



*The Employee Plans Function Should
Continue Its Efforts to Obtain Needed
Retirement Plan Information*

September 20, 2011

Reference Number: 2011-10-108

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:

2(f) = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

THE EMPLOYEE PLANS FUNCTION SHOULD CONTINUE ITS EFFORTS TO OBTAIN NEEDED RETIREMENT PLAN INFORMATION

Highlights

Final Report issued on
September 20, 2011

Highlights of Reference Number: 2011-10-108 to the Acting Internal Revenue Service Commissioner for the Tax Exempt and Government Entities Division.

IMPACT ON TAXPAYERS

Beginning in January 2010, retirement plan sponsors were no longer required to report certain information on annual returns that are processed by the Department of Labor and provided to the Internal Revenue Service. The Employee Plans (EP) function's effectiveness will be reduced because it will no longer receive detailed information on the operational and financial activities of plans, which was used to identify the characteristics of noncompliant plans for examination. Focusing on those plans most likely to be noncompliant is important because bringing plans back into compliance through examinations provides plan participants with greater assurance that promised benefits will be available upon retirement.

WHY TIGTA DID THE AUDIT

TIGTA initiated this audit because EP function personnel expressed concerns that the lack of previously available information was affecting the EP function's ability to achieve its tax administration responsibilities. The overall objective of this review was to determine whether the EP function's ability to achieve its tax administration responsibilities has been significantly affected by a reduction of previously available information from employer-sponsored retirement plans annual return filings.

WHAT TIGTA FOUND

Through discussions with EP function personnel, TIGTA determined that information no longer

required to be filed was used by the EP function to help identify abusive transactions, identify funding or minimum coverage requirements issues, and conduct special projects to identify potentially noncompliant retirement plans. While it is too early to tell the full impact on the EP function, it is clear through discussions with EP function personnel that the lack of this information will have an impact on the EP function's ability to effectively focus on specific indicators of noncompliance when selecting retirement plans for examination.

As TIGTA's audit work concluded, the EP function was taking actions to mandate electronic filing of its returns and schedules, which could allow the EP function to pursue obtaining additional retirement plan information as part of annual returns. However, EP function officials are concerned that it may take a long time before additional information is required to be filed due to differences in the regulatory approval processes between the Internal Revenue Service and the Department of Labor.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, EP, Tax Exempt and Government Entities Division, 1) continue to evaluate the information the EP function needs, while exploring its regulatory and legislative options for the mandatory electronic filings of annual returns from employer-sponsored retirement plans, and 2) coordinate with the Department of Labor on the development of a timetable for implementing changes to the annual return filings to obtain the information to meet its tax administration responsibilities.

In response to the report, IRS officials agreed with the recommendations. They plan to annually evaluate their needs from annual filings, continue to work with the Tax Exempt and Government Entities Counsel and the Office of Benefits Tax Counsel to explore legislative options for mandatory electronic filing of annual returns, and work with the Department of Labor to develop a timetable for implementing periodic changes to the content of annual returns.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 20, 2011

MEMORANDUM FOR ACTING COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Nancy A. Nakamura

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Employee Plans Function Should Continue
Its Efforts to Obtain Needed Retirement Plan Information
(Audit # 201110018)

This report presents the results of our review to determine whether the Employee Plans function's ability to achieve its tax administration responsibilities has been significantly affected by a reduction of previously available information from employer-sponsored retirement plans annual return filings. This review is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

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

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 Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

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The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Abbreviations

DOL	Department of Labor
EFAST	ERISA Filing Acceptance System
EP	Employee Plans
IRS	Internal Revenue Service



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Background

There are more than 867,000 employer-sponsored retirement plans (hereafter referred to as plans) filing Form 5500 series returns¹ (hereafter referred to as annual returns) with assets totaling approximately \$5.3 trillion. The Employee Retirement Income Security Act of 1974² sets uniform standards to ensure plans are established and maintained in a fair and financially sound manner. Under the Employee Retirement Income Security Act, jurisdiction over plans is divided among three Government agencies: the Department of Labor (DOL), the Pension Benefit Guaranty Corporation, and the Internal Revenue Service (IRS). The IRS enforces the standards that relate to such matters as how employees become eligible to participate in plans; how they become eligible to earn rights to benefits; and how much, at a minimum, employers must contribute. Within the IRS, the Employee Plans (EP) function is responsible for ensuring plan sponsors comply with applicable statutes and regulations designed to ensure employees receive promised benefits. The EP function accomplishes this by helping customers understand and comply with applicable tax laws and protecting the public interest by applying the tax law with integrity and fairness to all.

The primary source of information regarding the operations, funding, and investments of plans are the annual returns. The annual returns include plan identifying information, assets and liabilities of the plan, insurance, and key financial transactions that assist in identifying actual or potential violations of the Employee Retirement Income Security Act and the Internal Revenue Code.

Figure 1: Top of the Annual Return/Report of Employee Benefit Plan (Form 5500) Showing the Three Government Agencies Responsible for Compliance With the Employee Retirement Income Security Act and the Internal Revenue Code

<p>Form 5500</p> <p>Department of the Treasury Internal Revenue Service</p> <hr/> <p>Department of Labor Employee Benefits Security Administration</p> <hr/> <p>Pension Benefit Guaranty Corporation</p>	<p>Annual Return/Report of Employee Benefit Plan</p> <p>This form is required to be filed for employee benefit plans under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 (ERISA) and sections 6047(e), and 6058(a) of the Internal Revenue Code (the Code).</p> <p>▶ Complete all entries in accordance with the instructions to the Form 5500.</p>	<p>OMB Nos. 1210-0110 1210-0089</p> <hr/> <p>2010</p> <hr/> <p>This Form is Open to Public Inspection</p>
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Source: Form 5500.

¹ This includes Annual Return/Report of Employee Benefit Plan (Form 5500), Short Form Annual Return/Report of Small Employee Benefit Plan (Form 5500-SF), Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan (Form 5500-EZ), and related schedules.

² Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5 U.S.C., 18 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.).



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

In Plan Year³ 1999, the DOL assumed the administrative responsibilities for accepting and processing paper and electronic annual returns through the ERISA⁴ Filing Acceptance System (EFAST). Once it completes processing the annual returns, the DOL provides annual return information to the IRS to meet its statutory requirements.

In June 2005, the Government Accountability Office reported⁵ that paper-based EFAST processing took three times longer to process with twice as many errors than electronically processed returns. This resulted in a substantial delay before the information was available for compliance and law enforcement activities. As a result, the Government Accountability Office recommended the DOL, the Pension Benefit Guarantee Corporation, and the IRS implement an electronic processing system and mandate the electronic filing of annual returns. While the IRS initially agreed with the report, it later determined it needed to publish regulations to mandate the electronic filing of information needed to enforce the Internal Revenue Code. IRS officials stated that they agreed to forego requiring certain IRS information to be filed through the DOL⁶ temporarily until it could take steps to mandate electronic filing. A detailed list of the information no longer required to be filed on annual returns is shown in Appendix IV.

Beginning in January 2010, the DOL began using a new system called the EFAST 2 to electronically process filed returns specifically required under the Employee Retirement Income Security Act. Figure 2 shows the EFAST 2 login screen for electronically filed annual returns.

Figure 2: EFAST 2 Login Screen

ERISA Filing - Login

Enter your User ID and Password to log into the EFAST2 System.

User ID:
Password:

[Forgot User ID](#) [Forgot Password](#)

Users must register to:

- Start and Complete ERISA filings through the EFAST2 system
- Review and update ERISA filings
- Sign ERISA filings

[Register Now](#)

Source: DOL web site.

³ A plan year is a calendar year, or an alternative 12-month period, a retirement plan uses for plan administration. However, the plan year can be shorter in certain circumstances (e.g., the first year a plan is in operation).

⁴ ERISA – Employee Retirement Income Security Act.

⁵ *Private Pensions: Government Actions Could Improve the Timeliness and Content of Form 5500 Pension Information* (GAO-05-491, dated June 2005).

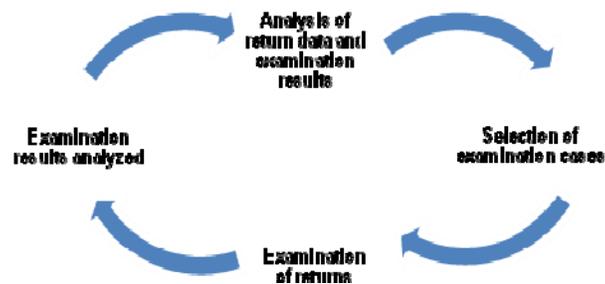
⁶ For purposes of this report, information no longer required to be filed is defined as IRS annual return filing information subject to the filing requirement under the Internal Revenue Code, but not subject to the filing requirements under the Employee Retirement Income Security Act.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

We initiated this audit because EP function personnel expressed concerns that the lack of previously available information was affecting the EP function's ability to meet its tax administration responsibilities. The IRS uses the information from annual returns for both compliance and research activities. In general, the EP function analyzes annual return data to look for characteristics that might indicate that a plan is not operating in accordance with tax-exempt qualification provisions and within the terms of the plan document. The IRS then selects plans for examination and field examiners work with plan sponsors to ensure plan sponsors are making contributions to the plan as required, assets truly exist to satisfy liabilities and are properly classified, and plans are operating in accordance with plan design. Once examinations are complete, the EP function analyzes the results of examinations for noncompliance characteristics that will help select additional plans for examinations that have the most potential for being noncompliant. Figure 3 provides an overview of the EP function's examination process and how information from annual returns is used in this process.

Figure 3: EP Function Examination Process



Source: Treasury Inspector General for Tax Administration depiction of the EP function examination process.

Bringing plans back into compliance through examinations and other methods is important because it provides plan participants with greater assurance that promised benefits will be available upon retirement.

This audit was being conducted while changes were being considered by the EP function regarding potential electronic filing of IRS annual return information. Any changes that have occurred since we concluded our interviews in May 2011 are not reflected in this report. As a result, this report may not reflect the current status of the EP function's information needs.

This review was performed at the Tax Exempt and Government Entities Division EP Examination function in Baltimore, Maryland, and Washington, D.C., during the period November 2010 through May 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.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Results of Review

Through discussions with EP function personnel, we determined that information no longer required to be filed was used by the EP function to help identify abusive transactions, identify funding or minimum coverage requirements issues, conduct special projects to identify potentially noncompliant retirement plans, and populate risk models.⁷ While it is too early to tell the full impact on the EP function, it is clear through discussions with EP function personnel that the lack of this information will have an impact on the EP function's ability to effectively focus on specific indicators of noncompliance when selecting retirement plans for examination. Without sufficient information to select potentially noncompliant retirement plans, the IRS may select more compliant plans, which increases burden on the plans and results in inefficient use of EP function resources by conducting unnecessary examinations. The ability to identify and focus on potentially noncompliant plans is important because bringing these plans into compliance provides plan participants with greater assurance that promised benefits will be available upon retirement.

As our audit work concluded, the EP function was taking actions to begin drafting regulations that would allow the IRS to mandate electronic filing of its returns and schedules. If electronic filing of IRS returns and schedules is mandated, the IRS could begin receiving additional information electronically and could pursue obtaining additional retirement plan information, such as the information that is no longer required to be filed. Therefore, the EP function has a key opportunity to reassess its data needs and determine whether previously available and/or new information is needed to meet its tax administration responsibilities. This is a critical assessment because of the potential impact on all retirement plans and the increased cost of processing IRS returns and schedules through the EFAST 2. However, IRS officials are concerned that it may take a long time before additional information is required to be filed due to differences in the regulatory approval processes used by the DOL and the IRS. In the interim, the IRS may not have the information it needs to effectively focus on potentially noncompliant retirement plans when selecting plans for examination.

The Impact of No Longer Obtaining Return Information for Retirement Plans Cannot Be Quantified; However, Taxpayer Burden May Increase Without This Information

The ability of the EP function to effectively select retirement plans for examination is essential to achieving its core mission of protecting plan assets and participants' benefits through a fair,

⁷ The EP function's risk modeling program analyzes noncompliance issues identified during examinations and uses this information to better select potentially noncompliant plans for future examinations.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

objective, and effective compliance program. The selection process should allow EP function personnel to analyze annual return information to determine what compliance issues should be addressed and to identify and focus its examination cases on plans most likely to have noncompliance issues. Also, this process should provide information to grade examination cases⁸ to ensure they are assigned to the field examiners with the required expertise and knowledge level to work issues related to the cases.

The ability to effectively identify retirement plans that are noncompliant will be affected by the lack of return information

We could not quantify the full impact of the inability to effectively identify potential noncompliance because the annual returns with less information initially filed through the EFAST 2 are just beginning to enter the EP function examination process. However, EP function personnel provided logical explanations on how the lack of information will reduce their overall effectiveness to identify and take law enforcement actions against noncompliant retirement plans.

The EP function's effectiveness will be reduced because it will no longer receive detailed information on the operational and financial activities of plans. This detailed information is used to identify the characteristics of noncompliant plans for examination. Without this information, the EP function is more likely to select and perform examinations on compliant plans, which is a less efficient use of the EP function's limited resources and increases the burden on compliant retirement plans that may not have been selected for examination if the information from these plans were readily available.

The EP function uses return information at various points in the examination cycle (see Figure 3) to ensure plan sponsors are complying with the applicable statutes and regulations. The following is a synopsis of how the individual EP function programs used the line-item information that is no longer required to be filed:

- **Abusive Transactions:** The EP function used annual return information to identify plan sponsors that promote abusive transactions and identify unusual plan assets or investment arrangements. Without the information, the effectiveness of the EP function's compliance efforts will be reduced because it will be

According to EP function personnel, some plan sponsors are no longer required to file information the EP function once used to identify potentially abusive transactions.

⁸ Grading examination cases is a process where the EP function reviews examination cases and determines the grade level (required expertise and knowledge) needed to work the cases.



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difficult to evaluate the nature and scope of the abuse or potential areas of noncompliance and identify emerging issues.⁹

- **Examination Case Grading:** The EP function analyzed annual return information to assign cases to examiners with the required expertise and knowledge to conduct the examination. Without previously available information, examination cases may not be assigned to examiners with the required expertise and knowledge. As a result, examiners may close cases without identifying and working with plan sponsors to correct noncompliance with tax laws. At the same time, cases with simpler issues assigned to overqualified examiners will result in an inefficient use of EP function resources if they could had been working cases with more difficult issues.
- **Minimum Coverage Issues:** This information is used to determine whether employees that qualify for retirement benefits are properly included. The lack of information makes it difficult to effectively determine whether a business owner is circumventing statutory minimum coverage requirements. *****2(f)*****
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- **Compliance Issues:** Program models score line-item information from annual return filings to identify retirement plans with the greatest audit potential for examination and identify issues that need to be examined for potential noncompliance. Without annual return information, the EP function will be unable to effectively research annual return line items to identify retirement plans that are not compliant, identify new areas of noncompliance, and facilitate noncompliance risk assessment strategies. For example, EP function officials stated that certain current examination projects that identified high rates of noncompliance cannot be replicated in the future due to the loss of certain annual return information.

A detailed list showing the objective of each EP function program and how the lack of information previously available to it affects its ability to achieve its tax administration responsibilities is presented in Appendix V.

In the future, the lack of information may also negate improvements the EP function has made to identify areas of noncompliance. A recently issued Treasury Inspector General for Tax

⁹ Emerging compliance issues can include unusual assets or investments by plans and invalid collective bargaining arrangements.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Administration report¹⁰ noted the EP function's methods for selecting examinations have evolved over the years and examinations are now identifying a larger percentage of retirement plans that are noncompliant. The improvements ensured the EP function's resources were being used more efficiently and reduced the burden on plan sponsors and administrators by focusing on plans that were most likely to be noncompliant. However, these improvements can potentially be negated because some annual return information is no longer available, which may prevent the EP function from effectively selecting noncompliant retirement plans for examinations. For example, an EP function official stated that the EP function could still examine statistically valid samples of annual returns to ensure plans were compliant; however, this sample would likely include both compliant and noncompliant plans. In addition, examinations of the noncompliant plans may not start with any pre-identified issues to focus on during the examination which could cause examinations to take longer.

The EP function must continue its efforts to obtain information needed to select retirement plans most likely to be noncompliant

While the EP function lacks the data to fully quantify the impact that the lack of information is having on its ability to efficiently meet its tax administration responsibilities, logical explanations were provided to explain why it is more difficult to identify potentially noncompliant retirement plans with less annual return information. With less information being filed, the EP function has explored alternative methods for meeting its tax administration responsibilities regarding retirement plans. For example, EP function personnel have located information by researching web sites, used historical return data (which eventually will become outdated and less useful), and developed new types of risk models. These methods are useful as an interim solution, but the EP function believes they are not sufficient for meeting the EP function's long-term tax administration responsibilities because they provide only general information and not the detailed line-item return information needed to identify the operational and financial activities of retirement plans. According to EP function personnel, detailed line-item information is necessary to effectively identify individual noncompliant plans for examinations.

In addition to using other methods to collect data on retirement plans, the EP function has also been actively working on potentially mandating electronic filing of IRS information under the Internal Revenue Code. A group comprised of officials from the EP function's Rulings and Agreements office and the IRS Office of Chief Counsel, as well as executives from the Department of the

As part of its study of potentially mandating electronic filing, the IRS will need to work with the DOL to obtain the information it needs to meet its tax administration responsibilities.

¹⁰ *The Employee Plans Function Has Improved the Process for Selecting Retirement Plans for Examination* (Reference Number 2011-10-050, dated May 10, 2011).



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Treasury, approved a project to obtain explicit authority to mandate electronic filing of IRS returns and schedules under the Internal Revenue Code.

As our audit work concluded, this project team was in the process of identifying the scope, issues, and content necessary to begin actual drafting of the regulation that will allow the IRS to mandate electronic filing of its returns and schedules. If electronic filing of IRS returns and schedules is mandated, the IRS could begin receiving additional information electronically and could pursue obtaining additional retirement plan information, such as the information it previously received prior to the implementation of the EFAST 2.

While the actions being taken to mandate electronic filing sound promising, there are a couple of potential risks that must be considered. One risk is that the IRS may not be successful in obtaining the explicit authority to mandate electronic filing. If that is the case, the EP function should continue to explore alternative methods for receiving needed information. In addition, IRS officials informed us that even if they know what information they would like added to the annual return, it may take time for any changes to come about. According to IRS officials, the IRS and the DOL have different regulatory processes in meeting their respective statutory requirements, which could result in delays.¹¹ They further indicated that the IRS agreed to temporarily allow certain data not to be filed as part of the annual return with the understanding that the IRS would be able to make changes to all versions of the Form 5500 series of returns in Fiscal Year 2011; however, the proposed changes have been delayed until at least Fiscal Year 2013. As our audit work ended, IRS officials were not sure when the next window of time would be available for making changes to annual return requirements.

Recommendations

As part of the IRS's exploration to potentially mandate the electronic filing of annual return information covered specifically under the Internal Revenue Code, the Director, EP, Tax Exempt and Government Entities Division, should:

Recommendation 1: Continue to evaluate the information the EP function needs to receive on the annual return filings for employer-sponsored retirement plans to meet its tax administration responsibilities by ensuring that the benefits of obtaining the information generally outweigh the cost and any burden imposed on plan sponsors and administrators. To assure that the EP function meets its tax administration responsibilities, it should also continue to explore regulatory and legislative options for mandatory electronic filings of annual returns from employer-sponsored retirement plans.

Management's Response: The IRS agreed with this recommendation. To continue to evaluate the EP function's information needs, the EP function will:

¹¹ In addition, significant revisions will require the two agencies to renegotiate the interagency agreement and the EFAST 2 will need to be changed to capture the new information.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

- Annually evaluate the information it needs from annual filings to meet its tax administration responsibilities for employer-sponsored retirement plans. In doing so, the EP function will ensure that the benefits of this information outweigh the cost and burden on plan sponsors and administrators.
- Continue to work with the Tax Exempt and Government Entities Council to explore regulatory options for mandatory electronic filing of annual returns.
- Continue to work with the Department of the Treasury Office of Benefits Tax Counsel to explore legislative options for mandatory electronic filing of annual returns.

Recommendation 2: Coordinate with the DOL on the development of a timetable for implementing changes to the annual return filings to obtain information needed to meet the tax administration responsibilities of the EP function.

Management's Response: The IRS agreed with this recommendation. The EP function and the Tax Exempt and Government Entities Division Business Systems Planning office will work with the DOL to develop a timetable for implementing periodic changes to the content of the annual return to obtain information needed by the EP function.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the EP function's ability to achieve its tax administration responsibilities has been significantly affected by a reduction of previously available information from employer-sponsored retirement plans annual return filings. To accomplish this objective, we:

- I. Determined what information is no longer required on the revised Form 5500 series of returns¹ and transmitted to the IRS by the new EFAST 2.
 - A. Compared Plan Year² 2008 Forms 5500 and related schedules to Plan Years 2009 and 2010 forms and schedules, developed for use after implementation of the EFAST 2, to determine what information is no longer required.
 - B. Compared the prior EP function's Returns Inventory and Classification System³ database record layout with the information the DOL is currently providing to the EP function to determine the differences. We confirmed the previously available information by reviewing EP function reports and interviewing EP function Classification and Examination program personnel.
 - C. Interviewed EP function personnel involved in the Form 5500 revision process to determine the causes or reasons for the loss of previously available information.
- II. Determined what impact the loss of previously available Form 5500 information has on the EP function's ability to accomplish its tax administration responsibilities.
 - A. Interviewed EP function Classification and Examination program personnel to determine their concerns and issues.
 - B. Interviewed EP function Classification and Examination program personnel to determine how they can accomplish their tax administration responsibilities without the previously available information.

¹ This includes Annual Return/Report of Employee Benefit Plan (Form 5500), Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan (Form 5500-EZ), and related schedules.

² A plan year is a calendar year, or an alternative 12-month period, a retirement plan uses for plan administration. However, the plan year can be shorter in certain circumstances (e.g., the first year a plan is in operation).

³ The Returns Inventory and Classification System provides users access to information related to the filing and processing of forms for the Tax Exempt and Government Entities Division, which includes the EP function.



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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 process used to select and classify cases for examination from IRS returns and schedules that were no longer required to be filed and the process used to identify and implement alternatives to obtain previously available information. We evaluated these controls by performing general tests to determine what information is no longer received since the DOL began electronically processing through the EFAST 2, what impact the information that is no longer required would have on the EP function's ability to achieve its tax administration responsibilities, and what alternatives are used or may exist to meet the EP function program's informational needs.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Appendix II

Major Contributors to This Report

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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
Acting Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Employee Plans, Tax Exempt and Government Entities Division SE:T:EP
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
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Division SE:T:CL



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Appendix IV

Information No Longer Received on Annual Returns

Prior to January 2010, the DOL manually processed IRS paper returns and schedules. Beginning in January 2010, plans subject to filing requirements under the Employee Retirement Income Security Act of 1974,¹ but not the Internal Revenue Code, were required to file an electronic return. Because the EP function did not issue regulations to mandate electronic filing under the Internal Revenue Code and the DOL accepts electronically filed returns only under the EFAST 2, the EP function agreed that it would no longer require certain IRS information to be filed through the DOL. This appendix shows a detailed list of the previously available IRS information from annual returns.

Beginning in January 2010, the DOL also began accepting a Short Form Annual Return/Report of Employee Benefit Plan (Form 5500-SF). The Form 5500-SF was designed as an alternative for selected retirement plans who met specific filing requirements instead of the longer Annual Return/Report of Employee Benefit Plan (Form 5500). However, because our audit only included analysis of information on forms that were required to be filed before January 2010, the Form 5500-SF was not considered to be within the scope of our audit.

Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan (Form 5500-EZ)

This return is used by retirement plans that are not subject to the requirements of the Employee Retirement Income Security Act, but are subject to IRS filing requirements. Because the EFAST 2 accepts only electronically filed returns, the IRS regained the responsibility for manually processing paper Forms 5500-EZ that capture less information. While the EP function has the authority over what information can be captured on the Form 5500-EZ, the IRS wanted to allow retirement plan sponsors the option to either file electronically using the Form 5500-SF or manually using the Form 5500-EZ. To ensure the plan sponsors have this option, the EP function ensured the same questions that were on the Form 5500-EZ were incorporated on the Form 5500-SF. As a result, the EP function is missing 39 lines of information from this return that were previously captured before the electronic-filing mandate.² Figure 1 shows the previously available line-item information no longer being received.

¹ Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5 U.S.C., 18 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.).

² During the same time period, a new Form 5500-SF was developed which allowed plans with up to 100 participants to file a smaller amount of information than previously required on the Form 5500. IRS officials noted that this change resulted in much less information being provided by plans with a small number of participants.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Figure 1: Form 5500-EZ Information No Longer Required to Be Filed

Line Number(s)	Description of Previously Required Information
5	Name and address showing who prepared the return.
6a – 6f	The type of plan filing the Form 5500-EZ.
7a	Opinion/notification letter number if the plan is a master/prototype or a regional prototype plan.
7b	Type of participants covered by the plan (e.g., self-employed individuals, partners in a partnership).
8a	Number of qualified benefit plans maintained by the employer.
8b	Checkmark indicating there is more than 1 plan and total assets of all plans exceed \$250,000.
9a – c	The number of plan participants by age category.
10a	Is this a plan funded entirely by insurance or annuity contract?
10b	Cash contributions received by the plan during the plan year.
10c	Noncash contributions received by the plan during the plan year.
10d	Total plan distributions to plan participants or beneficiaries.
10e	Total nontaxable distributions to plan participants or beneficiaries.
10f	Transfers to other plans.
10g	Amounts received by plans other than contributions.
10h	Expenses incurred by the plan other than distributions.
10i	Is this a defined benefit plan subject to minimum funding requirements?
12a	Current value of plan assets of partnership/joint venture interests.
12b	Current value of employer real property assets.
12c	Current value of real estate held other than employer real property.
12d	Current value of employer securities.
12f	Current value of loans other than to plan participants.
12g	Current value of tangible personal property.
13a	Amount of any sales, exchanges, or lease of property transactions.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Line Number(s)	Description of Previously Required Information
13b	Amount of any payments for services.
13c	Amount of any acquisitions or holding of employer securities.
13d	Amount of any loans or extension of credits.
14a	Are there employees other than the owner/partners and spouses?
14b	Number of employees including owner, partners, and their spouses.
14c	Does the plan meet coverage requirements?
15a	Did the plan distribute any annuity contracts during the plan year?
15b	Did the plan make distributions to a married plan participant in a form other than a qualified joint and survivor annuity or were there distributions made on account of the death of a married plan participant to beneficiaries other than the spouse of the plan participant?
15c	Were there any loans to married plan participants during the plan year?

Source: Treasury Inspector General for Tax Administration comparison of Plan Year 2008 Form 5500-EZ to information available through the EFAST 2 in Plan Years 2009 and 2010.

ESOP³ Annual Information (Form 5500 Schedule E)

Schedule E was used to satisfy IRS reporting requirements for employee stock ownership plans. Every employee stock ownership plan or plan administrator of a plan that contained an employee stock ownership plan was required to file this schedule. Because this schedule is no longer required to be filed, the EP function no longer receives 32 lines of information that were captured prior to the electronic filing mandate. Figure 2 shows the previously available line-item information no longer being received.

³ ESOP – Employee Stock Ownership Plan. An employee stock ownership plan is an employee benefit plan that makes its employees owners of stock in that company.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Figure 2: Schedule E Information No Longer Required to Be Filed

Line Number(s)	Description of Previously Required Information
1a	Is the employee stock ownership plan maintained by S corporation?
1b	Were prohibited allocations of securities in an S corporation made to any disqualified persons?
2a	Did the employee stock ownership plan have any outstanding securities acquisition loans during the plan year?
2b	Did the employee stock ownership plan pay out dividends on employer's stock?
3	What is the value of employee stock ownership plan assets?
4	Under what formula is the preferred stock convertible into common stock?
5a – c	If unallocated employer securities were released from a loan suspense account, indicate what type of method was used: principal and interest, principal, or other?
7b – c	If a loan is part of a "back to back" loan, are the two loans similar, and do they have the same amortization schedule?
8	Is this an immediate allocation loan?
9a	Date of the securities acquisition loan.
9b	After the acquisition of the employer securities with the loan proceeds, did the employee stock ownership plan own more than 50 percent of each class of outstanding stock of the employer corporation or the total value of all outstanding stock of the corporation?
9c	If line 9b is "No," does the securities acquisition loan satisfy transition rules or a specific exception?
9d	If line 9c is "No," enter name and address of payee to whom interest with respect to securities acquisition loan was paid.
10	Amount of interest paid on securities acquisition loan.
11a	Were any securities disposed of within 3 years of acquiring certain securities in a taxable event?
11b	If line 11a is "Yes," does one or more of the exceptions apply to all dispositions of employer securities?



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Line Number(s)	Description of Previously Required Information
12a	Were any of the employee stock ownership plan's securities acquisition loans refinanced during the reporting period?
12b	If line 12a is "Yes," does the refinancing meet the requirements of the Small Business Job Protection Act of 1996? ⁴
13a – b	Do the amounts of dividends paid exceed the employer's current or accumulated earnings and profits and was it under applicable State law?
14	If dividends deducted were used to repay an exempt loan, were any dividends used to repay the loan generated by securities that were not acquired with the proceeds of the loan being repaid?
15	If line 14 is "Yes," were the dividends paid with respect to employer securities that satisfy transition rules?
16	Did the employer make payments in redemption of stock held by employee stock ownership plan participants and deduct them?
17a	Were dividends subject to an election by plan participants or beneficiaries to reinvest the dividends in employer securities?
17b	Did the election on line 17a comply with certain requirements?
17c	Are dividends reinvested in employer securities pursuant to the election fully vested?
18a-c	Class of stock, dividend rates, and dividends used to repay exempt loans.

Source: Treasury Inspector General for Tax Administration comparison of Plan Year 2008 Form 5500 Schedule E to information available through the EFAST 2 in Plan Years 2009 and 2010.

Annual Return of Fiduciary of Employee Benefit Trust (Form 5500 Schedule P)

Trustees had the option to file this IRS schedule to satisfy the requirements for an annual information return from every Section 401(a) organization⁵ exempt from tax. During the revision process to prepare the annual returns for electronic processing, EP function management decided to eliminate this schedule. However, the eight lines from this schedule assisted EP function personnel in identifying the trustee, whether the trustee is different from the employer, and several types of abuse. Figure 3 shows the previously available line-item information no longer being received.

⁴ Pub.L. No. 104-188, 110 Stat. 1755 (1996).

⁵ A 401(a) organization is a trust created or organized in the United States and forms part of a stock bonus, pension, or profit-sharing plan of an employer.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Figure 3: Schedule P Information No Longer Required to Be Filed

Line Number(s)	Description of Previously Required Information
1a	Name of the plan trustee or custodian.
1b – c	Address of the plan trustee or custodian.
2a	Name of the trust.
2b	Trust’s employer identification number.
3	Name of the plan if different from the name of the trust.
4	Has the trustee or custodian furnished the participating employee plan(s) with the trust financial information required to be reported by the plan(s)?
5	Plan sponsor’s employee identification number on Form 5500 or Form 5500-EZ.

Source: Treasury Inspector General for Tax Administration comparison of Plan Year 2005 Form 5500 Schedule P to information available through the EFAST 2 in Plan Years 2009 and 2010.

Qualified Pension Plan Coverage Information (Form 5500 Schedule T)

This IRS schedule was filed if a plan was maintained by 1) more than one employer and it benefits employees who are not collectively bargained employees or 2) an employer that operates a qualified separate line of business. Schedule T was eliminated prior to the migration to electronic processing. However, EP function personnel contend the information was useful to identify discriminatory plans⁶ and to determine if the statutory requirement level of participation for qualified plans was met. Figure 4 shows the previously available line-item information no longer being received.

⁶ A discriminatory plan is a plan that has not met the statutory requirements for the level of participation to all employees who have met the eligibility requirements, such as length of employment.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Figure 4: Schedule T Information No Longer Required to Be Filed

Line Number(s)	Description of Previously Required Information
1a – b	Name and identification number of employer.
2a	Number of qualified separate lines of business the employer operates.
2b	Number of employees in separate lines of businesses.
2c	Did the employer apply minimum coverage requirements on an employer-wide rather than on a qualified separate line of business basis?
2d	If the entry on line 2b is two or more and line 2c is “No,” identify the qualified separate lines of business to which the coverage information is given.
3a – e	Description of the employer’s plan (more than one line may apply): a) employs only highly compensated employees, b) no highly compensated employees benefited under the plan, c) benefits only collectively bargained employees, d) benefits all nonexcludable non-highly compensated employees, and e) plan treated as satisfying minimum coverage requirements.
4	Date the plan year began for which coverage data are being submitted.
4a	Did leased employees perform services for the employer during the plan year?
4b	Does the employer aggregate plans in testing whether the plan satisfies coverage and nondiscrimination tests?
4c – d	Total excludable and nonexcludable employees and the plan’s ratio using information from line 4c.
4e – f	Any disaggregated part of the plan and type of coverage requirements met.

Source: Treasury Inspector General for Tax Administration comparison of Plan Year 2004 Form 5500 Schedule T to information available through the EFAST 2 in Plan Years 2009 and 2010.



Appendix V

Impact of the Lack of Previously Required Information on Employee Plans Function Programs

The lack of previously captured information from the Form 5500 series returns and schedules¹ affects many programs within the EP function. However, each EP function program is affected differently, both by degree and type of impact. Figure 1 summarizes EP function personnel statements showing program objectives and how the lack of previously required information affects EP function programs.

Figure 1: EP Function Personnel Concerns Regarding the Impact of the Lack of Previously Required Information on EP Function Programs

EP Function Programs	Objective(s) for the Program	Impact on Program Because Certain Form 5500 Information Is No Longer Required
Promoter Investigations	<ol style="list-style-type: none"> 1. Identifies abusive transactions and the promoters of those transactions. 2. Takes law enforcement action against promoters of abusive transactions. 	<ol style="list-style-type: none"> 1. Decreased compliance. The EP function's ability to effectively evaluate the nature and scope of the abuse will be reduced.
Abusive Tax Avoidance Transactions	<ol style="list-style-type: none"> 1. Identifies abusive transactions relating to unusual plan assets or investments and invalid collective bargaining arrangements. 	<ol style="list-style-type: none"> 1. Decreased compliance by making it more difficult to identify abusive tax avoidance transactions that are surfacing.

¹ This includes Annual Return/Report of Employee Benefit Plan (Form 5500), Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan (Form 5500-EZ), and related schedules.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

EP Function Programs	Objective(s) for the Program	Impact on Program Because Certain Form 5500 Information Is No Longer Required
Investigative Workstations	1. Identifies unique audit risks associated with electronic commerce that has changed the business practices and compliance behavior of retirement plans allowing them to engage in a variety of global transactions.	1. Decreased compliance from reduced ability to identify abuse or potential areas of noncompliance.
EP Risk Model	1. Focuses EP function's efforts on returns with the greatest audit potential for identifying noncompliance.	1. Increased burden placed on compliant retirement plans that may not have been selected for examinations if additional annual return information were available. 2. Inefficient use of resources to effectively identify noncompliant retirement plans and compliance issues.
Small Business Plans	1. Performs projects to address compliance issues related to retirement plans.	1. Decreased compliance by making it difficult to focus examinations on noncompliant retirement plans. 2. Inefficient use of resources by performing more examinations on compliant retirement plans.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

EP Function Programs	Objective(s) for the Program	Impact on Program Because Certain Form 5500 Information Is No Longer Required
EP Compliance Unit	<ol style="list-style-type: none"> 1. Identifies and evaluates noncompliance issues. 2. Identifies the characteristic(s) of noncompliant retirement plans associated with a compliance issue to identify examination cases. 	<ol style="list-style-type: none"> 1. Increased burden placed on compliant retirement plans by subjecting them to needless examinations. 2. Less efficient use of resources to identify noncompliant retirement plans for examination.
Classification Unit	<ol style="list-style-type: none"> 1. Receives orders from field examiners requesting copies of Forms 5500. Classifiers perform research to identify retirement plans with the compliance issue. 2. Grades examination cases for assignment to field examiners with the required expertise and knowledge level to work the cases. 	<ol style="list-style-type: none"> 1. Less efficient use of resources resulting from less information making it difficult to identify noncompliant retirement plans. 2. Decreased compliance with plan laws when field examiners close examination cases above their level of expertise and knowledge without the necessary changes.

Source: Treasury Inspector General for Tax Administration interviews with various EP function personnel.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Received
08/30/2011

AUG 29 2011

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph H. Grant, Acting Commissioner
Tax Exempt and Government Entities Division *Joseph H. Grant*

SUBJECT: "The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information"
Audit # 201110018)

I appreciate your work on the introduction in 2010 of the EFAST2 system. While this new electronic filing system has many advantages for the IRS, our ERISA partners the Department of Labor and the Pension Benefit Guaranty Corporation, and the Employee Plans community, it has nonetheless affected the compliance work of the Tax Exempt and Government Entities Division's Employee Plans function. Your report identifies information which we received when the processing of Form 5500 series returns was paper based but which we no longer receive under EFAST2's electronic processing regime. As you point out, the IRS lacks the authority, at present, to require all plans to file their annual returns electronically. This is the principal obstacle to receiving all the compliance information we formerly received. It is also one of the obstacles to obtaining new categories of information.

Your report reinforces the need for us to continue to search for ways to gather and make use of all categories of compliance information. I agree with your two recommendations about how we might approach this. The ideal solution would be one that would allow IRS to require all filers to report the employee plan information electronically with DOL via the EFAST2 system. In the meantime, we will continue to work cooperatively with DOL and PBGC to ensure that retirement plan related information is reported effectively.

I look forward to your continued interest in our Employee Plans function and in our ability to gather and use important compliance information.

Our responses to your recommendations are on the attachment. If you have any questions, please contact Robert S. Choi, Director, Employee Plans, at (202) 283-2100.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

Attachment

Recommendation 1

Continue to evaluate the information EP function needs to receive on the annual return filings for employer-sponsored retirement plans to meet its tax administration responsibilities by ensuring that the benefits of obtaining the information generally outweigh the cost and any burden imposed on plan sponsors and administrators. To assure that the EP function meets its tax administration responsibilities, it should also continue to explore regulatory and legislative options for mandatory electronic filings of annual returns from employer-sponsored retirement plans.

Corrective Action 1

Employee Plans (EP) will:

- Annually evaluate the information it needs from annual filings to meet its tax administration responsibilities for employer-sponsored retirement plans. In doing so, EP will ensure that the benefits of this information outweigh the cost and burden on plan sponsors and administrators.
- Continue to work with TE/GE Counsel to explore regulatory options for mandatory electronic filing of annual returns.
- Continue to work with the Office of Benefits Tax Counsel to explore legislative options for mandatory electronic filing of annual returns.

Implementation Date

June 30, 2012

Responsible Official

Director, EP

RECOMMENDATION 2

Coordinate with the DOL on the development of a timetable for implementing changes to the annual return filings to obtain information needed to meet the tax administration responsibilities of the EP function.



The Employee Plans Function Should Continue Its Efforts to Obtain Needed Retirement Plan Information

2

Corrective Action 2

EP and TE/GE's Business Systems Planning (BSP) will work with DOL to develop a timetable for implementing periodic changes to the content of the annual return to obtain information needed by the EP function.

Implementation Date

June 30, 2012

Responsible Officials

Director, EP and Director, BSP