

United States Senate Committee on Finance

For Immediate Release
Wednesday, May 17, 2006

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GRASSLEY, BAUCUS CALL FOR REVIEW OF IRS USE OF FOREIGN-SOURCE INCOME INFORMATION

Washington, DC — U.S. Senators Charles Grassley (R-Iowa) and Max Baucus (D-Mont.), Chairman and Ranking Member of the Senate Finance Committee, yesterday requested more information on IRS handling of foreign-source income information documents received from foreign countries. American taxpayers generally are taxed on their worldwide income and these reports are a good way for the IRS to find out if they are paying everything they owe. A Treasury Inspector General for Tax Administration (TIGTA) report recently found that the IRS fails to make good use of these reports to identify income earned overseas by American taxpayers. The Finance Committee subsequently learned that most of the older, paper documents have been destroyed and the IRS does not have procedures in place to make use of newer, electronic data. In a letter yesterday, the Senators asked the IRS to explain why the agency is letting this valuable information go to waste. The Finance Committee holds sole Senate jurisdiction over tax policy.

Text of the letter follows here:

May 16, 2006

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Dear Commissioner Everson:

We have serious concerns about the Internal Revenue Service's (IRS) use of foreign source income information documents. Between 1999 and 2003, foreign investments by United States (US) residents nearly tripled, from \$2.6 trillion to \$7.2 trillion. In Audit Report #2005-30-101, the Treasury Inspector General for Tax Administration (TIGTA) found that the IRS needs to make better use of foreign source information documents to detect unreported income from foreign investments by US taxpayers. After consultation with TIGTA and several meetings with IRS personnel about this matter, it appears to us that the IRS is not using this information effectively, or actually, at all. We are requesting that you personally look into this matter and report to us on why the IRS is not effectively using this data and what plans will be made to quickly remedy the situation.

Under the Automatic Exchange of Information Program, the IRS exchanges information

with approximately twenty tax treaty countries. As part of the program, the IRS receives electronic and paper data listing foreign source income paid to US residents and businesses. US residents are taxed on their worldwide income. As far back as 1976, the Congress urged the IRS to begin a systemic use of foreign source information documents. However, based on our meetings with TIGTA and IRS personnel, we see little evidence that the IRS is making any substantive use of this data to determine if taxpayers are reporting foreign income properly.

Until recently, most of these information documents were received in paper format at the IRS Philadelphia Service Center. TIGTA found that these forms were stored in boxes, but the IRS never did anything with them. The IRS has several excuses for this, including incompatible currency and reporting formats and the extensive labor resources that would be needed to analyze the reports. It is our understanding that these documents have been destroyed. We were surprised to learn that the IRS managers responsible for those forms only recently found out that this had occurred and that we apparently knew about the destruction before they did.

Today, almost all of this data is received in electronic format on computer disks in an Organization of Economic Cooperation and Development (OECD) compatible format. Still, it seems that the IRS has no specific process to use this data to detect unreported foreign income.

We have been told there are insufficient resources to access and analyze the data so it can be matched against tax returns or shared with the field examiners for use during audits. The IRS also advises us that it has not identified a secure server to store the information. Moreover, the IRS Criminal Investigation Division has been unable to access the data for use in connection with its investigations. Responsible IRS personnel don't even know how long the IRS is required to retain this information.

Due to the large volume of information being collected and the fact that most of it is available in electronic format, it makes sense that the electronic data could be downloaded from the disks into a database to be stored on a server for access by personnel with a need-to-know. We understand that there are technological and logistical challenges associated with this process because of formatting, security and timing issues. However, we do not believe these obstacles are insurmountable. Please comment on the feasibility of this suggestion.

In addition, please answer the following questions as part of your explanation for why this situation has been allowed to continue for so long, and what your plans are to change it.

1. Why has the IRS found it to be difficult to use this foreign source income data for compliance purposes?
2. Please provide a status update on the IRS's efforts to implement the recommendations in TIGTA report 2005-30-101.
3. What efforts does the IRS make to inform field agents that this foreign source income information is available?

4. Describe the current process for field agents to obtain this information, including the time frame.
5. When were the paper information documents stored in Philadelphia destroyed? Why were they destroyed? Who authorized this action? Were the documents destroyed in response to the Senate Finance Committee's inquiries?
6. What is the record retention period for paper and electronic documents? Was this requirement violated when the paper documents were destroyed?
7. Where are the new paper information documents being sent to and where are they stored?
8. Why did Modernization and Information Technology Services (MITS) stop processing the electronic data?
9. What plans do you have to begin processing the electronic data again, including, but not limited to, extracting, storing, matching and analyzing data and making it available to the field? This response should include server capacity and privacy issues. Provide specific action items, timeframes and milestones.
10. How much would it cost to design and implement an electronic system that would make the foreign source data easily accessible for matching, analyzing and auditing? How long would it take to bring the system on-line?
11. How much tax do you estimate goes unpaid because of unreported foreign income?
12. How much of the unpaid tax in Question 11 do you estimate would be collected if the IRS utilized the foreign source income data as part of its Automated Underreporter Program?
13. Provide the Research Plan for the ongoing IRS project to test the value of the documents being received.

We appreciate your prompt attention to this matter and request your response by May 31, 2006. If you have any questions concerning this letter, please contact [staff names redacted].

Sincerely yours,

Charles E. Grassley
Chairman

Max Baucus
Ranking Member

cc: The Honorable David M. Walker
The Honorable J. Russell George

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