



*Improvements Are Needed to Ensure  
the Central Withholding Agreement  
Program Fosters Nonresident Alien  
Withholding Compliance*

**September 30, 2011**

**Reference Number: 2011-30-117**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

1 = Tax Return/Return Information

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## HIGHLIGHTS

### **IMPROVEMENTS ARE NEEDED TO ENSURE THE CENTRAL WITHHOLDING AGREEMENT PROGRAM FOSTERS NONRESIDENT ALIEN WITHHOLDING COMPLIANCE**

## Highlights

**Final Report issued on September 30, 2011**

Highlights of Reference Number: 2011-30-117 to the Internal Revenue Service Commissioner for the Large Business and International Division.

### **IMPACT ON TAXPAYERS**

Internal Revenue Code Section 1441 generally requires that any United States (U.S.) or foreign person having control of certain U.S. source income must withhold 30 percent of the gross income prior to any payments made to a nonresident alien (NRA) individual or partnership. The purpose of a Central Withholding Agreement (CWA) is to reduce the 30 percent withholding tax rate to be more in line with an NRA's annual projected tax liability. However, if NRAs who enter into CWAs are allowed to improperly reduce withholding, the Government's interest may not be protected.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated to determine whether the CWA Program is working as intended. This audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Globalization.

### **WHAT TIGTA FOUND**

CWA Program management has taken positive actions to ensure sensitive information is not transmitted via email to NRAs or their representatives. However, managerial oversight of the CWA Program needs improvement. There is no managerial guidance or a quality review process to ensure cases are properly processed. In 25 of 133 closed cases, tax specialists did not take timely and appropriate action. In 37 closed cases, documentation was missing and/or incomplete. Inconsistencies

were found in 13 of 47 CWA closed cases with approving and denying CWA applications based on the timeliness of the submission.

CWA specialists do not have detailed guidance for making a determination of ordinary and necessary business expenses for justifying a reduction of income for determining the proper withholding rate under CWAs. In addition, there was no consistency in the methodology for conducting site visits or the amount of information captured in the site visitation reports. The CWA Program has not established performance goals, and current measures do not show if it is fostering NRA compliance.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Director, International Individual Compliance, Large Business and International Division, establish performance goals and identify a method for measuring the level to which the CWA Program is fostering compliance. To ensure effective oversight, a quality review process and managerial guidance should be established. Additional training should be given to CWA tax specialists on evaluating ordinary and necessary business expenses submitted with the CWA requests. Procedures should be revised to provide clearer guidance that includes a methodology for conducting site visits and preparing site visitation reports.

In their response to the report, IRS management agreed with 10 of the 11 recommendations. Management stated they plan to establish goals and a standard for measuring program performance and effectiveness. They plan to determine if CWA cases can be incorporated into their current Quality Measurement System Program and establish managerial guidance. Future training is planned for CWA tax specialists. A standard Site Visit Request Form is to be used to ensure the decision-making process is properly documented before a site visit request is made. However, management disagreed with the recommendation to revise CWA tax specialist procedures to require that NRAs have either a Social Security Number or an Individual Taxpayer Identification Number in order to receive a CWA.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 30, 2011

**MEMORANDUM FOR** COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL  
DIVISION

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Improvements Are Needed to Ensure the  
Central Withholding Agreement Program Fosters Nonresident Alien  
Withholding Compliance (Audit # 201130006)

This report presents the results of our review to determine whether the Central Withholding Agreement Program is working as intended. This audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Globalization.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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## *Abbreviations*

CWA	Central Withholding Agreement
DWL	Directed Withholding Letter
EFTPS	Electronic Federal Tax Payment System
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
LB&I	Large Business and International
NRA	Nonresident Alien
SSN	Social Security Number
U.S.	United States



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## *Background*

United States (U.S.) source income from a U.S. trade or business, including wages, commissions, interest, dividends, pensions, and gambling winnings paid to foreign individuals, totals approximately \$140 billion each year and is responsible for a portion of the International Tax Gap. The International Tax Gap is defined as taxes owed but not collected on time from a U.S. person<sup>1</sup> or foreign person whose cross-border transactions are subject to U.S. taxation. While the Internal Revenue Service (IRS) has not developed an accurate and reliable estimate of the International Tax Gap, some non-IRS estimates place it between \$40 billion and \$123 billion annually. As a result, compliant taxpayers have an additional tax burden when noncompliant taxpayers do not pay their legal obligations.

***Non-IRS estimates place  
the International Tax Gap  
between \$40 billion and  
\$123 billion annually.***

Internal Revenue Code (I.R.C.) Section (§) 1441 generally requires that any U.S. or foreign person having control of certain U.S. source income must withhold 30 percent of the gross income prior to any payments made to a nonresident alien (NRA) individual or partnership. The person responsible for this withholding is known as a withholding agent.

Treasury Regulation § 1.1441-1(b) (April 2010) requires a withholding agent to withhold income tax from payments made to the NRA and to pay over the withheld tax to the IRS. In addition, Treasury Regulation § 1.1441-4(b)(3) (April 2010) stipulates that compensation for personal services of an NRA may be wholly or partially exempted from withholding if an agreement is reached between the IRS and the NRA with respect to the amount of withholding required. This agreement is known as a Central Withholding Agreement (CWA). To be a designated withholding agent for a CWA, the IRS requires that the person or entity must:

1. Be an unrelated party to ensure independence in compliance.
2. Have an independent U.S. bank account.
3. Be eligible to make Federal tax deposits using the Electronic Federal Tax Payment System (EFTPS).

A withholding agent can be held personally liable for any tax required to be withheld. This liability is independent of the tax liability of the NRA that receives the payment. If the withholding agent fails to withhold and the NRA fails to satisfy his or her U.S. tax liability, then both individuals are jointly and severally liable for the tax, as well as any interest and applicable

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<sup>1</sup> See Appendix VIII for a glossary of terms.



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penalties. If the NRA satisfies his or her U.S. tax liability, the withholding agent may still be liable for interest and penalties if he or she fails to withhold the taxes.

To help ensure compliance with I.R.C. § 1441, the CWA Program will send Directed Withholding Letters (DWL) to withholding agents instructing them to withhold at a rate of 30 percent of the gross U.S. sourced personal service income paid to or for the benefit of the NRA. However, a 30 percent withholding rate can create a financial hardship for NRAs if the amount of income actually realized after expenses is much less. To help offset the financial hardship, Treasury Regulation § 1.1441-4(b)(3) (April 2010) provides that the 30 percent withholding rate imposed on U.S. sourced personal service income of an NRA individual may be reduced to a lower withholding rate if a written agreement (i.e., a CWA) is signed by the IRS Commissioner or his delegate with the NRA individual and other affected parties. The lower rate of withholding is intended to reflect the NRA's anticipated Federal income tax liability computed at the graduated rates after allowing for deductions.

Revenue Procedure 1989-47 provides written guidance to NRA athletes and entertainers requesting a CWA to reduce their withholding rate. These procedures require that a list of the names and addresses of the NRAs to be covered by the agreement be submitted with copies of all contracts regarding the time period and performances or events to be covered. This will include contracts with employers, agents, and promoters; exhibition halls; persons providing lodging, transportation, and advertising; and accompanying personnel such as band members or trainers. A proposed budget containing itemized estimates of all gross income and expenses along with any documents that substantiate or support the estimates is also to be submitted along with contact information and the Employer Identification Number for the withholding agent. Upon approval of the estimated budget and the designated withholding agent, the IRS will prepare a CWA that must be signed by the designated withholding agent, the covered NRAs, and the authorized IRS representative.

Each withholding agent is required to file an Annual Withholding Tax Return for U.S. Source Income of Foreign Persons (Form 1042) and a Foreign Person's U.S. Source Income Subject to Withholding (Form 1042-S) for each tax year in which income is paid to a covered NRA with respect to the period and events covered by the agreement. The IRS will credit the withheld tax payments that are posted to the withholding agent's Form 1042 account. Each covered NRA must also agree to timely file a U.S. Nonresident Alien Income Tax Return (Form 1040NR) or, if qualified, a U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents (Form 1040NR-EZ) for the year in which the CWA covers independent personal services. Proper withholding averts future IRS collection efforts after the NRA has left the United States. Appendix IV provides a more detailed description of the relationship between the NRA athlete or entertainer, the promoter, and the withholding agent.

This review was performed at the IRS's Large Business and International (LB&I) Division National Headquarters in Washington, D.C., and the LB&I Division's International Individual Compliance offices in Las Vegas, Nevada; Portland, Oregon; and Austin, Texas, during the



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period November 2010 through June 2011. 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.



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## *Results of Review*

The IRS believes it is important to ensure proper tax reporting and payment withholding for NRAs working in the United States. While the IRS has made an effort to educate the public regarding NRA withholding requirements, we found that the CWA Program may not be providing all taxpayers with consistent and fair treatment. In addition, improvements are needed to ensure the Federal Government's interests are protected.

### ***Management Has Taken Positive Actions to Ensure Sensitive Information Is Not Transmitted via Email to Nonresident Aliens or Their Representatives***

When new cases are assigned to CWA tax specialists, Internal Revenue Manual (IRM) 5.24.2.5 requires that initial contact should be made within 72 hours and subsequent contacts should be made as necessary. These contacts with the taxpayer or his or her authorized representative can be made via telephone, fax, or mail. However, per IRM 1.10.3, Sensitive But Unclassified information, which includes Personally Identifiable Information, generally may not be sent by electronic mail (email) to taxpayers or their representatives. The main purpose behind this policy is that sensitive data transmitted in emails could be intercepted by unauthorized individuals or inadvertently sent to the wrong recipient, resulting in unintentional disclosure.

In March 2010, CWA Program management instructed their employees to follow the IRS email policy that prohibits the use of email to send Sensitive But Unclassified data to taxpayers or their representatives. Employees were told that they were permitted to send only generic emails. For example, it would not be a violation of IRS policy to send an unencrypted email to a taxpayer with a link to a regulation or publication available on IRS.gov. However, it would be a violation if the email message instructed the recipient to call regarding a case, even if the email did not identify a case number or a taxpayer's name.

In October 2010, CWA Program management determined some employees misunderstood the IRS email policy and were continuing to send unencrypted emails with Sensitive But Unclassified information to taxpayers and their representatives. As a result, they sent a report to the Treasury Inspector General for Tax Administration's Office of Investigations with a list of employees who had violated the IRS email policy. CWA Program management indicated that the referred employees received disciplinary actions. All CWA Program employees were once again reminded of the restrictions on sending Sensitive But Unclassified information in unencrypted emails. In addition, in January 2011, the Treasury Inspector General for Tax



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Administration's Office of Investigations and the IRS Disclosure Office gave presentations to the CWA employees regarding security and disclosure issues related to sending emails to taxpayers.

***Efforts Have Been Made to Conduct Outreach Regarding Nonresident Alien Withholding Requirements***

To its credit, the IRS has made an effort to educate the public regarding NRA withholding requirements through various outreach methods. According to CWA Program management, their employees spend approximately 30 percent of their time conducting outreach. This includes speaking engagements at various seminars, conferences, and the IRS Tax Forums, as well as personal contacts made to venue management, withholding agents, NRAs, and NRA representatives through telephone calls or site visits.

Additionally, in February 2008, a telephone forum was conducted to explain the responsibilities of withholding agents, give an overview of the CWA Program, and provide the public with an opportunity to ask questions. The questions and answers from this telephone forum and other outreach events are available on IRS.gov. The web site also directs the taxpayer to the IRS publication on *Withholding of Tax on Nonresident Aliens and Foreign Entities* (Publication 515), which further explains the rules for NRA withholding.

***Better Measures Are Needed to Determine Nonresident Alien Tax Compliance for Those Entering Into a Central Withholding Agreement***

Although the CWA Program has been in existence since 1989, the IRS had not established objectives, goals, or adequate performance measures to ensure the CWA Program is functioning as intended. IRM 5.24.1.2 states the purpose of the CWA Program "is to foster compliance and give the NRA athletes and entertainers the opportunity to more accurately reflect their anticipated tax liability by entering into a CWA." However, tax specialists do not conduct follow-up compliance checks to determine if individuals who are given a CWA file their subsequent year tax returns or make arrangements to full pay their tax obligations. Their current measures for success are primarily focused on the number of CWAs/DWLs issued and the amount of revenue generated by the CWAs/DWLs. However, there are no specific measures on how the CWA Program "fosters" NRA compliance. Appendix VI provides more details on the statistics the CWA Program uses to measure performance.

The Government Performance and Results Act of 1993<sup>2</sup> require Federal agencies to establish standards measuring their performance and effectiveness. Federal managers are seriously disadvantaged in their efforts to improve program efficiency and effectiveness because of insufficient articulation of program goals and inadequate information on program performance.

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<sup>2</sup> Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).



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If the purpose of the CWA Program is to foster compliance, the IRS needs to consider measures for determining if the taxpayers who are given an opportunity to decrease their tax withholding are in compliance with their filing and payment obligations for the tax year(s) of their CWAs.

### ***Recommendation***

***Recommendation 1:*** The Director, International Individual Compliance, LB&I Division, should establish performance goals and identify a method for measuring the level to which the CWA Program is fostering compliance of the NRAs who receive a CWA.

***Management's Response:*** IRS management agreed with this recommendation. The Director, International Individual Compliance, will establish objectives for the CWA Program. Based on these objectives, the CWA Program will evaluate various data sources available to establish goals and a standard for measuring performance and effectiveness. It will also establish a timeline of necessary actions to successfully accomplish the task.

### ***Additional Training Should Be Provided to Central Withholding Agreement Tax Specialists to Ensure the Federal Government's Interest Is Protected***

The IRS needs effective procedures to ensure the CWA Program protects the Federal Government's interest among NRA athletes and entertainers. Although there are IRM procedures specifying the duties for tax specialists, we found they do not provide the specialists with clear guidance for making a determination of ordinary and necessary business expenses. These determinations are used as the justification to reduce the amount of income in determining the proper NRA withholding rate under a CWA.

IRM 5.24.3.10 instructs tax specialists to consult with their group manager if items submitted by an NRA appear highly questionable. However, the determination as to what would be considered questionable is made using each employee's own judgment. Under Revenue Procedure 2005-32, the IRS could require the NRAs to submit additional evidence to support that their income and expenses are accurate, truthful, and complete. Prior to January 2011, the CWA Program did not request this type of detailed information and was not set up to conduct an in-depth review of a taxpayer's claimed expenses. However, in January 2011, CWA tax specialists were told to begin requesting additional documentation for large, unusual or questionable expense items submitted with CWA requests.

While we believe it is appropriate to assist taxpayers and to limit their burden, reduced taxpayer burden should not be provided without taking efforts to ensure that the appropriate amount of tax is being withheld. We reviewed a random sample of 47 closed CWA cases and determined that 30 NRAs claimed substantial expenses that reduced their income to the point of having little to



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no withholding. In addition, the expenses claimed in five of these cases appear to be questionable. The NRAs in these cases identified gross receipts totaling \$2.5 million. Without CWAs, the NRAs' withholding would have been approximately \$756,000 instead of \$126,000 that was actually withheld. This withholding would have resulted in an additional \$630,000 being collected.

In each of these cases, it appears that the NRA and/or their representative may have taken advantage of the CWA Program's limited expense validation. \*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

\*\*\*\*\*1\*\*\*\*\*

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\*\*\*\*\*1\*\*\*\*\*. Such a financial endeavor does

not appear to make good business sense and does not seem reasonable considering the amount of gross receipts and the status of the NRA. Without additional supporting documentation, neither the tax specialists nor the Treasury Inspector General for Tax Administration could determine the accuracy of the expense claims. Therefore, we believe the CWA Program should have obtained the evidence necessary for conducting a more in-depth review to validate the NRA's expenses.

While the CWA Program does have a process in place to refer cases for examination, there is no guidance for identifying the conditions or circumstances that warrant an examination referral. Additionally, even if these cases are referred for examination, the Examination function's involvement comes too late in the CWA process. The accuracy of expense claims should be addressed as soon as possible to ensure the proper amount of tax is being withheld as part of the CWA. The current process allows tax specialists to grant the CWAs and then make a referral to the Examination function. The CWA Program made 12 referrals in Fiscal Year (FY) 2010, of which only\*\*\*1\*\*\* were selected for examination. \*\*\*1\*\*\* examinations were ongoing as of August 4, 2011.

Tax specialists need more specific training for making a determination on ordinary and necessary business expenses. The lack of effective guidance can result in poor customer service, inequitable treatment of taxpayers, and a loss of revenue for the Federal Government.

**Recommendation**

**Recommendation 2:** The Director, International Individual Compliance, LB&I Division, should provide additional training to the CWA tax specialists for determining what is considered ordinary and necessary business expenses.

**Management's Response:** IRS management agreed with this recommendation and stated that the training has already been developed and they plan to provide it during upcoming Continuing Professional Education training. In addition, the CWA Program will continue to consult with Area Counsel to obtain legal advice on large, unusual, or



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questionable expenditures identified during the course of negotiations of CWAs with NRAs.

***Few Benefits Were Realized From Site Visits Conducted by Central Withholding Agreement Program Tax Specialists***

While site visits provide some opportunities for outreach to NRAs and their representatives, their overall benefit to the CWA Program is questionable. CWA Program management advised us that tax specialists will periodically conduct site visits to events in accordance with their normal course of business. The purposes of these visits are to identify additional revenues through overages on ticket sales and merchandising and additional revenue sources being provided to the NRA by the event/tour sponsors, as well as to verify income and expense information supplied for the CWA by the NRA and his or her representative. In addition, these visits are used to educate NRAs that may not be aware of the CWA Program or their filing requirements, and to encourage them to request a CWA. When a DWL is issued, the site visit may also be used to educate the venue on the proper amounts of withholding from the settlement sheet for the event.

We reviewed site visitation reports prepared by tax specialists for 27 events<sup>3</sup> that occurred during the period October 2009 through February 2011 and found:<sup>4</sup>

- 18 site visits were made to 7 boxing events and resulted in only 12 boxers requesting CWAs and no additional revenue sources being identified. No problems were identified with the income and expense information provided by the NRAs and their representatives for the CWAs.
- 22 site visits were made to 20 music events and resulted in no new CWAs and no additional revenue sources being identified. No problems were identified with the income and expense information provided by the NRAs and their representatives for the CWAs.

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<sup>3</sup> There can be multiple site visits for some events. For example, one music event covered multiple days. Also, for a boxing event, a tax specialist might attend the press conference, weigh-in, and boxing event.

<sup>4</sup> We requested all the site visitation reports for the time period noted. However, the IRS informed us they were not able to provide one report.



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Figure 1 provides our summary of the site visitation reports.

**Figure 1: Summary of Site Visitation Reports**

	Music Event	Boxing Event
Site visitation reports.	20	7
Visits to the venue.	22	18
CWAs secured before visit.	87	0
CWAs secured after visit.	0	12
CWAs where NRA was noncompliant.	0	3
Site visit was for a DWL.	**1**	**1**
Additional revenue sources identified.	0	0
Problems identified with income or expenses provided by NRAs and their representatives.	0	0

*Source: Our summary of Site Visitation Reports for events that occurred from October 2009 through February 2011.*

In addition, we noted there was no consistency in the CWA Program’s methodology for identifying which venues to select for a site visit or the type and amount of information that was captured in the site visitation reports. While we did not determine the costs associated with these site visits (such as transportation and overtime pay), some of these events (e.g., boxing matches and many of the concerts) may have occurred after regular office hours.

IRM 5.24.3.9 instructs specialists to leave the site once business is concluded. However, it further states that if the site visit is for a boxing event, the specialist may need to remain at the site to verify revenue sources and meet with boxing officials. When tax specialists attend an event like a boxing match, they are provided with a free pass to gain access to the event. In many cases, they receive preferential seating that is not available for sale to the general public. Although CWA Program management believes there is a business case for such site visits, we question the IRS’s rationale due to (1) the limited benefits derived from the site visits and (2) the potential appearance of professional impropriety. Allowing site visits to continue to be conducted using existing procedures could potentially cause harm to the CWA Program’s credibility, as well waste valuable resources on unproductive work.

## **Recommendations**

The Director, International Individual Compliance, LB&I Division, should:

**Recommendation 3:** Revise CWA tax specialist procedures to clarify criteria for determining when and why a venue should be selected for a site visit to ensure consistent treatment of taxpayers.



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**Management's Response:** IRS management agreed with this recommendation and stated that they have already taken actions to address it. According to management, the CWA Program has developed a standard Site Visit Request Form to ensure that the decision-making process is properly documented before the site visit request is made. The development of the Site Visit Request Form should clarify for the CWA tax specialists and their managers the criteria to use for determining site visits. The second type of control is a two-level managerial approval process.

**Recommendation 4:** Conduct a study to determine if the current benefits realized by the CWA Program from the site visits are worth the cost and the potential negative public perception appearances.

**Management's Response:** IRS management agreed with this recommendation and stated that all tax specialists in the CWA Program should be using a standardized Site Visit Report that documents the benefits realized from the site visit and the expenses associated with the site visit. This standardized reporting will help the IRS conduct the cost-benefit analysis.

### **Managerial Oversight of the Central Withholding Agreement Program Needs Improvement**

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government*<sup>5</sup> state that internal controls serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. In short, internal controls, which are synonymous with management controls, help Federal Government program managers achieve desired results through effective stewardship of public resources. Although the CWA Program has been in existence in varying capacities for more than two decades, a dedicated manager to oversee the CWA tax specialists was not selected until October 2005. At that time, the group consisted of only two full time and one part time tax specialists. While the current version of the Program includes a Program Manager, 3 Group Managers, 1 analyst, 25 tax specialists, 4 tax examiners, and 1 management assistant, there still is no IRM for CWA managers. Considering that group managers are the "internal controls" that provide oversight to their staff, we believe it is equally important to have written guidance to assist group managers in carrying out their managerial responsibilities and to enable them to assess whether their employees are properly handling NRA cases.

#### **The quality of the CWA Program's case documentation needs improvement**

During our review, we selected and analyzed a random sample of 47 closed CWAs, 42 closed DWLs, and 44 closed Policy Closure cases processed in FY 2010. Of the 133 closed cases, we

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<sup>5</sup> GAO/AIMD-00-21.3.1, dated November 1999.



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found that \*\*\*\*\*1\*\*\*\*\* had missing and/or incomplete documentation. Figure 2 shows the type and number of occurrences of missing and incomplete documentation.

**Figure 2: Types of Missing and Incomplete Documentation  
for FY 2010 Closed Cases<sup>6</sup>**

CWA, DWL, and Policy Closure Cases	
Number of Cases	Description of Missing and Incomplete Documentation
19	Activity Records missing (IRM 5.24.2.2(3)).
10	EFTPS receipts missing for CWAs (IRM 5.24.3.8).
**1**	Case files missing necessary information (IRM 5.24.2.2(1)).
**1**	CWA cases missing signatures for all relevant parties (IRM 5.24.3.2).
**1**	DWL cases without documentation of follow-up with venue (IRM 5.24.3.12(2)).
**1**	Policy closures without managerial approval (IRM 5.24.3.13).

*Source: Our analysis of closed cases from FY 2010.*

We also analyzed the closed cases for timeliness and appropriateness of actions taken by the tax specialists. Out of the 133 closed cases, we identified 25 cases (19 percent) for which the tax specialists did not take timely and appropriate action.<sup>7</sup> Figure 3 shows the type and number of occurrences of untimely and inappropriate action.

**Figure 3: Untimely and Inappropriate Action on  
FY 2010 Closed Cases**

CWA, DWL, and Policy Closure Cases	
Number of Cases	Description of Untimely and Inappropriate Action
13	Contacts were untimely by not contacting the NRA/representative within 72 hours of case assignment (IRM 5.24.2.5).
12	Follow-up contacts were untimely because they were not made within 8 days after a CWA was sent to the NRA for signature (IRM 5.24.3.2(2)c).
**1**	Cases were not assigned timely (delays ranged from 15 days to 3 months). <sup>8</sup>

*Source: Our analysis of closed cases from FY 2010.*

In addition, we reviewed site visitation reports prepared by tax specialists for \*\*\*1\*\*\* events that occurred during the period October 2009 through February 2011. We found that 14 reports

<sup>6</sup> See Appendix VII for detailed definitions of the IRM references that we used as the basis for our criteria.

<sup>7</sup> \*\*\*1\*\*\* had more than one type of untimely and/or inappropriate action.

<sup>8</sup> Although there is no IRM procedure to identify how long it should take to assign a case, we observed from our case review that cases were generally assigned the same day they were received. Therefore, it is our opinion that these cases were not assigned timely. Had the \*\*\*1\*\*\* been assigned timely, the tax specialists may have been able to issue DWLs.



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(52 percent) had missing and/or incomplete documentation.<sup>9</sup> Figure 4 shows the type and number of occurrences of missing and incomplete documentation.

**Figure 4: Missing and Incomplete Documentation for  
Site Visitation Reports for Events That Occurred During  
October 2009 Through February 2011**

Site Visitation Reports	
Number of Reports	Description of Missing and Incomplete Documentation
14	Site Visit Reports missing required information (IRM 5.24.3.9.1(2)). <ul style="list-style-type: none"> <li>• 14 missing managerial approvals.</li> <li>• 6 missing one or more required items such as the purpose of the visit, revenue sources discussed, or person contacted.</li> </ul>

*Source: Our analysis of Site Visitation Reports for events that occurred from October 2009 through February 2011.*

During an interview with CWA Program management, we were advised that group managers are expected to conduct 10 case reviews for mid-term evaluations and 10 case reviews for annual evaluations. However, there is no IRM guidance for CWA group managers establishing a standardized methodology for quality case evaluations. There is also no requirement or criteria for management to evaluate the site visitation reports. In addition, CWA group managers are not provided any formal training on how to conduct quality reviews. Based on the results of our case review, it would appear that CWA managerial reviews need improvement. In addition, the CWA Program is not included in the LB&I Quality Measurement System, which is used by management to assess program performance, improve work processes, and identify training and educational needs.

**More consistency is needed in dealing with nonresident aliens requesting CWAs**

Our review of the random sample of 47 closed CWA cases found several instances of inconsistent treatment for some NRA athletes and entertainers seeking to enter into CWAs. It appears that CWA Program management was aware of the inconsistent treatment of the NRAs and made no effort to prevent it. We believe that management needs to take action to ensure that all NRAs are treated fairly and that these inconsistencies do not continue.

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IRM 5.24.2.7 states that prior to entering into a CWA, the taxpayer must be in

<sup>9</sup> Some site visitation reports had more than one type of missing or incomplete documentation.



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compliance with all prior year filing and paying requirements or currently entered into an installment agreement. CWA Program management was aware of the noncompliance of these NRAs and still allowed them CWAs, even though some of the other NRAs in our sample were required to get into compliance prior to being granted a CWA.

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- In nine cases, we found that not all NRAs entering into a CWA were able to provide either a Social Security Number (SSN) or an Individual Taxpayer Identification Number (ITIN). The total amount of taxes withheld for these 9 cases was \$1,330. If these individuals were not given a CWA, withholding on their gross receipts would have been at the 30 percent rate, which would have been \$36,065. \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*. As result, there is a good possibility that these individuals will not comply with their tax return filing requirement.

CWA Program management does not require NRAs to obtain an ITIN or SSN before entering into a CWA if it is their first time in the United States. The CWA Program uses a unique case number it creates for use on the CWA. However, this case number cannot be used to track taxes withheld or used by the NRA to file his or her Form 1040NR. In addition, the IRS Master File requires an SSN or ITIN for storage and retrieval of tax information. Further, CWA Program management indicated that some withholding agents may not file a Form 1042 or a Form 1042-S if the NRA was unable to obtain an SSN or ITIN.

CWA Program management indicated that many of the NRA athletes and entertainers do not meet the criteria established by the Social Security Administration for obtaining an SSN. As an alternative, NRAs may apply for an ITIN with an Application for IRS Individual Taxpayer Identification Number (Form W-7) when they file a tax return, or without filing a tax return if they meet one of several exceptions listed on Form W-7. However, none of the exceptions listed specifically relate to obtaining an ITIN in relation to earning personal service income. Without an SSN or ITIN, the IRS is unable to properly track the withholding payment information of an NRA.



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- In 13 cases, we found inconsistencies with approving and denying applications for CWAs based on the timeliness of the submission. For example, we found CWAs were issued to nine individuals who applied with less than 30 days before a tour or event, yet four other individuals in similar situations were denied CWAs. While we did not identify any inappropriate actions in the processing of these cases, we believe inconsistencies in the approval process give the appearance of preferential treatment for some NRAs.

Revenue Procedure 1989-47 instructs the NRAs to submit requests for a withholding agreement at least 90 days before the agreement is to take effect. The Application for Central Withholding Agreement (Form 13930) instructs NRA athletes and entertainers to submit an application at least 45 days before the tour begins or the event occurs to allow for timely evaluation. It also notes that exceptions will be considered on a case-by-case basis. However, CWA Program management informed us that they will attempt to establish a CWA for every application received for which there is at least 30 days before the tour or event. If an application is received with less than 30 days, CWA Program management stated they may attempt to establish a CWA, but it depends on staff availability and whether management believes the application can be processed before the tour or event begins.

## ***Recommendations***

The Director, International Individual Compliance, LB&I Division, should:

**Recommendation 5:** Establish IRM guidance for CWA managers to ensure effective oversight for the CWA Program.

**Management's Response:** IRS management agreed with this recommendation. IRM guidance will be established for CWA managers to ensure effective oversight for the CWA Program.

**Recommendation 6:** Include the CWA Program in the LB&I Quality Measurement System review process to ensure cases are properly processed.

**Management's Response:** IRS management agreed with this recommendation. The CWA Program will work with the LB&I Quality Measurement System Program Office to determine how to incorporate CWA cases into the Quality Measurement System Program to ensure that cases are properly processed.

**Recommendation 7:** Revise CWA tax specialist procedures to require the NRAs to have either an SSN or ITIN in order to receive a CWA.

**Management's Response:** IRS management did not agree with this recommendation. Mandating that NRAs have either an SSN or an ITIN would have the effect of prohibiting first-time performers from entering into a CWA. The IRS does not



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believe that tax administration would benefit by denying acceptance into the CWA Program of NRAs who are unable to obtain an SSN or ITIN.

**Office of Audit Comment:** Allowing an NRA to enter into a CWA for a reduced withholding amount of taxes without an SSN or ITIN provides no assurance that the NRA will meet his or her filing obligation to determine the proper amount of tax liability. We believe NRAs should not be given an unfair advantage over U.S. taxpayers who are required to have an SSN, pay their taxes in advance, and file a tax return to receive a refund of any overpaid taxes.

**Recommendation 8:** Establish a standardized time period for accepting and processing all CWA applications to ensure that all applicants are treated fairly and consistently.

**Management's Response:** IRS management agreed with this recommendation. As stated in the Treasury Inspector General for Tax Administration report, Revenue Procedure 1989-47 and the Application for CWA conflict on the time period for filing the application. However, both allow for the application to be processed at the discretion of the IRS. The CWA Program will establish a standardized time period for accepting and processing all CWA applications to ensure that all applicants are treated fairly and consistently. After a standardized time period is established, both the Revenue Procedure and Application for CWA will be updated.

### ***Steps Should Be Taken to Ensure Withholding Agents Comply With Rules and Regulations to Withhold the Proper Amount of Taxes***

Many venues, agents, and promoters that have the responsibility of being withholding agents do not recognize or fully understand their tax withholding requirements under I.R.C. §1441. Therefore, it is critical that the CWA Program identifies potential withholding agents and educate them as to their responsibilities. One way to do this is through the issuance of DWLs.

Tax specialists will issue a DWL 30 days prior to an NRA's first U.S. event/tour date if a CWA has not been executed and a DWL is determined to be in the Federal Government's interest. The letter directs the withholding agent to withhold taxes at a rate of 30 percent of the gross U.S. sourced personal service income paid to or for the benefit of the NRA.

After the event or tour has concluded, the tax specialist should be notified by the withholding agent as to the amount of money that was withheld from the NRA. The withholding agent generally provides notification through a Directed Withholding and Deposit Verification (Form 13920).<sup>10</sup> The withholding agent fills out the form showing the amount withheld and the date it was deposited. In some cases, the withholding agent may provide an EFTPS receipt. If the IRS does not receive a response from the withholding agent, the tax specialist is required to

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<sup>10</sup> See Appendix V for an example of a Form 13920.



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initiate one follow-up contact. However, the CWA Program does not have any enforcement authority to compel withholding agents to respond to its inquiries.

According to CWA Program statistics provided by the IRS for FYs 2008 through 2010, withholding agents provided deposit information in response to only 29 percent of the DWLs issued by the CWA Program over the 3-year period. As a result, the CWA Program cannot determine if the proper amount of tax was withheld and deposited for most of the DWLs issued. In addition, we reviewed a random sample of 42 closed DWL cases and found only 19 withholding agents had provided deposit notifications to the tax specialists. For the 19 DWL cases in which tax specialists received a response, withholding agents did not provide an EFTPS deposit slip in 13 of the cases. For these cases, the withholding agent provided only the Form 13920. Because the Form 13920 is filled out by the withholding agent, we do not believe this type of documentation is sufficient to verify a deposit was actually made, as the CWA Program does not have a way to validate its accuracy. Therefore, the withholding deposits reported by the CWA Program for DWL cases may be overstated.

As previously noted, designated withholding agents for CWAs are required to have an independent U.S. bank account and be eligible to make Federal tax deposits using the EFTPS. If withholding agents for DWLs are submitting deposits directly to the U.S. Treasury, they are also required to use the EFTPS. However, withholding agents for DWLs are also permitted to make deposits through third parties, such as a financial institution, using other types of approved electronic payment methods. In those instances, they would not have an EFTPS deposit slip, but should receive or be able to obtain some other type of confirmation of the electronic deposit, such as a confirmation number or bank statement that identifies a payment transfer.

CWA Program management noted that deposits by withholding agents for DWLs are typically not made for an individual, but rather for all individuals during a specific period of time for which they are required to withhold Federal income tax. For any deposits that are not solely related to the DWL individual, the CWA Program would be unable to discern for whom the deposit was made. That determination would be unable to be made until the withholding agent submitted the Form 1042-S the following year. However, obtaining a copy of the electronic deposit slip, or some other form of proof, would at least show that a deposit was made, which we believe would add credibility to the information written on the Form 13920 by the withholding agent.

Based on the comparison of withholding deposits made for CWAs versus DWLs, we believe the IRS could potentially be losing millions of dollars each year by not requiring withholding agents to provide EFTPS (or some other type of electronic deposit confirmation) verification for DWLs. Figure 5 illustrates the large disparity in the amount of revenue accounted for as withheld as a result of DWLs compared to CWAs.



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**Figure 5: Comparison of Revenue Withheld by Withholding Agents to the Number of CWAs and DWLs for FYs 2008 Through 2010**

	FY 2008		FY 2009		FY 2010	
	Number Issued	Revenue Withheld	Number Issued	Revenue Withheld	Number Issued	Revenue Withheld
CWAs	655	\$49,604,367	944	\$59,005,844	994	\$47,521,376
DWLs	993	\$9,583,417	1,052	\$11,337,891	1,265	\$10,988,829
<b>Actual Withholding Revenue</b>		<b>\$ 59,187,784</b>		<b>\$ 70,343,735</b>		<b>\$ 58,510,205</b>

Source: Our analysis of CWA Statistical Reports for FYs 2008 through 2010.

One reason withholding agents may not be responding to the tax specialists is that the IRS does not usually conduct audits of the Form 1042 because the information on these forms is not routinely transcribed. However, the LB&I Division has an ongoing initiative to begin capturing this data. Once the IRS begins auditing these forms, the CWA Program would be able to refer cases for examination to ensure the withholding is properly being deposited with the IRS.

Additionally, the LB&I Division is in the process of developing a system, called the e-trak Non-Resident Filing System, where Form 1042 liabilities can be matched to its related Form 1042-S. The System is designed to allow document matching and credit verification on Form 1042-S and the Foreign Partner's Information Statement of Section 1446 Withholding Tax (Form 8805). We believe that access to this System may also be beneficial for the CWA Program. This System should give CWA employees the ability to verify whether a withholding agent or venue submitted the proper withholding amounts for a particular NRA, as specified by the CWA or DWL. The first phase of the project, which includes 1042-S data, became operational in February 2011 but will not be rolled out for Service-wide use until all phases of development and testing are complete.

### **Recommendations**

The Director, International Individual Compliance, LB&I Division, should:

**Recommendation 9:** Require CWA tax specialists to request an EFTPS deposit slip, or a similar electronic deposit confirmation for the DWLs, to help ensure the accuracy of deposits made by withholding agents.

**Management's Response:** IRS management agreed that this is a necessary procedural step. According to IRM 5.24.3.8, the CWA Program currently requires tax specialists to request an EFTPS deposit slip or a similar electronic deposit confirmation for the DWLs.



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**Recommendation 10:** Conduct a study to determine a way to improve the withholding agents' response rate to the DWLs with information regarding withholding.

**Management's Response:** IRS management agreed with this recommendation. The CWA Program will conduct a study to determine whether it is possible to improve the withholding agents' response rate to the DWLs with information regarding withholding.

**Recommendation 11:** Evaluate the e-trak Non-Resident Filing System (when it becomes available) to see if access for CWA tax specialists will enable them to verify withholding deposits.

**Management's Response:** IRS management agreed with this recommendation. At the time the e-trak Non-Resident Filing System becomes available, the CWA Program will work with the International Business Compliance foreign payments group to evaluate whether providing access to CWA tax specialists will enable them to verify withholding deposits.



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether the CWA Program is working as intended. To accomplish our objective, we:

- I. Identified a volume of 1,155 CWA, DWL, and Policy Closure cases closed by the CWA Program in FY 2010.
  - A. Obtained a list of cases closed in FY 2010 from the CWA Program staff.
  - B. Obtained a download of cases closed in FY 2010 from the closed Integrated Collection System<sup>1</sup> file available from the Treasury Inspector General for Tax Administration Data Center Warehouse.
  - C. Validated the volume of cases closed in FY 2010 by comparing the data obtained in Steps I.A. and I.B.<sup>2</sup>
- II. Determined how the IRS monitors CWAs to ensure all related parties are acting in accordance with the terms of the agreements.
  - A. Interviewed CWA Program management in Las Vegas, Nevada; Portland, Oregon; and Austin, Texas.
  - B. Reviewed IRM 5.24 and training documents.
- III. Identified actions taken by the IRS in instances where withholding agents did not withhold and remit payments in accordance with the terms of the CWAs.
  - A. Determined how the IRS identifies the CWAs where payment withholding and remittance was not in accordance with terms of the agreement through discussions with CWA Program management.
  - B. Selected a random sample of 47 CWAs<sup>3</sup> from the population of 629 CWAs closed in FY 2010 that were included in the data obtained in Step I to identify actions taken by the IRS and determined whether the actions were appropriate.

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<sup>1</sup> See Appendix VIII for a glossary of terms.

<sup>2</sup> We compared the unique case numbers from each source and were able to reconcile the three differences we identified between the files.

<sup>3</sup> We selected a random sample to eliminate bias and for the potential of projecting results. The population of CWA cases closed in FY 2010 was 629. Our random sample of 47 cases was based on a confidence level of 90 percent, a precision of  $\pm 5$  percent, and an error rate of 4.9 percent.



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- IV. Determined whether the IRS took appropriate actions on the DWLs and Policy Closures.
  - A. Queried the data obtained in Step I to identify a population of 226 DWLs and 300 Policy Closures closed in FY 2010.
  - B. Selected random samples of 42 DWLs and 44 Policy Closures<sup>4</sup> identified in Step IV.A. to identify actions taken by the IRS and determined whether the actions were appropriate by comparing information in the case files to the requirements outlined in the IRM 5.24.
- V. Evaluated steps taken by the IRS to promote the CWA Program, identify potential applicants, and provide information and guidance on the application process.
  - A. Interviewed CWA Program management in Las Vegas, Nevada; Portland, Oregon; and Austin, Texas.
  - B. Reviewed 27 site visitation reports prepared by tax specialists during the period October 2009 through February 2011.<sup>5</sup>
  - C. Reviewed CWA Phone Forum documentation and information regarding the CWA Program available to the public on IRS.gov.

**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 the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices for processing CWA applications. We evaluated these controls by interviewing CWA Program management and reviewing random samples of CWA, DWL, and Policy Closure case files.

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<sup>4</sup> We selected a random sample to eliminate bias and for the potential of projecting results. Our random samples of 42 DWL cases and 44 Policy Closure cases were both based on a confidence level of 90 percent, a precision of  $\pm 5$  percent, and an error rate of 5 percent.

<sup>5</sup> We requested all of the site visitation reports for the period of October 2009 through February 2011. However, the IRS informed us they were unable to provide one report. We received and reviewed 27 site visitation reports.



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**Appendix II**

*Major Contributors to This Report*

Margaret Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Bryce Kisler, Director  
Amy Coleman, Audit Manager  
Carole Connolly, Acting Audit Manager  
Todd Anderson, Lead Auditor  
Kristi Larson, Senior Auditor  
Michele Jahn, Auditor



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**Appendix III**

*Report Distribution List*

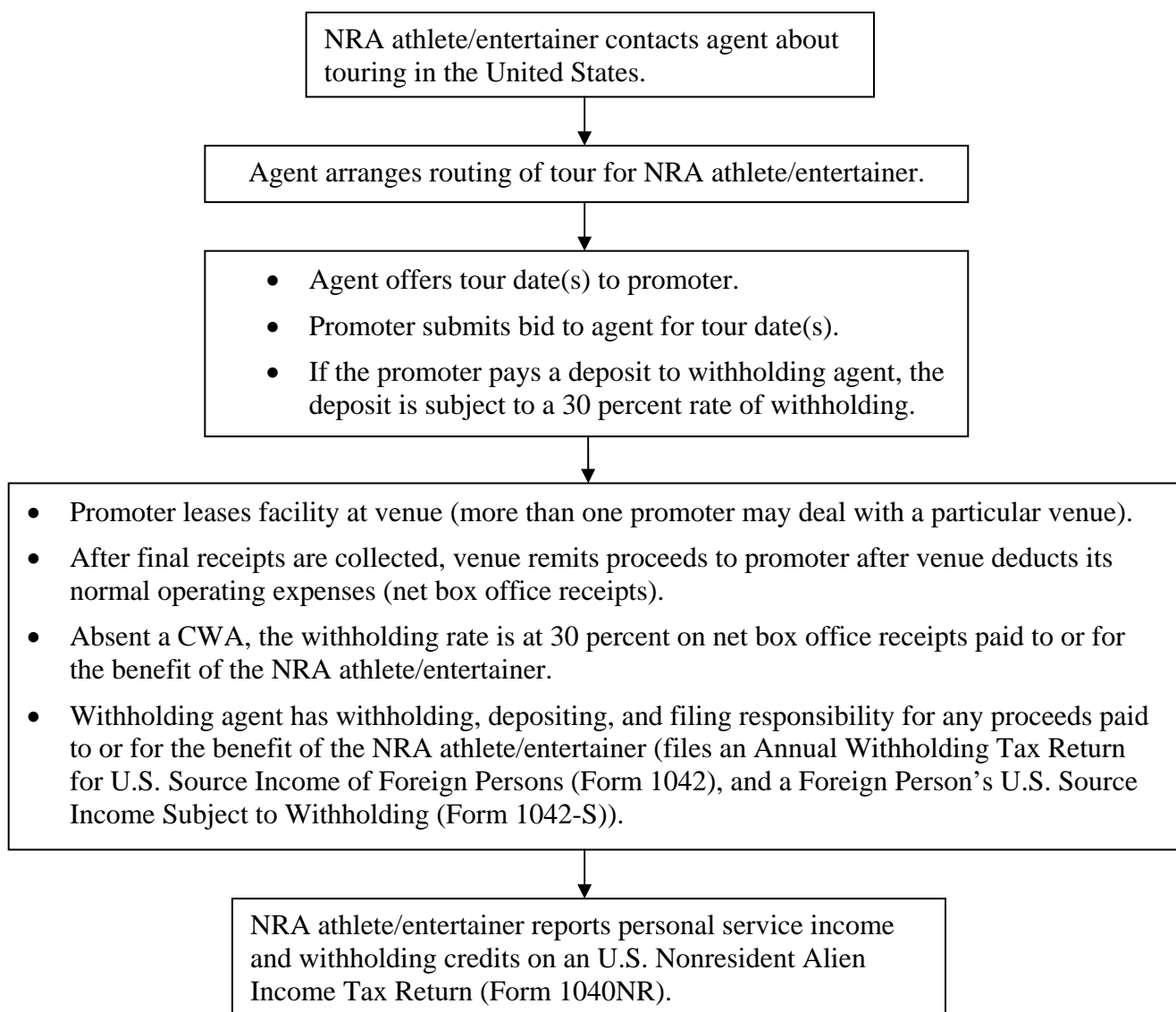
Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner (International), Large Business and International Division SE:LB:IN  
Executive Assistant (International), Large Business and International Division SE:LB:IN  
Director, International Individual Compliance, Large Business and International Division  
SE:LB:IN  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaison: Commissioner, Large Business and International Division SE:LB:IN



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**Appendix IV**

*Illustration of the Relationships Between the  
Various Entities for a Nonresident Alien  
Involved in a United States Tour*



Source: IRM Figure 5.24.2-1.



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**Appendix V**

*Example of a Directed Withholding and  
Deposit Verification (Form 13920)*

Form <b>13920</b> (November 2008)		Department of the Treasury — Internal Revenue Service	
		<b>Directed Withholding and Deposit Verification</b>	
Depositor		Performance date (mmddyyyy)	
Athlete/Entertainer			
<b>Withholding Agent: Please provide the following information and return this Form to the Internal Revenue Service.</b>			
Settlement Amount: (\$) _____			
Amount Withheld: (\$) _____			
Deposit Date: (mmddyyyy) _____			
(Completed by the IRS)		(Please provide any corrections or additions to your contact information in the space below)	
Firm Name	_____	_____	_____
Name of Contact	_____	_____	_____
Address 1	_____	_____	_____
Address 2	_____	_____	_____
City, State, ZIP Code	_____	_____	_____
Telephone Number	_____	_____	_____
Fax Number	_____	_____	_____

**Return to: Internal Revenue Service**

**Attn :** \_\_\_\_\_

By Mail:

or

By Fax: (     )



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**Appendix VI**

*Statistics of the Central  
Withholding Agreement Program*

Central Withholding Agreement (CWA) Program				
		FY 2008	FY 2009	FY 2010
<b>Director of Collection Report Items</b>				
	Total Assignments	N/A	1,527	1,776
	Number of CWAs	655	944	994
	Number of DWLs Issued to Venues	993	1,052	1,265
	Total Withholding Revenue	\$59,597,656	\$70,862,319	\$58,979,352
<b>CWA</b>				
1	Number of Individuals With CWAs	N/A	434	612
2	Number of CWAs	655	944	994
3	Number of Streamlined Cases	230	600	673
4	Number of CWAs 3rd Level Review/Approval	38	43	20
5	Number of CWAs With Counsel Review	45	63	18
<b>DWL</b>				
6	Number of Individuals for Whom DWLs Were Issued	N/A	360	456
7	Number of DWLs Issued to Venues	993	1,052	1,265
8	Number of DWLs Confirmed Deposits	352	303	316
9	Number of CWAs Entered Into After DWL Issued	N/A	106	67
<b>Policy Closures</b>				
10	Policy Closures	41	159	315
<b>Returns</b>				
11	Number of Returns Secured	197	110	118
12	Number of Tax Returns With Balance Due	N/A	9	34
13	Balance Due Amount	N/A	\$14,092	\$392,575
<b>Inventory – Assignments</b>				
14	Total Assignments – New Receipts	N/A	1,527	1,776
<b>Revenue</b>				
15	CWA	\$49,604,367	\$59,005,844	\$47,521,376
16	DWL	\$9,583,417	\$11,337,891	\$10,988,829
17	<b>Actual Withholding Revenue</b>	<b>\$59,187,784</b>	<b>\$70,343,735</b>	<b>\$58,510,205</b>
18	Other Income/Withholding	\$409,872	\$518,584	\$469,147
19	<b>Total Withholding Revenue</b>	<b>\$59,597,656</b>	<b>\$70,862,319</b>	<b>\$58,979,352</b>

Source: CWA Statistical Reports for FYs 2008 through 2010.



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## **Appendix VII**

### *Internal Revenue Manual References*

- IRM 5.24.2.2(1)** Requires that the case file must contain the necessary information for the reader to quickly ascertain case status.
- IRM 5.24.2.2(3)** Requires that each case file must contain an Activity Record, a copy of the current CWA, and copies of all letters sent to the taxpayer or withholding agent.
- IRM 5.24.2.5** Requires tax specialists to make initial contact with the taxpayer or the taxpayer's representative within 72 hours of case assignment.
- IRM 5.24.3.2** Requires tax specialists to retain a copy of the completed signed CWA in the case file.
- IRM 5.24.3.2(2)c** Requires tax specialists to follow up with the taxpayer's representative after 7 days if a CWA was sent and there is no confirmation that the representative received the CWA and returned it to the IRS for signature.
- IRM 5.24.3.6(2)** Requires tax specialists to take appropriate action when a CWA has not been signed prior to the first tour or event date.
- IRM 5.24.3.8** Requires confirmation of CWA deposits and CWA contracts require that deposits be made through EFTPS.
- IRM 5.24.3.9.1(2)** Requires site visitation reports to include the business purpose, approvals requested and received, date of visit, name of person who provided the site tour, revenue sources discussed, facility tour information, and other information.
- IRM 5.24.3.12(2)** Requires tax specialists to initiate one follow-up contact with a venue for any DWL where no response is received.
- IRM 5.24.3.13** Requires managerial concurrence for policy closures.



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## **Appendix VIII**

### *Glossary of Terms*

<b>Central Withholding Agreement</b>	A contract between an NRA athlete or entertainer, a designated withholding agent, and an authorized representative of the IRS for a specific tour or series of events, which provides for the correct amount of withholding based upon net income at graduated rates.
<b>Central Withholding Agreement Program</b>	A prefiling program for NRA athletes and entertainers performing independent personal services in the United States who wish to reduce their tax withholding by entering into an agreement with the IRS.
<b>Data Center Warehouse</b>	The Data Center Warehouse provides data and data access services; centralizes storage, security, and administration of files; and develops uniform and user-friendly interfaces for users to access data.
<b>Electronic Federal Tax Payment System</b>	The EFTPS was designed to process Federal tax deposits and all other types of business and individual payments.
<b>Employer Identification Number</b>	A unique nine-digit number used to identify a taxpayer's business account.
<b>Examination Quality Measurement System</b>	The Small Business/Self-Employed Division's process to measure examination quality and assess long-term trends of performance, in keeping with the IRS's balanced measures. It is used to identify national trends, system changes, and training needs; establish baselines; and provide an understanding of the quality of examinations.
<b>Foreign Person</b>	A foreign person includes a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, and any other person who is not a U.S. person.
<b>Individual Taxpayer Identification Number</b>	A Taxpayer Identification Number issued by the IRS to individuals who are required for U.S. tax purposes to have a Taxpayer Identification Number but do not have, and are not eligible to obtain, an SSN.



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<b>Installment Agreement</b>	Installment agreements are generally equal monthly payments that will result in full payment of the taxes owed within the 10-year period during which the IRS is allowed to collect.
<b>Integrated Collection System</b>	An information management system designed to improve revenue collections by providing revenue officers access to the most current taxpayer information, while in the field, using laptop computers for quicker case resolution and improved customer service.
<b>Internal Revenue Manual</b>	The primary guidance relating to the administration and operation of the IRS. It contains the directions IRS employees need to carry out their responsibilities in administering the tax laws or other agency obligations.
<b>Master File</b>	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
<b>Nonresident Alien</b>	An individual who is not a U.S. citizen or U.S. national who has not passed the green card test or the substantial presence test.
<b>Personally Identifiable Information</b>	Specific type of sensitive information which includes personal data of taxpayers.
<b>Policy Closure</b>	Cases closed due to policy decisions (staffing, date of receipt of request is late) and a DWL is not issued.
<b>Sensitive But Unclassified Information</b>	Information which, if lost, misused, accessed, or modified in an unauthorized way, could adversely affect the national interest, the conduct of Federal programs, or the privacy of individuals.
<b>U.S. Person</b>	A U.S. person is defined by the I.R.C. § 7701(a)(30) as a citizen or resident of the United States, domestic partnership, domestic corporation, any estate (not defined as a foreign estate under I.R.C. § 7701(a)(31)), and any trust, if administered by a U.S. court or supervised by one or more U.S. persons.



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**U.S. Sourced Personal  
Service Income**

All wages and any other compensation for services performed in the United States are considered to be from sources in the United States. The place where the services are performed determines the source of the income, regardless of where the contract was made, the place of payment, or the residence of the payer.



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Nonresident Alien Withholding Compliance*

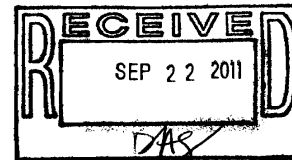
**Appendix IX**

*Management's Response to the Draft Report*

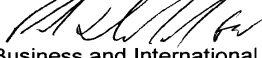


DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

SEP 19 2011



MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Improvements Are Needed to Ensure the  
Central Withholding Agreement (CWA) Program Fosters  
Nonresident Alien Withholding Compliance (Audit 201130006)

We reviewed your draft report entitled, Improvements Are Needed to Ensure the Central Withholding Agreement (CWA) Program Fosters Nonresident Alien Withholding Compliance, originally issued August 10, 2011. LB&I agrees that improvements are needed to ensure the CWA Program fosters nonresident alien (NRA) withholding compliance. We agree with all recommendations, except Recommendation 7 to require the NRAs to have either a Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN) to receive CWAs. The attached response to your audit recommendations includes an explanation for the disagreement.

The International Individual Compliance Office, Large Business and International (LB&I) Division, assumed responsibility for the CWA Program in September 2009. However, the CWA Program has been in existence for more than two decades. It was established in 1989 by Revenue Procedure 1989-47. Under the Program, an NRA athlete or artist can request an agreement with the Internal Revenue Service (IRS) to be wholly or partially exempt from withholding required under Internal Revenue Code (IRC) Section 1441. Under a CWA agreement, the tax withheld more closely approximates the net income tax liability that would be due if the NRA filed a U.S. income tax return.

Between 1989 and 2004, the CWA Program was administered by the Associate Chief Counsel International (ACCI). ACCI focused on outreach, encouraging qualified NRAs to participate in the Program as a means of ensuring tax compliance by NRAs, who were sometimes present in the United States for very limited periods. In 2004, the Small Business Self-Employed Division (SB/SE) joined ACCI in administering the CWA Program, and the Program focus shifted from outreach to enforcement. The CWA Program hired its first group manager in late 2007. Currently, the CWA Program consists of a Program Manager, three group managers, an analyst, 25 tax specialists, four tax examiners, and one management assistant.



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If you have any questions on our planned corrective actions addressing the audit recommendations, please contact me at (202) 283-8710 or Rosemary Sereti, Director International Individual Compliance, at (212) 719-6258.

Attachment



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*Improvements Are Needed to Ensure the  
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Attachment

**RECOMMENDATION 1**

The Director, International Individual Compliance, LB&I Division, should establish performance goals and identify a method for measuring the level to which the Central Withholding Agreement (CWA) Program is fostering compliance of the nonresident aliens (NRAs) who receive a CWA.

**CORRECTIVE ACTION**

The LB&I Division agrees with this recommendation. The Director, International Individual Compliance will establish objectives for the program. Based on these objectives, the program will evaluate various data sources available to establish goals and a standard for measuring the performance and effectiveness of the program. The CWA Program will establish a timeline of necessary actions to successfully accomplish the task.

**IMPLEMENTATION DATE**

September 30, 2012.

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 2**

The Director, International Individual Compliance, LB&I Division, should provide additional training to the CWA tax specialists for determining what are considered ordinary and necessary business expenses.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. Training has already been developed, and it will be provided during the upcoming Fiscal



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Year 2011 Continuing Professional Education (CPE) training. In addition, the CWA Program will continue to consult with Area Counsel to obtain legal advice on large, unusual, or questionable expenditures identified during the course of negotiations of CWAs with NRAs.

**IMPLEMENTATION DATE**

The Fiscal Year 2011 CPE training will be completed by September 16, 2011.

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I training through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 3**

The Director, International Individual Compliance, LB&I Division, should revise CWA tax specialist procedures to clarify criteria for determining when and why a venue should be selected for a site visit to ensure consistent treatment of taxpayers.

**CORRECTIVE ACTION**

The Director, International Individual Compliance, LB&I Division, agrees with this recommendation. However, we have already taken actions to address the recommendation. We have two types of controls in place that are intended to ensure consistent treatment of taxpayers. First, the CWA Program provides CWA tax specialists with specific criteria for use in determining when and why a venue should be selected for a site visit. The CWA Program developed a standard Site Visit Request Form to ensure that the decision-making process is properly documented before the site visit request is made. The development of the Site Visit Request Form has clarified for the CWA tax specialists and their managers the criteria to use for determining site visits. The second type of control is a two-level managerial approval process

**IMPLEMENTATION DATE**

Completed August 1, 2011



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**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 4**

The Director, International Individual Compliance, LB&I Division, should conduct a study to determine if the current benefits realized by the CWA Program from the site visitations are worth the cost and the potential negative public perception appearances.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. All tax specialists in the CWA Program are now filing a standardized Site Visit Report that documents the benefits realized from the site visit and the expenses associated with the site visit. This standardized reporting will help us conduct the cost-benefit analysis. The CWA Program will establish a timeline of necessary actions to successfully accomplish the study.

**IMPLEMENTATION DATE**

September 30, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 5**

The Director, International Individual Compliance, LB&I Division, should establish IRM guidance for CWA managers to ensure effective oversight for the CWA Program.



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**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. Internal Revenue Manual (IRM) guidance will be established for CWA managers to ensure effective oversight for the CWA Program.

**IMPLEMENTATION DATE**

September 30, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 6**

The Director, International Individual Compliance, LB&I Division, include the CWA Program in the LB&I Quality Measurement System review process, to ensure cases are properly processed.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. The CWA Program will work with the LB&I Quality Measurement System (LQMS) Program Office to determine how to incorporate CWA cases into the LQMS Program to ensure that cases are properly processed.

**IMPLEMENTATION DATE**

September 30, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division



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**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 7**

The Director, International Individual Compliance, LB&I Division, should revise CWA tax specialist procedures to require the NRAs to have either a Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN) to receive a CWA.

**CORRECTIVE ACTION**

The Director, International Individual Compliance does not agree with this recommendation. Mandating the NRA have either an SSN or an ITIN would have the effect of prohibiting first-time performers from entering into a CWA. The IRS does not believe that tax administration would benefit by denying acceptance into the CWA Program of NRAs who are unable to obtain an SSN or ITIN. An NRA cannot apply for a SSN the first time the NRA is in the country unless the NRA has been in the United States (1) at least 10 days and (2) has 14 days remaining on the visa. On the other hand, an ITIN can not be obtained until the SSN application has been denied. An NRA who has previously visited the United States and requests an SSN on a subsequent visit often experiences difficulty obtaining a denial letter. Without the denial letter, the ITIN would not be issued.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 8**

The Director, International Individual Compliance, LB&I Division, should establish a standardized time period for accepting and processing all CWA applications to ensure that all applicants are treated fairly and consistently.



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**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. As stated in the TIGTA report, Revenue Procedure 1989-47 and the Application for CWA conflict on the time frame for filing the application. However, both allow for the application to be processed at the discretion of the IRS. The CWA Program will establish a standardized time period for accepting and processing all CWA applications to ensure that all applicants are treated fairly and consistently. After a standardized time period is established, the CWA Program will work with National Office Counsel to issue a revised Revenue Procedure to reflect this time period. In addition, the Application for CWA will be updated. The CWA Program will establish a timeline of necessary actions that incorporates expected outcomes and dates to successfully accomplish the corrective actions.

**IMPLEMENTATION DATE**

September 30, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 9**

The Director, International Individual Compliance, LB&I Division, should require CWA tax specialists to request an Electronic Federal Tax Payment System (EFTPS) deposit slip, or a similar electronic deposit confirmation for the Directed Withholding Letter (DWL) to help ensure the accuracy of deposits made by withholding agents.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees that this is a necessary procedural step. According to IRM 5.24.3.8, the CWA Program currently requires tax specialists to request an EFTPS deposit slip, or a similar electronic deposit confirmation for the DWLs. If TIGTA thinks further enhancements are required, the Director, International Individual Compliance welcomes further discussion.



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It should be noted that there is no legal requirement for a withholding agent under the CWA Program (as contemplated by IRC Section 1441) to provide documentation such as the EFTPS deposit slip or Form 13290, Directed Withholding and Deposit Verification, to the IRS.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 10**

The Director, International Individual Compliance, LB&I Division, should conduct a study to determine a way to improve the withholding agents' response rate to the DWLs with information regarding withholding.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. The CWA Program will conduct a study to determine whether it is possible to improve the withholding agents' response rate to the DWLs with information regarding withholding. The CWA Program will establish a timeline of necessary actions that incorporates expected outcomes and dates to successfully accomplish the study.

**IMPLEMENTATION DATE**

September 30, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.



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**RECOMMENDATION 11**

The Director, International Individual Compliance, LB&I Division, should evaluate the e-trak Non-Resident Filing System (when it becomes available) to see if access for CWA tax specialists will enable them to verify withholding deposits.

**CORRECTIVE ACTION**

The Director, International Individual Compliance agrees with this recommendation. At the time the e-trak Non-Resident Filing system becomes available, the CWA Program will work with the International Business Compliance foreign payments group to evaluate whether providing access to CWA Tax Specialists will enable them to verify withholding deposits.

**IMPLEMENTATION DATE**

September 30, 2012 – Subject to the availability of the e-trak Non-Resident Filing System; provided the system becomes available by March 31, 2012

**RESPONSIBLE OFFICIAL**

Director, International Individual Compliance, LB&I Division

**CORRECTIVE ACTION MONITORING PLAN**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I actions through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.