Treasury Inspector General for Tax Administration
Office of Audit

OPPORTUNITIES EXIST TO IDENTIFY MORE TAXPAYERS WHO UNDERREPORT RETIREMENT INCOME

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Highlights

Highlights of Report Number: 2012-30-011 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Due to the amount and volume of tax assessments made, the Automated Underreporter (AUR) Program is one of the IRS's more successful compliance programs in increasing taxpayer awareness and contributing to the reduction of the Tax Gap. Given the magnitude of underreporting, even small improvements in the IRS's examination of tax returns with retirement income could increase taxpayer compliance and generate substantial revenue to the Federal Government to reduce the Tax Gap.

WHY TIGTA DID THE AUDIT

In a Tax Gap study for Tax Year 2001, the IRS estimated that as much as $4.2 billion can be attributed to underreported retirement income. The overall objective of this review was to determine whether the IRS has effective controls and processes in place to ensure that taxpayers and retirement income providers are correctly computing and reporting the taxable portion of retirement income.

WHAT TIGTA FOUND

For Tax Years 2008 and 2009, the IRS Statistics of Income Program reported that taxpayers filed approximately 21 million tax returns with taxable Individual Retirement Arrangement (IRA) income totaling $293 billion and approximately 52.2 million tax returns with taxable pension income totaling $1 trillion.

TIGTA determined that the AUR Program is effectively determining the proper reporting of retirement income when Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, discloses the taxable amount of the retirement distribution. For example, for Tax Year 2007, AUR Program examiners made tax assessments totaling approximately $607.5 million on 217,811 tax returns. However, additional tax form information, if available, would improve compliance.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division: 1) revise the Form 1099-R to clarify the meaning of the *Taxable amount not determined* box in order to reduce taxpayer confusion and include the dates needed to identify retirement savings program distributions and transfers not rolled over within 60 days as required, and 2) establish procedures to transcribe additional lines from various tax forms.

The IRS substantially agreed with our recommendations and plans to revise the instructions to Form 1099-R to clarify taxpayer responsibilities and the amounts to report. The IRS plans to consider the feasibility and the benefits of including the dates of distributions and their respective contributions to identify distributions not rolled over within 60 days. However, TIGTA maintains this information would be useful to the AUR Program when taxpayers do not utilize direct transfers between financial institutions.

The IRS plans to conduct its own study to determine the benefit of transcribing additional lines from tax forms. TIGTA maintains that the cost to transcribe the forms would be nominal and would not increase taxpayer burden.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

http://www.treas.gov/tigta/auditreports/2012reports/201230011fr.pdf.