



Highlights of [GAO-07-823T](#), a testimony before the Committee on Finance, U.S. Senate

TAX COMPLIANCE

Challenges in Ensuring Offshore Tax Compliance

Why GAO Did This Study

Offshore tax evasion is difficult for the Internal Revenue Service (IRS) to address. IRS examines tax returns to deal with offshore evasion that has occurred. IRS's Qualified Intermediary (QI) program seeks to foster improved tax withholding and reporting.

GAO was asked to testify on two topics. First, GAO was asked to provide information on (1) the length of, and assessments from, IRS's examination of tax returns with offshore activity and (2) the impact of the 3-year statute of limitations on offshore cases. Second, for the QI program, GAO was asked to address (1) program features intended to improve withholding and reporting, and (2) whether weaknesses exist in the U.S. withholding system for U.S. source income and QI external reviews and IRS's use of program data. GAO relied on prior work for the first topic. For the QI program, GAO used the latest data that were available and corroborated by IRS.

What GAO Recommends

A report GAO released today suggests that Congress make an exception to the 3-year civil statute of limitations period for taxpayers involved in offshore financial activity. GAO will consider recommendations for the QI program in a forthcoming report.

www.gao.gov/cgi-bin/getrpt?GAO-07-823T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek on (202) 512-9110 or brostekm@gao.gov.

What GAO Found

Examinations involving offshore tax evasion take much more time to develop and complete than other examinations—a median of 500 more days for cases from fiscal years 2002 to 2005, but their resulting median assessment is almost three times larger than for all other examinations. Nevertheless, because they take more staff time, offshore examinations yielded tax assessments per hour of staff time that were about one-half of that for all other examinations. Because of the 3-year statute of limitations, the time needed to complete an offshore examination means that IRS sometimes prematurely ends offshore examinations or decides not to open an examination, despite evidence of likely noncompliance. Congress has granted a statute change or exception when enforcement challenges similar to those found in offshore cases have arisen in the past.

QIs are foreign financial institutions that contract with IRS to withhold and report U.S. source income paid offshore to foreign customers. The QI program provides IRS some assurance that QIs are properly withholding and reporting tax on U.S. source income paid offshore. QIs (1) are more likely to have a direct working relationship with customers who claim reduced tax rates under tax treaties, (2) accept responsibilities for ensuring customers are in fact eligible for treaty benefits, and (3) agree to have independent parties review a sample of accounts and report to IRS.

However, a low percentage of U.S. source income flows through QIs. For tax year 2003, about 12.5 percent of U.S. source income flowed through QIs. About 87.5 percent flowed through U.S. withholding agents, which provide somewhat less assurance of proper withholding and reporting than do QIs. In addition, U.S. persons may be able to evade taxes by masquerading as foreign corporations.

The contractually required independent reviews of QIs' accounts do not require auditors to follow up on indications of illegal acts, as would reviews under U.S. *Government Auditing Standards*. While IRS obtains considerable data from withholding agents, it does not make effective use of the data to ensure proper withholding and reporting has been done.

U.S. Source Income Flowing through QIs and to Foreign Corporations, 2003

Dollars in billions

Total U.S. source income	Amount and percentage flowing through QIs		Amount and percentage flowing to foreign corporations	
	Amount	Percentage	Amount	Percentage
\$293.3	\$36.6	12.5	\$200.5	68.4

Source: GAO analysis of IRS data.