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GAO

Report to the Committee on Finance, U.S. Senate

April 2012

FOREIGN ACCOUNT REPORTING REQUIREMENTS

IRS Needs to Further Develop Risk, Compliance, and Cost Plans

GAO-12-484

Contents

Abbreviations

FATCA	Foreign Account Tax Compliance Act
FBAR	Report of Foreign Bank and Financial Accounts
FFI	foreign financial institution
IRS	Internal Revenue Service
IT	information technology
LB&I	Large Business & International

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United States Government Accountability Office
Washington, DC 20548

April 16, 2012

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate

Given the mobility of money and proliferation of foreign financial institutions (FFI), the potential for U.S. taxpayers to evade taxes on funds held in offshore accounts is greater than ever. To improve tax compliance for foreign accounts and entities, and cross-border transactions, Congress passed the Foreign Account Tax Compliance Act (FATCA) as part of the Hiring Incentives to Restore Employment Act of 2010.[1] FATCA requires certain U.S. taxpayers to report to the Internal Revenue Service (IRS) their overseas assets and requires U.S. entities to withhold a portion of certain payments made to FFIs that have not entered into an agreement with IRS to report certain information with respect to the FFI's U.S. accounts. FATCA is an effort to reduce tax evasion by creating greater transparency and accountability with respect to offshore accounts and entities held by U.S. taxpayers and by providing IRS with tools to further enforce tax laws. IRS believes that implementing these new requirements will increase tax compliance, which will help close the gap between taxes owed and taxes paid. IRS recently estimated a net tax gap of $385 billion for tax year 2006, though IRS has not estimated the percentage of the tax gap specifically attributable to offshore accounts. Implementing FATCA will provide IRS with a substantial amount of new information. However, that new information could be challenging to manage.

You asked us to review IRS's FATCA implementation plans. Our objectives were to (1) assess IRS's approach for implementing the FATCA requirements, (2) assess the extent to which IRS has developed plans to use the information from FATCA to improve tax compliance, and (3) determine the extent to which IRS is incorporating leading practices to develop its resource estimate for implementing FATCA.

[1]Pub. L. No. 111-147, Title V, subtitle A, 124 Stat. 97 (2010).

Scope and Methodology

To assess IRS's approach for implementing FATCA, we reviewed the statutory requirements for FATCA.[2] We reviewed IRS documents related to FATCA, including its data flow map and communication strategy, relevant notices, and temporary and proposed regulations.[3] To further assess IRS's approach, we identified leading practices on implementing new programs using past GAO reports and GAO's internal control standards.[4] Those practices include identifying an implementation team, communicating with external stakeholders, issuing guidance, communicating with staff, and assessing risk.

To assess the extent to which IRS has developed plans to use the information from FATCA to improve tax compliance, we reviewed IRS documents on the use of FATCA information, including prepared presentations and documents outlining planned program design. We compared IRS's plans to leading practices identified in past GAO reports on IRS implementation of new programs, which establish the importance of a documented strategy that includes developing a timeline and performance measures.[5]

To determine the extent to which IRS is incorporating leading practices to develop its resource estimate for implementing FATCA, we identified and reviewed existing IRS information on cost estimates for FATCA, such as

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[2]Ibid.

[3]IRS uses notices to relate what regulations will say in situations where the regulations may not be published in the immediate future.

[4]GAO, *Patient Protection and Affordable Care Act*: *IRS Should Expand Its Strategic Approach to Implementation*, GAO-11-719 (Washington, D.C.: June 29, 2011); *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, GAO-03-669 (Washington, D.C.: July 2, 2003); *Tax Administration: Planning for IRS's Enforcement Process Changes Included Many Key Steps but Can Be Improved*, GAO-04-287 (Washington, D.C.: Jan. 20, 2004); *Financial Derivatives: Disparate Tax Treatment and Information Gaps Create Uncertainty and Potential Abuse*, GAO-11-750 (Washington, D.C.: Sept. 20, 2011); *Risk Management: Further Refinements Needed to Assess Risks and Prioritize Protective Measures at Ports and Other Critical Infrastructure*, GAO-06-91 (Washington, D.C.: Dec. 15, 2005); *Standards for Internal Control in the Federal Government,* GAO/AIMD-00-21.3.1. (Washington, D.C.: November 1999); and *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001).

[5]GAO, *Tax Preparer Regulation: IRS Needs a Documented Framework to Achieve Goal of Improving Taxpayer Compliance*, GAO-11-336 (Washington, D.C.: Mar. 31, 2011), and GAO-11-719.

a work breakdown structure and an investment summary report. These documents primarily discuss cost estimation for the information technology (IT) components of FATCA. We interviewed officials from IRS's Modernization and Information Technology Services to discuss the IT cost estimate for FATCA and FATCA program officials to discuss future cost estimation plans. We compared this information with leading practices that agencies should follow when developing cost estimates, including ensuring that estimates are well documented and comprehensive.[6]

For all objectives, the leading practices we identified do not represent the universe of practices that agencies could employ when implementing a new initiative. We selected examples of leading practices that we judged to be important for IRS to consider during the early stages of FATCA implementation. We shared with IRS the practices on which we based our descriptions and assessments in our three objectives during the course of our audit work, and IRS agreed with our approach. We discuss these practices in greater detail in appendix I.

For all objectives, we interviewed IRS and Department of the Treasury officials to discuss existing and future plans related to FATCA implementation.

We conducted this performance audit from June 2011 to April 2012 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

FATCA requirements for U.S. taxpayers and FFIs will be phased in over the next few years. Starting in 2012 for calendar year 2011, U.S. individual taxpayers with total overseas assets in excess of $50,000 generally are required to report the assets to IRS on Form 8938

[6]GAO, *GAO Cost Estimating and Assessment Guide: Best Practices for Developing and Managing Capital Program Costs*, GAO-09-3SP (Washington, D.C.: March 2009).

(Statement of Specified Foreign Financial Assets).[7] Taxpayers may be subject to penalties for failure to disclose overseas assets and for underpayments related to such undisclosed assets.

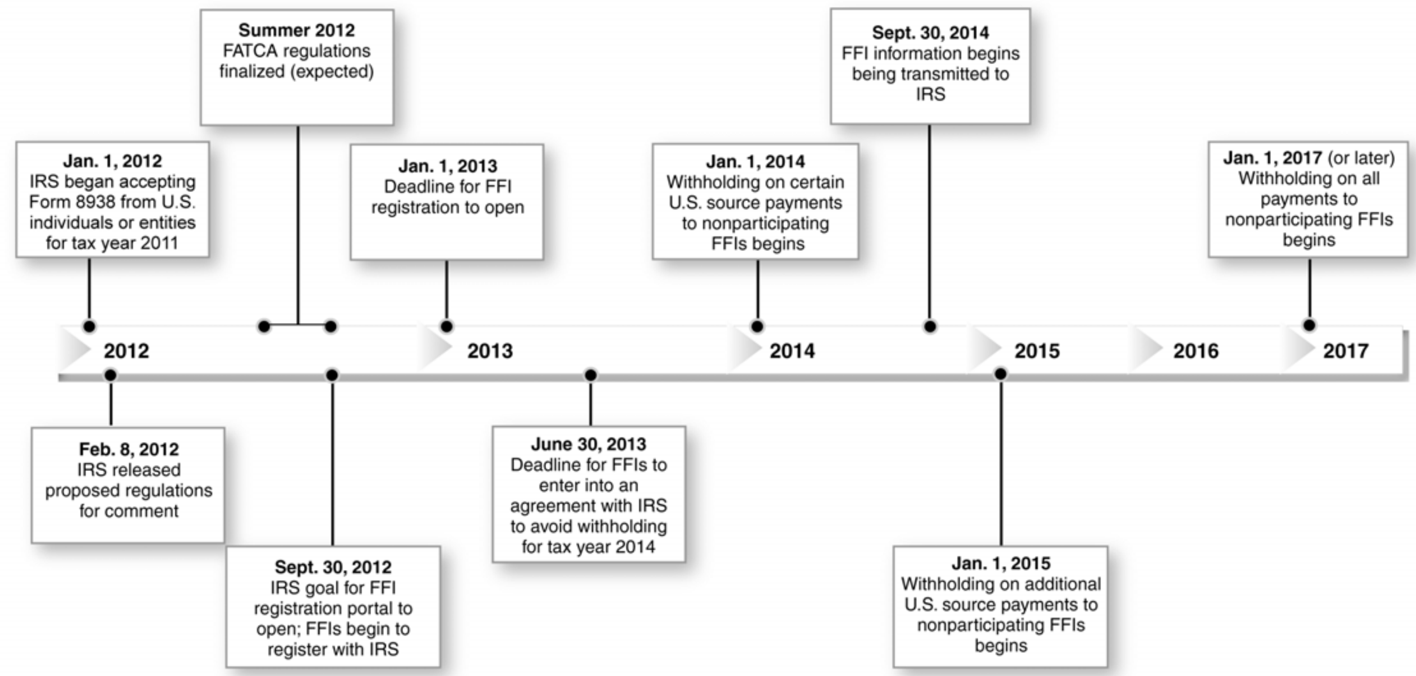
Beginning on January 1, 2014, U.S. entities will be required to withhold 30 percent on certain payments to FFIs[8] unless the FFIs have entered into an agreement with IRS. IRS has announced that FFIs must enter into an agreement by June 30, 2013, in order to ensure that they will be identified as participating FFIs in sufficient time to allow U.S. withholding agents to refrain from withholding beginning on January 1, 2014. FFIs that enter into an agreement after this deadline may experience withholding on some payments until U.S. entities have added the FFIs to the list of participating FFIs. By entering into an agreement with IRS, the FFIs agree to employ due diligence procedures to identify and report details on U.S. account holders to IRS and withhold a percentage of payments under certain circumstances. Figure 1 illustrates the timeline of when FATCA requirements are to take effect.[9]

[7]An unmarried taxpayer living in the United States or married taxpayers filing separate income tax returns living in the United States must file if the total value of his or her specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. Married taxpayers filing a joint income tax return and living in the United States must file if the total value of their specified foreign financial assets is more than $100,000 on the last day of the year or more than $150,000 at any time during the tax year. Taxpayers living abroad must file if the total value of their specified foreign financial assets is more than $200,000 total on the last day of the tax year or more than $300,000 at any time during the year. For married taxpayers living abroad filing a joint income tax return, they must file if the total value of all specified foreign financial assets that one spouse owns is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the year.

[8]An FFI is defined as a financial institution that is a foreign entity. An entity is a financial institution if (1) it accepts deposits in the ordinary course of a banking or similar business; (2) as a substantial portion of its business, it holds financial assets for the account of others; or (3) it is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.

[9]FATCA gives the Secretary of the Treasury authority to prescribe regulation and guidance to carry out the purposes of, and prevent the avoidance of, the law. (This provision has been codified as 26 U.S.C. 1474(f).) Under that authority to prescribe regulations and guidance, IRS and the Department of the Treasury have chosen to implement a phased approach.

Figure 1: Timeline of FATCA Requirements



Source: GAO analysis of IRS documents.

FFIs excepted from FATCA include foreign governments (including a wholly owned agency or instrumentality), international organizations, foreign central banks, and institutions IRS deems to pose a low risk of tax evasion.[10]

Separate from the FATCA requirements, the Bank Secrecy Act requires individuals and some businesses to file reports on foreign bank financial accounts with balances exceeding $10,000 during the year.[11] The

[10]FATCA also provides for a category of FFIs deemed to be compliant. To be deemed compliant, an FFI must comply with procedures to ensure that it does not maintain U.S. accounts. The FFI must also meet other requirements that the Secretary of the Treasury may prescribe. The proposed regulations define the scope of deemed compliant entities to reduce or eliminate burdens on truly local FFIs and other FFIs that do not implicate the policy concerns of FATCA.

[11]Pub. L. No. 91-508, titles I and II, 84 Stat. 1114 (Oct. 26, 1970) (codified as amended at 12 U.S.C. § § 1829b, 1951-1959; 31 U.S.C. § § 5311-5322).

information is filed on Treasury Form TD 90-22-1, known as the Report of Foreign Bank and Financial Accounts (FBAR), and is processed by IRS. Taxpayers required to file the FBAR form may also have to file Form 8938. We recently reported that some FATCA and FBAR reporting requirements overlap and recommended ways to address that overlap.[12]

Summary of Findings

- IRS has taken initial steps to implement FATCA requirements in line with leading implementation practices, including establishing a team to manage the implementation process and issuing guidance and proposed regulations. IRS has involved external stakeholders in the implementation process, which has helped inform IRS's implementation plans and regulations. IRS has also communicated initial information to IRS staff. However, although IRS assessed the risks of some aspects of FATCA implementation, it has not consolidated existing risk assessment information or future risk assessment plans into an overall risk assessment. Without a consolidated assessment, there is less assurance that all risks have been comprehensively identified. FATCA officials told us they had not documented a consolidated risk assessment because they were awaiting the release of final regulations, which will increase their ability to develop an overall risk assessment. Officials also cited the challenge of conducting a full risk assessment for a multiphased program still in its early stages. While we recognize this difficulty, we believe it is still important to lay the foundation for these plans. GAO's internal control standards suggest that risk assessments can and should evolve as short-term and long-term forecasting occur and therefore should be reviewed on an ongoing basis.

- IRS plans to compare multiple sources of information to identify U.S. taxpayers and FFIs failing to comply with the FATCA requirements and, more broadly, taxpayers failing to report their overseas income. IRS has begun to discuss how it will use information to improve compliance, but it has not yet completed or fully documented a broader strategy for doing so, which we identified as a leading implementation practice in our prior work. For example, it has not developed key internal milestones for accomplishing the tasks necessary to enable it to use FATCA information to improve taxpayer

[12] GAO, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, GAO-12-403 (Washington, D.C.: Feb. 28, 2012).

compliance or performance measures to assess the cost and benefits of its compliance efforts. IRS officials told us that many of these decisions are contingent on areas of program design that have not yet been finalized. If IRS does not document a broad strategy, it risks negatively affecting FATCA implementation. Given that IRS's implementation of FATCA is in its early stages, the strategy may be a high-level road map with timelines that could evolve over time.

- IRS has developed its initial resource estimate for FATCA implementation, specifically for IT systems. For its IT resource estimate, IRS has taken steps to incorporate leading practices for a well-documented resource estimate, as identified in GAO's *Cost Estimating and Assessment Guide*. However, IRS has not developed a comprehensive resource estimate for FATCA implementation. Comprehensiveness is another resource estimation leading practice. Without a timeline to develop the estimate, IRS may not be able to develop a reliable cost estimate and therefore risks not communicating key cost information to Congress and IRS management in time for them to make decisions affecting the implementation of FATCA. Given that IRS is in the early stages of implementing the FATCA requirements, it would be difficult for IRS to develop a comprehensive cost estimate at this time. However, IRS can take steps that would help ensure that it produces a timely, comprehensive estimate, such as establishing a timeline for completing the estimate. IRS told us that it does not have a timeline for a comprehensive estimate because some design details will not be known until later in the implementation process.

Appendix I provides more detail on each of our objectives and related findings.

Conclusions

FATCA's impact on improving taxpayer compliance will depend, in part, on IRS's effectiveness in implementing the requirements. IRS has made progress by taking initial implementation steps that align with some leading practices, such as identifying an implementation team and communicating with external stakeholders and staff. IRS needs to build on its initial progress and complete other steps that could help it effectively implement the requirements. As IRS is phasing in FATCA over multiple years, and some aspects of program design have not been finalized, IRS will not be able to complete detailed plans for all aspects of FATCA implementation in the near term. However, IRS can begin to document its broad strategies for assessing risk, using information it obtains from taxpayers and FFIs to improve taxpayer compliance and developing a comprehensive resource estimate. Given that FATCA implementation is in its early stages, initially IRS's documented strategies may not be detailed but may evolve as IRS further develops its FATCA program design.

Recommendations for Executive Action

In order to improve FATCA implementation, but recognizing that IRS is phasing in implementation, we recommend that the Commissioner of Internal Revenue take the following three actions, which may evolve over time:

- develop a consolidated risk assessment;
- complete a broad strategy, including a timeline and performance measures, for how IRS intends to use information collected based on the FATCA requirements to improve tax compliance; and
- establish and document a timeline for completing a comprehensive FATCA cost estimate.

Agency Comments

We provided a draft of this report to the Commissioner of Internal Revenue and the Secretary of the Treasury for their review and comment. IRS's Deputy Commissioner for Services and Enforcement provided written comments, which expressed appreciation to GAO for recognizing IRS's achievements toward implementing FATCA and agreed with all of our recommendations. In response to the first recommendation, the Deputy Commissioner stated that IRS has started developing a risk management plan that will incorporate risks from all work streams that make up FATCA. In response to the second recommendation, IRS will continue to develop a strategy to improve tax compliance that will evolve as FATCA regulatory issues are resolved. In response to the third recommendation, IRS noted steps already taken and said it will develop a comprehensive estimate once the FATCA regulations are finalized. These comments are reprinted in appendix II. Treasury did not provide official comments. IRS and Treasury provided us with technical comments, which we incorporated into the report as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

James R. White
Director, Tax Issues
Strategic Issues

Objective

Assess IRS's approach for implementing the FATCA requirements.

Leading Practices

- *Identifying an implementation team.* Previous GAO work has emphasized the importance of identifying an implementation team—including representation of high-level management—to manage the process and define program goals. (GAO-03-669, GAO-11-719)
- *Communicating with external stakeholders.* GAO internal control standards indicate that management should communicate with and obtain information from external stakeholders. (GAO/AIMD-00-21.3.1)
- *Issuing guidance.* As previous GAO work has reported, IRS guidance can come in many forms and can improve taxpayer compliance. (GAO-11-750)
- *Communicating with staff.* GAO has reported on the importance of keeping employees informed of decisions and maintaining communication about the goals and progress of the effort. (GAO-04-287)
- *Assessing risk.* GAO's internal control standards state that management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties. (GAO/AIMD-00-21.3.1)

IRS Has Incorporated Leading Practices in Initial FATCA Implementation but Has Not Developed a Consolidated Risk Assessment

The Internal Revenue Service (IRS) has established a Foreign Account Tax Compliance Act (FATCA) implementation team, which is a small office within IRS's Large Business & International (LB&I) division. The implementation team includes representatives from divisions across IRS, and has engaged upper-level management as well. This includes a senior executive group that was organized early on that consists of executives from the Department of the Treasury (Treasury) and IRS. These executives analyzed policy choices, obtained and assessed internal and external stakeholder input, and obtained decisions on the key policy issues from the Commissioner, Chief Counsel, and Assistant Secretary. Team officials told us that for the past year, the team has worked toward developing the structure of the FATCA office, estimating resource needs and defining program goals. The team has requested and received funding for contractors to support the development of the foreign financial institution (FFI) registration project and other areas related to FATCA implementation. The team also received approval to assign 15 full-time equivalent staff. This team manages the implementation of outreach for, education on, and updates to the FATCA program. The team also led the development and rollout of Form 8938, which IRS began receiving from individual taxpayers in January 2012.

IRS has involved external stakeholders, such as industry groups, researchers and experts, law and accounting firms, foreign governments, and FFIs, in implementing FATCA. IRS initially communicated with stakeholders through published notices, which IRS uses to relate what regulations will say in situations where the regulations may not be published in the immediate future. IRS also communicated through draft reporting forms and other information posted on IRS's website. IRS obtained information from stakeholders through formal written comments, receiving 278 public comments as of February 2012 from various sectors and industries, including banking, insurance, and mutual funds. In these comments, many entities expressed objections to the law itself, citing adverse effects the law would have on their businesses. Other concerns included the time and costs needed to make significant modifications to the information management systems of FFIs and withholding agents and the need for extensive coordination with foreign governments. IRS designated a team to catalog, analyze, and share comments internally across various divisions. Further, as of February 2012, IRS and Treasury had held 45 meetings with stakeholders to address such comments. As a result of stakeholder input, IRS and Treasury determined that a phased implementation for FATCA was reasonable. IRS and Treasury subsequently released proposed regulations. Likewise, IRS and Treasury are currently considering ways to collect needed information through intergovernmental transfers of information, thus potentially reducing reporting burden and addressing legal impediments some FFIs face in reporting directly to IRS.

IRS and Treasury have issued some guidance on FATCA implementation, but regulations have not been finalized. Treasury and IRS released proposed regulations for public comment in February 2012. After considering public comments, they anticipate publishing final regulations in the summer of 2012.

IRS has communicated preliminary FATCA implementation plans to IRS staff and additional guidance is pending. For staff involved in the execution of the Form 8938 rollout, officials told us that they provided more specific guidance, such as responses to frequently asked questions on the website and servicewide program updates. By highlighting press announcements and the Commissioner's speeches on the agency's intranet site and using internal employee e-mail and news channels, IRS officials have attempted to increase IRS employees' awareness of FATCA. IRS is currently developing an advisory document for the workforce summarizing key aspects of FATCA and drawing attention to the information posted on the FATCA site. According to IRS's draft communication strategy and LB&I officials, IRS will provide specific guidance for employees whose jobs are directly affected by FATCA. These include employees in taxpayer assistance, stakeholder liaison, media relations, and compliance.

IRS has begun some FATCA risk assessment activities but has not yet developed a consolidated risk assessment approach. According to FATCA program officials, IRS has conducted an initial risk assessment based on scheduled deployment dates of the activities throughout the phased implementation, with the main focal point being the deliverables that are due earliest. For example, they explained that for the first year, Form 8938 was already delivered and the risks mitigated. The next deliverable is the FFI registration portal. IRS has begun to catalog and address risks for the information technology system deployment and the business processes needed to support it. IRS has developed a risk management plan that addresses risks and issues associated with establishing the FFI registration portal but, understandably, has not yet documented a detailed risk management plan for the latter stages of implementation.

Officials stated that they have also identified high-level program, budgetary, legal, and legislative risks and are working to mitigate them. Further, they have created a tracking tool for issues that remain unresolved so that they can be addressed. However, IRS has not consolidated existing information or future plans into an overall risk framework. FATCA program officials told us they had not completed a consolidated risk assessment because they were awaiting the release of final regulations, which will increase their ability to develop an overall risk assessment. Without a consolidated assessment, IRS has less assurance that all risks have been comprehensively identified. Documenting an ongoing effort is key to ensuring that various stakeholders and contributors within IRS have a common understanding of program goals and progress. Officials also cited the challenge of conducting a full risk assessment for a multiphased program still in its early stages. While we recognize this difficulty, we believe it is still important to lay the foundation for these plans. Leading practices suggest that risk assessments can and should evolve as short-term and long-term forecasting occur and therefore should be reviewed on an ongoing basis. A consolidated risk assessment is key to identifying and evaluating potential risks to the program's goals so that countermeasures can be designed and implemented to prevent or mitigate the risks.

Objective

Assess the extent to which IRS has developed plans to use the information from FATCA to improve tax compliance.

Leading Practices

- *Documented strategy.* A documented strategy can serve as a high-level road map to achieving taxpayer compliance results sooner and at a lower cost, and could include information on IRS's strategies and tactics for improving taxpayer compliance. (GAO-11-336)

GAO has identified areas that a strategic document can address. These areas include the following:

- *Timeline.* Establishing a timeline that includes critical phases and essential activities that need to be completed by particular dates to achieve results is important for accountability and success in implementing a project. (GAO-11-336)
- *Performance measurement.* GAO has highlighted the importance of identifying potential program benefits early to help aid program success, including the ability to monitor and evaluate the program, as well as identifying opportunities for improvement. (GAO-11-336, GAO-11-719)

IRS Has Begun Developing a Strategy to Use FATCA Information but Has Not Completed It

The Internal Revenue Service (IRS) has begun to discuss how it will use Foreign Account Tax Compliance Act (FATCA) information to improve compliance, but has not yet fully completed a broader strategy for doing so. FATCA program officials have identified the primary method for using FATCA information to improve tax compliance. According to the officials, IRS will compare multiple information sources to identify U.S. taxpayers and foreign financial institutions (FFI) failing to comply with the FATCA requirements and, more broadly, taxpayers failing to report overseas income. Specifically, IRS plans to match the following documents:

- from taxpayers, asset information from Forms 8938 and financial account information from Report of Foreign Bank and Financial Accounts (FBAR) forms;
- from registered FFIs, U.S. taxpayers' foreign asset information on a yet-to-be-developed information return; and
- from other third parties, information from Form 1042-S (Foreign Person's U.S. Income Subject to Withholding) and international third-party data.

IRS has not developed a broader documented strategy to guide its efforts. For example, FATCA program officials told us that as IRS receives Forms 8938 from taxpayers, it will conduct research to better understand and prepare for the information it will receive as the implementation progresses. However, IRS has not included this work within the framework of an overall strategy for FATCA. Documenting the research within a strategic framework could identify the purposes of the research and the potential uses of the research as implementation continues. Such research could be included in a broader discussion of the methods and tactics IRS is considering to improve taxpayer compliance results through FATCA.

Although IRS has established a timeline for implementing the FATCA requirements, it has not developed a timeline for using this information to improve tax compliance. A timeline would identify key internal milestones IRS needs to achieve to enable it to use this information to improve tax compliance. Without a timeline to help it manage implementation, it is less certain that IRS will be prepared to use the FATCA information timely and effectively.

Further, IRS has not yet identified performance measures for its FATCA efforts. IRS officials told us that performance measures are contingent on areas of program design that have not yet been finalized. For example, because it is not certain whether foreign governments or FFIs will transmit asset information to IRS, it is difficult to set up performance goals for processing this information. Although challenging, it is still important to lay the foundation for performance measurement early on, as a performance measurement plan could help IRS assess the costs and benefits of its compliance efforts.

If IRS does not have a broad strategy, it risks negatively affecting FATCA implementation. First, without this strategy, IRS may not be able to effectively communicate to internal stakeholders the overall goals of FATCA and steps needed to achieve these goals. Second, because the program has already experienced implementation challenges because of program design uncertainty, a documented strategy would allow IRS management to make more informed resource and program decisions.

An incomplete strategy hinders accountability. Given that FATCA implementation is in its early stages, the strategy may be a high-level road map with timelines and performance measures that could evolve over time.

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Objective

Determine the extent to which IRS is incorporating best practices to develop its resource estimate for implementing FATCA.

Leading Practices

GAO's Cost Guide identifies best practices for cost estimation (GAO-09-3SP). Among other functions, cost estimation supports the budget process by providing estimates of funding to efficiently execute the program. Congress and IRS need reliable cost estimates to make well-informed decisions. According to the Cost Guide, cost estimates should be well documented, comprehensive, accurate, and credible. Satisfying all four criteria is important, but in the early stages of developing an estimate, the first two characteristics—well documented and comprehensive—are key.

- *Well-documented estimate*. Among other characteristics, the estimate tracks data to their source documentation, includes a technical baseline description, and documents all steps in its development.
- *Comprehensive estimate*. An estimate should be structured in sufficient detail to ensure that cost elements are neither omitted nor double counted. Among other characteristics, the estimate identifies the assumptions and definitions used to produce the estimate, and includes the work necessary to accomplish the program objectives.

IRS's Initial Resource Estimate Is Well Documented, but IRS Has Not Established a Timeline for Completing a Comprehensive Estimate

The Internal Revenue Service (IRS) has developed an initial resource estimate for Foreign Account Tax Compliance Act (FATCA) implementation. Currently, its estimate includes the cost of two new information technology (IT) projects: developing the foreign financial institution (FFI) registration portal and developing the document matching program described previously.[1] IRS has used a resource estimation team and guidance from various sources, including GAO's *Cost Estimating and Assessment Guide* (Cost Guide) and lessons learned from past IRS initiatives, in developing this estimate. IRS also submitted a budget request of $37.1 million for funding FATCA implementation for 2013, including the costs to staff examiners and agents dedicated to enforcing FATCA, along with IT development costs. This budget request does not identify the resources needed for implementation beyond fiscal year 2013.[2]

For its IT resource estimate, IRS has taken steps to incorporate best practices for a well-documented resource estimate. IRS identified the sources of the estimate and the methodology used to develop it. IRS has identified the planned capabilities of the IT system—a technical baseline—with the known information. It also documented the steps taken to develop the estimate for the IT system. As IRS continues to develop cost estimates for implementing FATCA, it will be important to continue incorporating the best practices of a well-documented estimate. A well-documented estimate is essential for validating and defending a cost estimate. It will explain the methodology and the calculations underlying the cost elements and provide a historic database that can be used to replicate or develop future estimates.

IRS has not identified all the components needed for a comprehensive resource estimate. Because the program design is not final, IRS has not been able to identify all of the work necessary to accomplish the program's objectives. Consequently, it has been unable to ascertain all potential costs beyond those for IT resources. FATCA program managers told us that they plan to further develop their estimate as additional information on program design becomes available. The officials told us that they plan to include estimates for other resources needed, including staffing, contractor needs, and training. A comprehensive estimate provides the basic framework necessary to facilitate resource tracking.

Without a comprehensive estimate, management may not have the proper insight to successfully calculate resources needed or reliably estimate the cost of future similar efforts. Given that IRS is in the early stages of implementing the FATCA requirements and the uncertainty about key features of the program, it would be difficult for IRS to develop a comprehensive cost estimate at this time. However, IRS can take steps to prepare for a comprehensive estimate, such as establishing a timeline

[1]In September 2011, IRS estimated that the total life cycle cost of developing and maintaining the FFI registration portal will be $31.4 million and the total life cycle cost of developing and maintaining the document matching compliance program will be $12.8 million.
[2]IRS also submitted a budget request for implementing FATCA in fiscal year 2012, but this request was unfunded. IRS officials told us they were able to reallocate funding to FATCA implementation during this year.

for completing the estimate. IRS has told us that it does not have a timeline for a complete estimate because some design details will not be known until later in the implementation process. However, a timeline that identifies those key details and sets time frames for completing the estimate could be developed.

Without such a timeline, IRS may not be able to timely develop a reliable, comprehensive cost estimate, and therefore risks not communicating key cost information to Congress and IRS management in time for them to make decisions affecting FATCA implementation.[3] Without the proper information, IRS decisions may not lead to the most efficient execution of the program. Furthermore, because reliable cost estimates inform budget requests, IRS may not be able to properly support budget requests to fund FATCA operations over time.

[3]GAO recently recommended that IRS ensure that it is following best practices in its cost estimation for the new Information Reporting and Document Matching system. See GAO, *IRS Management: Cost Estimate for New Information Reporting System Needs to be Made More Reliable*, GAO-12-59 (Washington, D.C.: Jan. 31, 2012).

Appendix II: Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

April 9, 2012

Mr. Michael Brostek
Director, Tax Issues
Strategic Issues Team
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Brostek:

Thank you for providing your draft report, *Foreign Account Reporting Requirements: IRS Needs to Further Develop Risk, Compliance, and Cost Plans* (GAO-12-484), for our review and comments. We appreciate the time your GAO Team spent with us assessing our initial work, project plans, and estimates on the implementation of the new Foreign Account Tax Compliance Act (FATCA) requirements. As your report indicates, we have incorporated leading practices in the initial FATCA implementation, have begun developing a strategy to use the new information requirements to improve compliance, and have well-documented initial resource need estimates.

We are pleased that GAO recognizes that the FATCA implementation involves major, unique efforts and many stakeholders. FATCA is in the beginning phases of a six-year implementation project, which began in late 2010 and will continue through 2017. The IRS and Treasury recently published comprehensive proposed regulations (388 pages) that provide guidance on implementing the information reporting and withholding tax provisions under Chapter 4 of subtitle A of the Internal Revenue Code. Once these regulations are finalized, a number of outstanding issues will be resolved, allowing further progress on the six-year plan. Furthermore, Treasury and other U.S. Government officials are still evaluating standards surrounding the exchange of government-to-government data. Therefore, the FATCA Program Team has been largely focusing on implementation activities that are certain, such as Form 8938, Statement of Specified Foreign Financial Assets, inbound data, which began arriving in January 2012, and the Foreign Financial Institution (FFI) Registration system, which will be implemented by January 2013. Once the final regulations are issued as planned in the summer of 2012, the Program Team will begin addressing other long-term implementation efforts.

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We concur with GAO's recommendations. The IRS response addressing the three recommendations is enclosed.

For questions on our response, please contact Michael Danilack, Deputy Commissioner, International, Large Business and International Division, at (202) 435-5000.

Sincerely,

Steven T. Miller

Enclosure

Enclosure

GAO recommends that the IRS Commissioner take the following three actions, which may evolve over time.

RECOMMENDATION 1:

Develop a consolidated risk assessment.

RESPONSE:

We have started developing a consolidated FATCA Program Risk Management Plan that incorporates risks from all work-streams that make up this Program (Modernization and Information Technology Services (MITS) and Business initiatives). The draft Risk Management Plan highlights roles and responsibilities for capturing risks, a reporting and tracking approach, and a risk management methodology. The plan also includes a comprehensive template, which allows internal stakeholders to identify risks and issues on a continuous basis, while monitoring mitigation procedures at all Program levels.

RECOMMENDATION 2:

Complete a broad strategy, including a timeline and performance measures, for how IRS intends to use information collected based on the FATCA requirements to improve tax compliance.

RESPONSE:

Implementation of FATCA will depend, in part, on the resolution of certain issues in regulatory guidance. The IRS and Treasury recently published comprehensive proposed regulations under Chapter 4 of subtitle A of the Internal Revenue Code, and the finalization of those regulations will permit further progress on certain issues. For example, the transfer of Participating Foreign Financial Institutions (PFFI) account information via international Exchange of Information (EOI) procedures alters, to a certain extent, the environment in which the IRS can approach the PFFI regarding issues such as Taxpayer Identification Number (TIN) validation and completeness and accuracy reporting. This could in-turn impact the timing of Form 8938, Statement of Specified Foreign Financial Assets, and PFFI account information matching. However, we are certain that our compliance efforts can and will evolve as FATCA regulatory issues are resolved.

We are developing a FATCA Program Compliance Strategy that focuses on all aspects of tax and statutory compliance related to the FATCA legislation. For tax compliance, we are currently assessing how taxpayer-provided declarations of overseas accounts, provided on Form 8938, will factor into return identification and selection for treatment streams. We will be assessing the taxpayer populations submitting Form 8938 as the

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current filing season progresses, and we will evaluate the need for additional actions, such as taxpayer outreach and potential exam pilot tests, based on our findings. We are also working with stakeholders within the Large Business and International Division and other IRS organizations to assess how Form 8938 data will be used in conjunction with other data sources for more comprehensive compliance efforts. Regarding Foreign Financial Institutions (FFI) compliance with FATCA requirements, we are implementing the PFFI registration processes and customer service functions. We are also assessing how best to use PFFI-provided account information to monitor PFFI compliance with their registration agreements, taxpayer compliance with Form 8938 filing requirements, and U.S. withholding agent reporting compliance. Furthermore, the IRS has approved the standup of a new International Data Management (IDM) organization that will focus on the use of international tax data, including FATCA data, to strengthen the IRS's international and domestic tax efforts.

RECOMMENDATION 3:

Establish and document a timeline for completing a comprehensive FATCA cost estimate.

RESPONSE:

We have identified and defined costs for portions of the Program that are known, primarily the FFI Registration system. We have completed a cost estimate for the development and deployment of the FFI Registration portal, which includes associated staff and hardware forecasts. We have also developed cost estimates for other aspects of the FFI Registration process, which incorporates customer service support and proofing and verifying procedures surrounding FFI Responsible Officers. We anticipate being able to refine this analysis once final regulations are published as planned this summer. Once issued, we will develop more comprehensive Program-wide cost estimates.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

Michael Brostek (Director) and Jeffrey Arkin (Assistant Director) managed this assignment. Sonya Phillips (Analyst-in-Charge) and Jeffrey Niblack (Senior Analyst) made key contributions to all aspects of the work. Cynthia Saunders provided methodological assistance; Stacey Steele provided assistance with cost estimation best practices; Sabrina Streagle provided legal support; and Melanie Papasian provided key assistance with message development and writing.

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