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IRS to Address Problem of Fraudulent Tax Refunds to Nonresident Aliens

In a report the Treasury Inspector General for Tax Administration (TIGTA) called on the IRS to improve its controls over the issuance of tax refunds to nonresident aliens so as to prevent making refunds in error. Once the erroneous refunds are repatriated out of the United States by nonresident aliens residing overseas, the chances of retrieving them are virtually nil.

The report highlighted the fact that such refunds in error could result in heavy losses to the government of the United States as the incidents of these inaccurate refunds is high.

TIGTA Inspector General J. Russell George said in his statement that the current problem would be significantly exacerbated if the IRS does not take concrete steps to address the situation by reviewing its controls. TIGTA has identified and highlighted to the IRS the weaknesses it found in the controls and the IRS is taking certain measures to overcome them.

According to tax law, nonresident aliens working and drawing income from US sources must declare them and file the US Nonresident Alien

Income Tax Return through Form 1040NR. This income is taxable subject to income tax withholding. The IRS records show that in 2009, approximately 598,000 Forms 1040NR for tax year 2008 was processed by the agency. The total taxes withheld on these returns came up to more than \$2.4 billion and refunds amounted to more than \$712 million.

The challenge for the IRS is to ensure that only eligible and genuine nonresident aliens receive their due refunds. Amidst the many fraudulent and inaccurate Forms 1040NR received, TIGTA discovered that the proper IRS control procedures for processing refund claims from these Forms 1040NR were lacking. As a result many of such fraudulent Forms 1040NRs went undetected. From here, TIGTA identified several control weaknesses in the processing of refunds claimed on Forms 1040NR. There were about 40 cases of questionable refunds issued to nonresident aliens in which the refunds were very high, amounting to more than \$2.3 million.

There were 6 recommendations made by TIGTA which the IRS agreed to in their entirety. They include the requirement that the commissioner of the IRS' Large and Midsize Business Division should use the foreign country codes on Forms 1040NR to systemically verify that the correct rate of tax is applied according to the applicable tax treaty. The commissioner should also work with the IRS' Forms and Publications function to clarify what constitutes income from US sources when it comes to multi-level marketing companies.