Individual Compliance, Large Business and International Division

CORRECTIVE ACTION(S) MONITORING PLAN:

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

RECOMMENDATION 2:

The Commissioner, Large Business and International Division should coordinate with the SSA Competent Authority to request data from countries with which the United States has Totalization Agreements related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers that would help the IRS ensure compliance with the U.S. Social Security tax laws.

CORRECTIVE ACTIONS:

We agree with this recommendation, and will coordinate with the SSA Competent Authority to request data from countries with Totalization Agreements related to foreign social security taxes paid by American citizens, resident aliens, or withheld and paid by American employers that would help the IRS ensure compliance with the U.S. Social Security tax laws.

IMPLEMENTATION DATE:

March 30, 2016

RESPONSIBLE OFFICIAL(S):

Director, International Individual Compliance, Large Business and International Division

CORRECTIVE ACTION(S) MONITORING PLAN:

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

RECOMMENDATION 3:

The Commissioner, Large Business and International Division and the Commissioner of Small Business/Self-Employed Division should use the data obtained from the other Totalization Agreement countries and the SSA to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

CORRECTIVE ACTION 1:

The Commissioner, Large Business and International Division will explore the use of data obtained from the SSA and the other Totalization Agreement countries to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

If the results of pilot Form 1040 examinations identify a pattern of non-compliance, LB&I will review the use of the data received from the SSA and other Totalization Agreement countries pursuant to Recommendations 1 and 2.

IMPLEMENTATION DATE:

March 31, 2017

RESPONSIBLE OFFICIAL(S):

Director, International Individual Compliance, Large Business and International Division

CORRECTIVE ACTION(S) MONITORING PLAN:

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

4

CORRECTIVE ACTION 2:

The Commissioner, Small Business/Self-Employed Division will explore the use of data obtained from the SSA and the other Totalization Agreement countries to identify noncompliance with payment of U.S. Social Security and Medicare taxes.

If the results of pilot Form 1040 examinations identify a pattern of non-compliance, SB/SE will review the use of the data received from the SSA and other Totalization Agreement countries pursuant to Recommendations 1 and 2.

If the data is determined to be in a usable format and human capital and Information Technology resources are available, we will explore the use of the data to identify employer behaviors pertaining to quarterly federal employment tax reporting requirements and identify noncompliance with payment of U.S. Social Security and Medicare taxes. Commensurate with available human capital and IT resources and in coordination with other priority work, we will consider developing treatments, education, communication and/or conduct examinations on the most noncompliant employers.

IMPLEMENTATION DATE:

March 31, 2017

RESPONSIBLE OFFICIAL(S):

Director, Small Business/Self-Employed Specialty Exam Policy and Quality

CORRECTIVE ACTION(S) MONITORING PLAN:

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

5

Attachment II

Outcome Measure:

We agree that an outcome measure should be computed for this audit; however, we disagree with the methodology used. We believe the single random sample failed to consider the distinctions within the sample, specifically, different taxpayer populations and respective noncompliance issues. Finally, the single and five year projections are not accompanied by confidence intervals, which we believe would provide additional perspective.