

**HEALTH CHECKS AND
REMEDATION –
PREPARING FOR AUDIT**

Executive Enterprises
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WASHINGTON • LOS ANGELES

Agenda

- ♦ What is a health check and why would you do one?
- ♦ How do you approach the task?
- ♦ Who needs to be involved?
- ♦ What should you review?
- ♦ Once you know your status – then what?

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What is a health check and why would you do one?

- ♦ Pre-audit defense measure
- ♦ Know your problems and issues before the IRS arrives
- ♦ FIX THEM while you have the time to do so

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How do you approach the task?

- ◆ Existing guidance – Industry Directive as a guide
 - Analyze the withholding system – default logic and withholding rules must be in place
 - Review account opening and document validation procedures – should be able to produce comprehensive procedures manual
 - Reconcile Form 1042 to Form 1042-S amounts
 - Review documentation for proper classification of payees
 - Understand the income types and implications
 - Review the Form 1042-S reporting

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Who needs to be involved?

- ◆ Senior management for support and policy issues
- ◆ Business operations units for data
- ◆ Tax reporting units, if separate from business operations
- ◆ Client relations personnel for client communications issues

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What should you review?

- ◆ Two categories of payments
 - Financial institution payments
 - Accounts Payable – vendor or miscellaneous payments

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Financial Institution Payments

- ♦ Review systems and processes for classifying customers (certified, uncertified, treaty eligible, not treaty eligible)
- ♦ Review process for obtaining, reviewing and "validating", retaining, and updating tax documentation

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Financial Institution Payments (cont)

- ♦ Review systems and processes for determining the appropriate rate of withholding – relationships between:
 - Securities classification system and processes
 - Income collection system
 - Corporate Actions systems and processes
 - Tax Withholding System
- ♦ Review process for depositing withheld taxes

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Vendor or Miscellaneous Payments

- ♦ Determine if you are making FDAP payments to foreigners (e.g., vendor payments, royalties, etc.)
- ♦ Determine if payments are U.S. source (subject to withholding) or foreign source (not subject)
- ♦ Determine if you have collected appropriate Forms W-8 and/or Forms 8233 from foreign vendors or other recipients receiving U.S. source payments
- ♦ Determine if the proper amount of withholding has occurred, or that no withholding is due
- ♦ Determine that Forms 1042 and 1042-S were filed

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Vendor Payments (cont)

- ◆ The most challenging issue is determining whether US sourced or not
 - Services – where performed
 - Royalties – where property used
 - Software – complex (§1.861-18)
 - Rents – location of property
- ◆ THEN decide whether or not you need Form W-8 (BEN, ECI) or Form 8233 (from individuals providing services in the U.S.)

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Once you know your status – then what?

- ◆ REMEDIATE, REMEDIATE, REMEDIATE
 - "Documentation failures" are generally curable
 - HOW?
 - Massive solicitation (with affidavits) or massive review of documentation, and solicit for all flawed?
 - "Substantive underwithholding" – attempt to recover from customers
- ◆ Evaluate pros and cons of voluntary submission
 - May get more reasonable approach to minor discrepancies

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