INTERNATIONAL: The IRS’s Approach to Credit and Refund Claims of Nonresident Aliens Wastes Resources and Burdens Compliant Taxpayers

RESPONSIBLE OFFICIAL
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TAXPAYER RIGHTS IMPACTED
- The Right to Quality Service
- The Right to Privacy
- The Right to a Fair and Just Tax System
- The Right to Pay No More Than the Correct Amount of Tax

DEFINITION OF PROBLEM
Under Internal Revenue Code (IRC) §§ 1441-1443 and 1461-1465 (Chapter 3), the IRS imposes withholding on payments made to nonresident aliens and foreign corporations and allows credits and refunds of the amounts to which these taxpayers are entitled. For many years, the operation of this regime closely paralleled the approach taken by the IRS with respect to domestic withholding under IRC § 31 in that there were no restrictions limiting credits or refunds to the amount of withheld tax actually paid over to the IRS. Based on generalized concerns regarding the potential for fraud and systematic noncompliance, however, in 2015, the IRS altered its administrative policy regarding Chapter 3 refunds. It no longer allows credits and refunds when taxpayers can prove withholding has occurred, as is the practice in the domestic employment tax context. Instead, the IRS now grants credits and refunds only when the information on Forms 1040NR, U.S. Nonresident Alien Income Tax Return, substantially matches the information on Forms 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, issued directly to the IRS by withholding agents. (Hereafter, nonresident aliens seeking...

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2 See Treas. Reg. §§ 1.1441-2; 1.1464-1. Those payors charged with the responsibility of undertaking this withholding are referred to as “withholding agents.” Treas. Reg. § 1.1441-7(a). Often, the administrative tasks of withholding and reporting are outsourced to third parties, but ultimate legal responsibility for these duties remains with the individual or company on whose behalf they were undertaken. IRC § 1461.

3 For a discussion of prior IRS practice in the processing of Chapter 3 refund claims, see Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-40-121, Improvements Are Needed to Verify Refunds to Nonresident Aliens Before the Refunds are Sent Out of the United States 6 (Sept. 2010).

4 National Taxpayer Advocate 2015 Annual Report to Congress 346-47. Refunds under Chapter 4 (IRC §§ 1471-1474) follow the procedures for such refunds set forth with respect to Chapter 3. See IRC § 1474(b)(1).

5 IRM 21.8.1.11.14.3, FATCA – 1042-S Matching Program – General Information – Identifying Related Letters, Transaction Codes, Reason Codes, 1042-S Data Fields (Oct. 1, 2017); IRM 21.8.1.11.14.5(4), FATCA Matching Program Form 1042-S Credit Denials – Accounts Management Telephone/Written Inquiries – Letter 5904C (Oct. 1, 2017). Note that many of the procedures and some of the concerns discussed in this Most Serious Problem apply equally to foreign corporations filing Forms 1120-F, U.S. Income Tax Return of a Foreign Corporation, but these foreign corporations are not the focus of this analysis, as they also present distinct analytical and administrative issues from those arising in the case of individual nonresident aliens.
these credits and refunds associated with Forms 1042-S will be referred to, for simplicity, as “1042-S filers.”

Without an analytic foundation, the IRS took the drastic step of freezing refund claims of 1042-S filers for up to one year or longer while attempting to match the documentation provided by taxpayers with the documentation provided by withholding agents.\(^6\) The IRS did this even though most 1042-S filers (nearly 80 percent) claim relatively small dollar amounts of withholding (an average of approximately $1,100).\(^7\) Further, as a group, 1042-S filers appear to be substantially more compliant than a comparable portion of the U.S. taxpayer population.\(^8\) The IRS ultimately released these frozen refunds, which impacted over 100,000 taxpayers, after the systemic matching program yielded so many “false positives” that it proved untenable.\(^9\) The IRS is now redesigning this program.\(^10\) Nevertheless, only the tools and the processes are being revised, while the program’s philosophy remains unchanged and its underlying assumptions unchallenged. The IRS continues to treat 1042-S filers as “tax cheats” anytime a mismatch arises, even if that mismatch is beyond the taxpayer’s control or is based on some other good-faith error.

As a result, the National Taxpayer Advocate is concerned that:

- The IRS’s current approach to 1042-S filers does not appear to be based on analysis of quantitative evidence;
- The IRS is wasting resources and needlessly burdening taxpayers by its undifferentiated approach to 1042-S filers;
- The IRS has demonstrated a reluctance to enforce compliance among Form 1042-S withholding agents, even though it generally has the ability to do so; and
- The IRS position of forcing nonresident taxpayers to shoulder the burden of their withholding agents’ reporting and compliance may be subject to litigation hazards under *Portillo* and other naked assessment cases.

The IRS continues to treat 1042-S filers as “tax cheats” anytime a mismatch arises, even if that mismatch is beyond the taxpayer’s control or is based on some other good-faith error.


\(^7\) TAS Research, Compliance Data Warehouse (CDW), data drawn Oct. 12, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.

\(^8\) *Id.*


\(^10\) The systemic matching program previously employed by the IRS relied on a semi-automated tool, supplemented by manual review of taxpayer returns and forms where necessary. The systemic matching program was suspended because the semi-automated tool generated a significant false-positive rate, resulting in an overwhelming need for manual review. *Id.* TAS’s understanding is that this manual review is continuing on a more limited basis, but that, as part of its redesigned program, the IRS hopes to reintroduce a mechanism for automated matching.
ANALYSIS OF PROBLEM

The IRS’s Current Approach to 1042-S Filers Does Not Appear to Be Based on Analysis of Quantitative Evidence

The IRS is faced with legitimate challenges regarding information reporting and collection of taxes with respect to nonresident aliens and offshore accounts.11 Nevertheless, the IRS has not, to TAS’s knowledge, yet developed comprehensive statistical data establishing the existence and nature of widespread fraud or noncompliance on the part of 1042-S filers.12 This lack of information has caused the IRS to adopt a broad-brush approach, which generates tax administration prone to inequities, inefficiencies, and inaccurate assumptions.

In contrast to the blanket fears of the IRS, TAS analysis indicates that the vast majority of taxpayers who file income tax returns associated with a Form 1042-S actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population. In part, TAS bases this determination on an examination of data relating to reporting compliance. For example, for tax years (TY) 2013, 2014, and 2015, the “no change” rate for cases involving audits of 1042-S filers exceeded the audit “no change” rate for all Form 1040-NR filers as well as for all Form 1040 filers.13 This comparison can be seen in Figure 1.15.1.

FIGURE 1.15.1\(^{14}\)

Audit No Change Percentage Rates of Taxpayer Groups

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>All F1040</th>
<th>F1040-NR</th>
<th>F1042-S</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>14.7%</td>
<td>17.3%</td>
<td>25.4%</td>
</tr>
<tr>
<td>2014</td>
<td>12.9%</td>
<td>18.5%</td>
<td>20.4%</td>
</tr>
<tr>
<td>2015</td>
<td>13.4%</td>
<td>13.2%</td>
<td>24.7%</td>
</tr>
</tbody>
</table>

11 TIGTA, Ref. No. 2010-40-121, Improvements Are Needed to Verify Refunds to Non-resident Aliens Before the Refunds Are Sent out of the United States (Sept. 2010).
12 Large Business & International (LB&I) response to TAS information request (July 5, 2017); LB&I response to TAS information request (Sept. 6, 2016). In its responses, LB&I refers to a TIGTA report from September 2013, which ultimately was determined to be TIGTA Ref. No. 2013-40-083, Income and Withholding Verification Processes Are Resulting in the Issuance of Potentially Fraudulent Tax Refunds (Aug. 7, 2013). This report, however, does not address Form 1042-S filers.
13 TAS Research, CDW, data drawn Nov. 1, 2017. The selection criteria used to identify returns for audits sometimes varies across these filing groups. LB&I response to TAS fact check request (Nov. 16, 2017).
Further, 1042-S filers have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall. Since high-scoring DIF returns generally indicate compliance issues, while low-scoring DIF returns signify a more compliant group of taxpayers, this measure likewise furnishes evidence that 1042-S filers as a group are not a high-risk population.

This conclusion is further supported by the circumstance that the increased scrutiny generated by the Form 1042-S systemic matching program does not appear to have resulted in a drop in the number of claims by 1042-S filers. If a significant portion of 1042-S filers had been engaging in fraud or systematic noncompliance, it would follow that the enhanced IRS vigilance in this area would result in a reduced volume of Form 1042-S claims. By contrast, the number of 1042-S filers making credit claims has remained remarkably consistent between processing year (PY) 2013 and PY 2016, the last year for which complete data is available. Indeed, the aggregate dollar value of these claims has increased every year. Figure 1.15.2 elaborates on this claim activity.

**TABLE 1.15.2, Form 1042-S Claim Activity**

<table>
<thead>
<tr>
<th>Processing Year</th>
<th>Number of Returns</th>
<th>Aggregate Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>73,054</td>
<td>$336,803,000</td>
</tr>
<tr>
<td>2014</td>
<td>73,038</td>
<td>$384,249,000</td>
</tr>
<tr>
<td>2015</td>
<td>73,734</td>
<td>$420,906,000</td>
</tr>
<tr>
<td>2016</td>
<td>72,702</td>
<td>$546,167,000</td>
</tr>
</tbody>
</table>

The IRS Is Wasting Resources and Needlessly Burdening Taxpayers by Its Undifferentiated Approach to 1042-S Filers

As demonstrated above, the majority of 1042-S filers present little risk of noncompliance or revenue loss. As a result, applying a “one-size-fits-all” model of tax administration in this context will continue to disadvantage nonresident taxpayers, poorly allocate scarce funding, and undermine related IRS enforcement efforts.

Instead, the IRS should focus on high-risk taxpayer categories that would benefit from increased scrutiny and enforcement activity. For example, 86 percent of the 1042-S filers in one Total Positive Income (TPI) class show DIF scores that are suggestive of potential noncompliance. On the other hand, only one percent of those in a different TPI class, which encompasses over 80 percent of all 1042-S filers,
possess a DIF score indicative of noncompliance. While DIF scores are not always conclusive measures of compliance, at a minimum, they provide useful data that the IRS could employ to more efficiently and effectively narrow its oversight efforts.

Also, most 1042-S filers (nearly 80 percent) claim relatively small dollar amounts of withholding (an average of approximately $1,100). These individual filings can never be completely ignored, as, in the aggregate, they represent a statistically significant portion of the Form 1042-S credits and refunds sought on an annual basis (approximately 11 percent of total dollars). Nevertheless, absent the development of an accurate, timely, and seamless review mechanism, occasional, random examinations of these returns would seem most cost-effective and proportionate, and consistent with sound tax administration practices.

Conversely, a small group of 1042-S filers (less than five percent) claim nearly 74 percent of the credits measured in terms of dollars. The minimal size of this group and the high revenue risk it represents justify more focussed scrutiny. Figure 1.15.3 depicts these relationships.

FIGURE 1.15.3

Breakdown of Form 1042-S Filers and Claims, Tax Years 2013-2015

<table>
<thead>
<tr>
<th>Amount Claimed by Taxpayer</th>
<th>3.1%</th>
<th>14.5%</th>
<th>4.3%</th>
<th>5.0%</th>
<th>7.7%</th>
<th>7.5%</th>
<th>7.6%</th>
<th>0.8%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;$1,000</td>
<td>49.2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1,000-$4,999</td>
<td>40.1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$5,000-$9,999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10,000-$24,999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$25,000-$49,999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$50,000-$99,999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$100,000+</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

21 TPI class 72. TAS Research, CDW, data drawn Nov. 1, 2017. These DIF scores are for TY 2015, which is the last year for which relatively complete data is available.

22 TAS Research, CDW, data drawn Nov. 1, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.

23 Id.

24 Id.

25 Id.
Moreover, a variety of income sources, ranging from compensation for dependent services to gambling winnings to scholarship and fellowship grants to dividend payments, are associated with significant Form 1042-S credit claims.\textsuperscript{26} An analysis aimed at determining the intersection between compliance behavior and revenue risk associated with these income sources could provide some additional insight for fashioning a more tailored oversight regime that is less onerous for taxpayers and more resource-efficient for the government.

**The IRS Has Demonstrated a Reluctance to Enforce Compliance Against Form 1042-S Withholding Agents, Even Though It Generally Has the Ability to Do So**

The IRS is primarily concerned that 1042-S filers might attempt to obtain refunds of amounts not remitted to the IRS by withholding agents. This concern has some validity, as approximately $700 million of taxes for which withholding agents were liable went uncollected by the IRS from both domestic and foreign withholding agents in TY 2015.\textsuperscript{27} Figure 1.15.4 details this information.

**FIGURE 1.15.4, Withholding and Remittance Data in Millions of Dollars for Tax Year 2015\textsuperscript{28}**

<table>
<thead>
<tr>
<th>Withholding Agent</th>
<th>Domestic</th>
<th>Foreign</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number</td>
<td>39,963</td>
<td>7,082</td>
<td>47,045</td>
</tr>
<tr>
<td>Amount Liability</td>
<td>$15,859.6</td>
<td>$8,330.6</td>
<td>$24,190.3</td>
</tr>
<tr>
<td>Amount Remitted</td>
<td>$15,324.7</td>
<td>$8,161.4</td>
<td>$23,486.1</td>
</tr>
<tr>
<td>Amount Unremitted</td>
<td>$534.9</td>
<td>$169.2</td>
<td>$704.1</td>
</tr>
<tr>
<td>Remittance Percentage</td>
<td>97%</td>
<td>98%</td>
<td>97%</td>
</tr>
</tbody>
</table>

While the need to protect against fraud and systematic noncompliance is understandable, the IRS has so far allocated a disproportionate share of this burden to taxpayers and away from both itself and withholding agents, a step that has only exacerbated the problems caused by the undifferentiated approach adopted by the IRS with respect to 1042-S filers. Current IRS practice is to review certain credit and refund claims of 1042-S filers.\textsuperscript{29} Because the IRS’s legal position is that it has no obligation to honor Form 1042-S credits or refund claims unless the taxpayer has an accurate Form 1042-S from the withholding agent and the withholding agent has remitted the withholding to the IRS, a mismatch of various data fields will cause the issuance of a preliminary disallowance letter.\textsuperscript{30} That letter instructs the taxpayer to contact the withholding agent, figure out the reason for the mismatch, and resolve the issue.\textsuperscript{31} If the taxpayer is unable to carry out this instruction, or the withholding agent is unwilling to

\textsuperscript{26} TAS Research, CDW, data drawn Oct. 12, 2017.

\textsuperscript{27} LB&I response to TAS fact check request (Nov. 16, 2017).

\textsuperscript{28} Id.

\textsuperscript{29} IRM 21.8.1.11.14.3 (Oct. 1, 2017).

\textsuperscript{30} Id.; Notice 2015-10, 2015-20 I.R.B. 965. The scope of the fields emphasized by the IRS has varied over time, but currently the IRS looks to the following specific fields: name, taxpayer identification number, federal tax withheld, and escrow. LB&I response to TAS fact check request (Nov. 16, 2017).

\textsuperscript{31} Id.
Moreover, a variety of income sources, ranging from compensation for dependent services to gambling winnings to scholarship and fellowship grants to dividend payments, are associated with significant Form 1042-S credit claims. An analysis aimed at determining the intersection between compliance behavior and revenue risk associated with these income sources could provide some additional insight for fashioning a more tailored oversight regime that is less onerous for taxpayers and more resource-efficient for the government.

cooperate, the taxpayer is left with little practical recourse other than to seek redress in the courts, either against the withholding agent or the IRS itself.\textsuperscript{32}

This is a step that many taxpayers lack the resources to undertake, as it involves litigating against withholding agents, many of which are large global companies, or against the IRS. Moreover, as the withholding claimed by nearly 80 percent of 1042-S filers averages only about $1,100 per taxpayer, the cost of litigation for most of these taxpayers would vastly exceed the amounts they are attempting to recover.\textsuperscript{33} The IRS has, in effect, shifted the burden of withholding agent noncompliance to these taxpayers, who are comparatively ill-equipped to pursue any remedies in the event that simple reporting inconsistencies cannot be resolved.

By contrast to most taxpayers, the IRS has powerful tools allowing it to directly pursue, and collect from, withholding agents who fail to remit funds.\textsuperscript{34} In addition, the IRS can assess assorted failure to pay and failure to file penalties against these withholding agents.\textsuperscript{35} Nevertheless, the IRS has shown some reluctance to seek recovery from, and impose sanctions against, noncompliant withholding agents. For example, IRS actions to recover unpaid deposits from withholding agents have dropped from 4,302 for TY 2014 to only 1,139 for TY 2015.\textsuperscript{36}

Likewise, the IRS has in its arsenal a number of penalties that can be applied against withholding agents. These penalties, by all appearances, could be employed more vigorously to encourage compliance. Figure 1.15.5 presents IRS penalty activity with respect to withholding agents.

\begin{itemize}
\item \textsuperscript{32} Taxpayers in such situations generally will be entitled to appeal rights. See IRM 21.8.1.11.14.5(4), FATCA Matching Program Form 1042-S Credit Denials – Accounts Management Telephone/Written Inquiries - Letter 5904C (Oct. 1, 2017); IRM 21.5.3.4.6.1, Disallowance and Partial Disallowance Procedures (Mar. 2, 2017). Nevertheless, given the IRS’s current policies precluding credits and refunds in the absence of specified documentation, discussed above, the likelihood of successfully resolving such matters at Appeals remains open to question.
\item \textsuperscript{33} TAS Research, CDW, data drawn Oct. 12, 2017. These numbers represent an annual average derived from the 2013, 2014, and 2015 tax years.
\item \textsuperscript{34} Treas. Reg. § 1.1461-1(a)(1).
\item \textsuperscript{35} Treas. Reg. § 1.1461-1(a)(2); Treas. Reg. § 1.1461-1(h).
\item \textsuperscript{36} LB&I response to TAS information request (Oct. 31, 2017). These numbers are based on systemic assessments of the Failure to Pay penalty. LB&I response to TAS fact check request (Nov. 16, 2017). This decrease may be attributable to a variety of factors, including increased compliance by withholding agents, resource constraints on the part of LB&I, or a shift in enforcement emphasis to individual taxpayers.
\end{itemize}
Enforcing compliance on the part of withholding agents will not eliminate all possibility of fraud or noncompliance by individual 1042-S filers. Nevertheless, most large-scale attempts at fraud or noncompliance likely would involve collusion between withholding agents and taxpayers. Since 85 percent of withholding agents are domestic, however, the IRS has direct recourse in the event of fraud or systematic noncompliance in which these withholding agents participate. As a result, the IRS already possesses the ability to guard against and eliminate the majority of the fraud and noncompliance about which it is concerned. The IRS should act assertively on its own behalf and on behalf of taxpayers who are disadvantaged by withholding agent noncompliance. Further, it should consider more efficient ways of discouraging noncompliance by, and collecting unremitted funds from, foreign withholding agents, including exploring cooperative agreements with foreign jurisdictions.

The IRS Position of Forcing Nonresident Taxpayers to Shoulder the Burden of Their Withholding Agents’ Reporting and Compliance May Be Subject to Litigation Hazards Under Portillo and Other Naked Assessment Cases

Beyond causing unnecessary taxpayer burden, the Form 1042-S approach could create litigation risks for the IRS. In *Portillo v. Commissioner*, the Fifth Circuit Court of Appeals held that by failing to substantiate a Form 1099, the accuracy of which was challenged by the taxpayer, the IRS made a “naked assessment,” acted arbitrarily, and failed its burden of proof. Courts generally have limited the naked assessment analysis of *Portillo* and similar decisions to unreported income cases arising in the domestic context. Nevertheless, the IRS faces the risk that, in a case involving the creation of a deficiency attributable to a Form 1042-S mismatch, a court could extend *Portillo* and rule that IRS reliance on a withholding agent’s Form 1042-S while rejecting a taxpayer’s sworn Form 1040NR is arbitrary.

**FIGURE 1.15.5, Penalties Imposed Against Withholding Agents**

<table>
<thead>
<tr>
<th>Penalties</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRC § 6656, Failure to make deposit</td>
<td>3,913</td>
<td>3,784</td>
<td>957</td>
</tr>
<tr>
<td>IRC § 6672, Failure to collect and pay over, or attempt to evade and defeat tax</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IRC § 6651, Failure to file return or pay tax</td>
<td>1,485</td>
<td>1,504</td>
<td>414</td>
</tr>
<tr>
<td>IRC § 6662, Accuracy-related penalty</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>IRC § 6663, Fraud penalty</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IRC § 6721, Failure to file correct information returns</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IRC § 6722, Failure to furnish correct payee statements</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>IRC § 6723, Failure to comply with other information reporting requirements</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

37 LB&I response to TAS information request Oct. 31, 2017. LB&I penalty actions and enforcement with respect to withholding agents may be on the increase for the 2016 tax year, although it is still to early to analyze the extent of and reasons for this apparent increase.

38 LB&I response to TAS fact check request (Nov. 16, 2017). Treas. Reg. § 1.1461-1T(c). See also IRC §§ 6601, 6651(a)(2), and 6656. This recourse is sometimes more attenuated in the case of foreign withholding agents and is subject to accessibility constraints, permissions from foreign governments, and provisions of applicable treaties. LB&I response to TAS information request (June 19, 2017).

39 *Portillo v Comm'r*, 932 F.2d 1128 (5th Cir., 1991). The burden of proof in tax cases generally rests with the taxpayer. In a deficiency proceeding, however, when a taxpayer establishes that an assessment is “arbitrary and erroneous,” the burden shifts to the IRS to prove the correct amount of any taxes owed. *Id.* at 1133.

particularly where the program’s false-positive rate is high. Such a finding could result in immediate dismissal of the IRS’s case.

Further, even in a refund case, a taxpayer could come before a court and, using any available evidence, demonstrate that the withholding for which the refund is claimed actually occurred. Such a showing would open to judicial scrutiny the IRS’s policy of relying solely on withholding agents’ Forms 1042-S without any other validation, an approach treated as arbitrary by Portillo in the Form 1099 context. Additionally, it would enable a taxpayer to challenge the IRS’s current legal view that the IRS has no obligation to provide refunds unless it actually receives full remittances from withholding agents.  

**CONCLUSION**

The IRS’s current approach to 1042-S filers does not appear to be firmly grounded in comprehensive statistical analysis. Rather than using available data to focus compliance and enforcement efforts on high-risk taxpayers, the IRS has adopted an undifferentiated approach to 1042-S filers that wastes resources and needlessly burdens compliant taxpayers. Additionally, the IRS has demonstrated a reluctance to enforce compliance among Form 1042-S withholding agents, even though it generally has the ability to do so.

Instead, the IRS requires taxpayers to do its compliance work with respect to withholding agents, as well as to shoulder the risk that such compliance may not occur. Under current IRS policy, if a withholding agent reports incorrectly or fails to remit, even blameless taxpayers forfeit their credits and refunds while the IRS loses nothing. This allocation of risk and responsibility is not only unfair but inefficient. The IRS has strong tools at its disposal and should energetically use them to obtain increased compliance from withholding agents. This approach, combined with a more precise strategy for addressing potential noncompliance by 1042-S filers, would better protect taxpayer rights and more effectively utilize scarce IRS resources.

**RECOMMENDATIONS**

The National Taxpayer Advocate recommends that the IRS:

1. Compile and internally publish data relating to the results of manual review of frozen Form 1042-S credits and use this data to better understand and identify the sources and income stratifications generating increased risks of noncompliance.

2. Implement a policy that relies on data as the basis for developing effective programs and systems for validating the credit and refund claims of those relatively few Chapter 3 and Chapter 4 filers for whom such scrutiny is statistically justified.

3. Energetically enforce the withholding, reporting, and remittance obligations of withholding agents, rather than attempting to shift this obligation to nonresident taxpayers in ways that create hazards of litigation.

4. Consider more effective ways of discouraging noncompliance by, and collecting unremitted funds from, foreign withholding agents, including exploring cooperative agreements with foreign jurisdictions.

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