Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance

March 28, 2008

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MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance (Audit #200740010)

This report presents the results of our review to determine whether the Wage and Investment Division is adequately planning for and addressing tax issues related to Individual Retirement Accounts (IRA). This review is part of the Treasury Inspector General for Tax Administration's Fiscal Year 2007 Annual Audit Plan coverage under the major management challenge of Complexity of the Tax Law.

Impact on the Taxpayer

As the number of taxpayers reaching retirement age increases, their incomes will be transitioning from wages to investment and retirement benefits. IRAs are a key, tax-preferred way for individuals to save for retirement and are increasingly important as a way for individuals to roll over savings from pension plans. In 2005, estimated Roth IRA assets totaled $147 billion, and traditional IRA assets totaled $3.26 trillion. We found that taxpayers are sometimes contributing more than is allowed into tax-deferred or tax-free accounts and they are not taking taxable distributions when required, which could result in lost tax revenues. In addition, taxpayers could be treated inequitably due to the lack of monitoring of IRAs.

1 The term IRA is also known as Individual Retirement Arrangement and includes individual retirement annuities. It is popularly known as IRAs.
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Synopsis

The Internal Revenue Service (IRS) needs to strengthen its procedures and controls for ensuring that taxpayers and IRA custodians comply with IRA rules. Failure to ensure correct reporting by IRA custodians could hinder the IRS’ ability to identify excess contributions. Moreover, lack of adequate monitoring and enforcement could result in lost tax revenues when taxpayers make excess contributions or fail to pay excise taxes on required minimum distributions that are not taken.

There are two main types of IRAs, a traditional IRA and a Roth IRA. Both types allow taxpayers to contribute up to $4,000 per year ($4,500 if age 50 or older), and provide tax deferral of contributions or earnings. Traditional IRAs, within certain income limits and other eligibility factors, allow taxpayers to deduct the amount of their IRA contributions from their taxable income, thus adding to their tax deferral benefits. However, taxpayers must begin to withdraw funds from their traditional IRAs when they reach 70½, and the funds received are generally taxed as regular income.

Roth IRAs do not provide for a tax deduction for contributions, but the entire amount of the account is tax free when withdrawn. In addition, there is no age limit as to when withdrawals must take place, so taxpayers can accumulate investment earnings tax free for as long as they choose.

We analyzed more than 13.7 million IRA Contribution Information (Form 5498) showing IRA contributions in Tax Year (TY) 2005 and identified 51,109 taxpayers who had made IRA contributions in excess of the maximum allowable IRA contribution limit. Contributions that are in excess of the limits and not properly withdrawn are subject to a 6 percent excise tax. The 51,109 taxpayers we identified made excess contributions of more than $110 million and did not report excise taxes on these excess contributions. The loss to the IRS on unpaid excise taxes was more than $6.6 million in TY 2005. If taxpayers continue to make excess contributions at the same rate we identified, we estimate the amount of excise tax that would not be collected over 5 years would be approximately $33 million.

In addition, because the earnings on the excess contributions are not taxed, the potential loss of taxes paid on interest income could be significant. If these taxpayers continued to make excess contributions to their IRAs, the compounded interest earned over 5 years could total approximately $127 million, and the potential revenue loss from unreported interest income could be more than $19 million.

2 These were the contribution limits in effect for Tax Year 2005, which is the period we evaluated. The contribution limit for taxpayers 50 and over was raised to $5,000 for Tax Year 2006.

2 Eligibility takes into account whether the taxpayer has taxable compensation, age at the end of the year, and the income limits and filing status if the taxpayer or spouse had an employer-sponsored retirement account.
We also found that the IRS does not ensure that taxpayers are complying with the required minimum distributions rules for IRAs. We matched a file of taxpayers required to take minimum distributions in TY 2005 against a file of TY 2005 distributions and identified 471,383 taxpayers who did not report any distributions. We reviewed a judgmental sample of 30 taxpayer accounts and determined that 5 (17 percent) did not take any or all of their required minimum distributions. The required distributions not taken by the 5 taxpayers totaled $188,852. The 50 percent excise tax that was not reported on this income totaled $94,426. Our limited sample was not intended to provide an overall estimate of revenue loss. However, for perspective, if there are a similar proportion of taxpayers who did not take all of their TY 2005 required distributions, the potential revenue loss from unreported excise taxes could total as much as $1.5 billion for 1 year.

Finally, financial custodians of IRA accounts are making a significant number of errors when preparing and submitting Forms 5498. When analyzing the Forms 5498 for excess contributions, we initially identified more than 107,000 taxpayers who appeared to have made excess contributions. However, as we analyzed a sample of the Forms 5498, we found that more than 52 percent of the Forms 5498 contained obvious errors. We could not determine the cause of the errors without auditing the custodians' records. However, based on the amounts reported as contributions, it appears that in many instances custodians may have mistakenly included in the "contribution" box the total fair market value of the IRA or the amount rolled over from one IRA to another. We also found multiple Forms 5498 submitted for the same taxpayer that contributed to the appearance of excess contributions.

**Recommendations**

We recommended that the Commissioner, Wage and Investment Division:

- Coordinate with the IRS Office of Research, Analysis, and Statistics to conduct analyses for identifying and resolving erroneous Forms 5498. Possible corrective actions could include notifying custodians of errors and requesting corrected forms, establishing validity checks to reject Forms 5498 that are submitted with more than the maximum allowable contribution for that tax year, and assessing appropriate penalties against custodians who repeatedly submit erroneous Forms 5498.

- Develop and implement strategies to bring noncompliant taxpayers back into compliance. These strategies could include referring taxpayers identified with large excessive contributions to the IRS Criminal Investigation Division for further review, and revising the Automated Underreporter Program to include IRA contributions so excess contributions could be identified and applicable excise taxes assessed. If the Automated Underreporter Program cannot be modified, create a special program for sending "soft"
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notices to taxpayers appearing to have made excess contributions to their IRAs and explaining the need to withdraw the excess contributions or pay the required excise taxes.

- Utilize information from the Forms 5498 to identify taxpayers who are subject to required minimum distributions and compare this information to subsequent tax returns to determine whether distributions were reported.

- Require IRA custodians to compute and provide to the IRS the estimated required minimum distributions so this information could be used as part of the Automated Underreporter Program.

Response

The IRS agreed with all four of our recommendations. Specifically, the IRS plans to gather data through its National Research Program study of FY 2007 individual returns. The study will address issues for all four recommendations, including the following items:

- Focus on noncompliance with traditional and Roth IRA contributions rules and identify potential penalty amounts for key IRA rules, as well as for taxpayers over age 70½ who do not take required minimum distributions for traditional IRAs.

- Analyze Forms 5498 (including Box 11 data) in an effort to identify erroneous filings and develop outreach opportunities designed to improve taxpayer reporting accuracy.

- Determine the volume of excess contributions and identify trends related to noncompliant Roth IRA contributions (and will be expanded to include traditional IRA contributions information).

Once the research data becomes available the IRS will determine the best approach for improving taxpayer reporting behavior, identify cost-effective methods to address taxpayer accounts that are not compliant with Roth IRA contribution rules (such as soft notices), and determine what actions, if any, to take related to Box 11 Form 5498 data.

IRS management did not agree with the projected outcomes associated with the recommendation to develop and implement strategies to bring noncompliant taxpayers back into compliance because management does not believe the outcome measures will be realized if the IRS chooses to take a different route based on the results of its study. Management’s complete response to the draft report is included as Appendix VII.

Office of Audit Comment

We are pleased that the IRS is in full-agreement with our recommendations and plans to incorporate its corrective action in unison with its planned action resulting from the recent report.
issued by the Government Accountability Office. However, we are concerned with the IRS’ stated disagreement with the proposed outcome measures reflected in our report. These measures were projected over a 5-year period to show the significance of the potential revenue loss that may occur beyond the actual loss determined from a 100 percent computer analysis of 51,109 taxpayers in TY 2005. Our review of the TY 2005 data clearly indicates a combined revenue loss of $13.3 million and represents the base year figure used to project the combined 5-year outcome measurements of $52 million.

we advised them that the detailed data used to compile the 100 percent computer analysis could be made available to the IRS to enable it to analyze the 51,109 taxpayer accounts identified in TY 2005 and determine the level of subsequent year noncompliance by these taxpayers. This could be used to compliment the IRS’ planned compliance study.

The Treasury Inspector General for Tax Administration has designated this audit report as Sensitive But Unclassified pursuant to Chapter III, Section 23 of the Treasury Security Manual (TD P 71-15) entitled, “Sensitive But Unclassified Information.” Because this document has been designated Sensitive But Unclassified, it may be made available only to those officials who have a need to know the information contained within this report in the performance of their official duties. This report must be safeguarded and protected from unauthorized disclosure; therefore, all requests for disclosure of this report must be referred to the Disclosure Branch within the Treasury Inspector General for Tax Administration Office of Chief Counsel.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.

4 Individual Retirement Accounts: IRS Enforces Some but Not All Key Rules, and Opportunities Exist to Strengthen Taxpayer Compliance (GAO-07-1059SU, dated September 2007).
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Abbreviations

AUR  Automated Underreporter
IRA  Individual Retirement Account (also known as Individual Retirement Arrangement)
IRS  Internal Revenue Service
TY  Tax Year
Background

The United States population reached 300 million in October 2006, and by 2030 the population is projected to exceed 363 million. The percentage of the population over age 65 is increasing, and projections indicate this trend will continue. In 2005, there were about 36.8 million people aged 65 and older (12 percent of the total population), and the number of people aged 85 and older reached approximately 5.1 million. By 2030, the number of people aged 65 and over is expected to double to about 20 percent of the population, or more than 71 million people. The number of people aged 85 and older will be the fastest growing segment of the United States population.\(^1\) This trend is the result of the aging of the baby boomers born between 1946 and 1964.

More of these taxpayers over age 65 will be transitioning from wages to pension benefits. In addition to relying on Social Security and savings to prepare for retirement, a variety of tax-advantaged investments can be used that are specifically earmarked for retirement savings. These include Individual Retirement Accounts (IRAs),\(^2\) employer-sponsored defined contribution and defined benefit pension plans, and annuities.

Retirement assets reached a record high of $14.5 trillion in 2005, an increase of 7 percent over 2004. These savings vehicles are integral to overall retirement planning and preparedness and account for more than one-third of all household financial assets. More than 25 percent of all retirement assets were in IRAs.

IRAs are a key tax-preferred way for individuals to save for retirement and are increasingly important as a way for individuals to roll over savings from pension plans. The funds put into an IRA are tax-deferred, so the account can grow faster than a typical investment account. To illustrate, if a person were to contribute $4,000 a year to an IRA with an 8 percent rate of return for 30 years, the IRA would be worth $449,133 at the end of year 30. If the same funds were invested in a non tax-deferred account, assuming a 31 percent tax rate, it would be worth $286,752 instead of $449,133. That is 36 percent less, a difference of $162,381 (as shown in Figure 1).

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\(^2\) The term IRA is also known as Individual Retirement Arrangement and includes individual retirement annuities. It is popularly known as IRAs.
There are two main types of IRAs, a traditional IRA and a Roth IRA. Both types allow taxpayers to contribute up to $4,000 per year ($4,500 if age 50 or older) and provide tax-preferred ways of saving for retirement. However, there are some important differences between the types of IRAs.3

The traditional IRA, within certain income limits and other eligibility factors,4 allows taxpayers to deduct the amount of their IRA contributions from their taxable income, thus adding to their tax deferral benefits. However, taxpayers must begin to withdraw funds from their traditional IRAs when they reach 70½, and the funds received are generally taxed as regular income. Also, once taxpayers reach 70½, they can no longer contribute to their traditional IRA.

Roth IRAs, also subject to certain income limits, do not provide for a tax deduction for contributions, but the entire amount of the account is tax free when withdrawn. In addition, there is no age limit as to when withdrawals must take place, so taxpayers can accumulate investment earnings tax free for as long as they choose.

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1 These were the contribution limits in effect for Tax Year 2005, which is the period we evaluated. The contribution limit for taxpayers 50 and over was raised to $5,000 for Tax Year 2006.

2 Eligibility takes into account whether the taxpayer has taxable compensation, age at the end of the year, and the income limits and filing status if the taxpayer or spouse had an employer-sponsored retirement account.
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While these IRA provisions provide meaningful benefits to taxpayers, these same provisions can pose a significant risk for tax revenue loss to the Federal Government if the information provided by IRA account custodians is not effectively used to prevent potential taxpayer abuse and/or fraud.

For example, if a 50-year-old taxpayer fully funded one Roth IRA and then improperly established a second Roth IRA with a financial custodian different from the custodian of his or her one allowable account, the potential amount of unreported interest earned and tax-free flow-through to beneficiaries could be substantial over 30 years due to the annual compounding of interest earned, as shown in Figure 2.

**Figure 2: Potential Impact to Internal Revenue Service Revenues**

<table>
<thead>
<tr>
<th>Individual With One Unallowable Roth IRA</th>
<th>$4,500/Yr @ 7% for 10 Years</th>
<th>$4,500/Yr @ 7% for 20 Years</th>
<th>$4,500/Yr @ 7% for 30 Years</th>
<th>Tax Free Proceeds to Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal plus Interest</td>
<td>$62,174</td>
<td>$184,480</td>
<td>$425,074</td>
<td>$425,074</td>
</tr>
<tr>
<td>(less) Total Contributions</td>
<td>-$45,000</td>
<td>-$90,000</td>
<td>-$135,000</td>
<td></td>
</tr>
<tr>
<td>Total Unreported Interest</td>
<td>$17,174</td>
<td>$94,480</td>
<td>$290,074</td>
<td></td>
</tr>
</tbody>
</table>


Additionally, if a taxpayer had sufficient funds to establish more than one unallowable Roth IRA account at various financial institutions, the risk of significant unreported income could be substantially more than the amounts shown in Figure 2. To protect against this risk, IRA custodians are required to report IRA contributions to the Internal Revenue Service (IRS) on IRA Contribution Information (Form 5498) and provide copies to the IRA owners (taxpayers). A separate Form 5498 should be filed for each IRA account. An example of Form 5498 is shown in Appendix V.

Custodians are required to report distributions from IRA accounts on Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (Form 1099-R). Custodians must also provide the appropriate distribution codes. For example, code 7 for normal distribution, code 4 for death, etc. An example of Form 1099-R is shown in Appendix VI.

Custodians submit Forms 5498 and 1099-R to the IRS' Information Returns Branch. This branch collects and processes the information returns so they can be used by other IRS functions.

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5 A branch in the IRS Modernization and Information Technology Services function.
or programs. Once the information returns are processed, they are posted to the IRS Information Returns Master File. Data on this system may not be available for months, because some information returns are not due until the middle of the following year. For example, Tax Year (TY) 2005 Forms 5498 were not due until May 31, 2006.

The Automated Underreporter (AUR) program is one IRS program that uses the information return data. The AUR is an automated system that helps the IRS identify under-reported and/or over-reported issues by matching data on information returns to individual income tax returns.

This review was performed at the IRS Campus in Austin, Texas. It included a review of TYs 2004 and 2005 Forms 5498 and Forms 1099-R filed nationwide by custodians and stored on the Information Returns Master File, a review of TY 2005 individual income tax returns stored on the Individual Master File, and discussions with personnel from the Submission Processing and Automated Underreporter offices in the Wage and Investment Division and with personnel from the Office of Modernization and Information Technology Services. The review was performed during the period November 2006 through December 2007. 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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6 The Information Returns Master File contains tax information reported from third parties for the current and prior 5 tax years.
7 Form 1040 series: U.S. Individual Income Tax Return (Form 1040); U.S. Individual Income Tax Return (Form 1040A); Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ).
8 The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
9 The IRS database that maintains transactions or records of individual tax accounts.
Results of Review

IRS processing procedures for IRAs do not ensure that taxpayers and custodians are complying with the IRA rules. The IRS' procedures are not adequate for it to identify taxpayers who make IRA contributions in excess of what the law allows or taxpayers who are not taking their required minimum distributions. In addition, IRS processes do not identify custodians who incorrectly report IRA transactions.

Some Financial Custodians Are Making Errors When Reporting IRA Contributions

Financial custodians of IRA accounts annually report the amount of contributions to the IRS on Forms 5498. We performed computer analyses on more than 13.7 million Forms 5498 showing IRA contributions in TY 2005 and identified 107,129 taxpayer accounts that appeared to have exceeded the $4,500 maximum allowable IRA contribution limit for TY 2005 and did not report excise taxes on these excess contributions. We analyzed these forms and identified obvious errors totaling nearly $1.3 billion that were reported to the IRS from various financial custodians. Some examples of these custodial errors included:

- A total of $440.1 million of traditional IRA contributions attributable to 489 Forms 5498 (an average contribution of $900,000).

We could not determine the cause of these errors without auditing the custodians' records. However, based on the amounts reported as contributions, it could be that custodians mistakenly included in the "contribution" box the total fair market value of the IRA or the amount rolled into the IRA from other IRAs or pensions. The errors could also have been caused by misplaced decimal points or other typographical errors. We found that 100 financial custodians accounted for about 77 percent ($996 million of the $1.3 billion) of the total inaccuracies.

\[10\] We originally identified 114,107 taxpayer accounts that appeared to have exceeded the $4,500 maximum allowable limit. However, 6,978 of these taxpayer accounts had multiple Forms 5498, and we could not determine if they were custodial errors. These accounts were eliminated from our total taxpayer accounts reported of 107,129.

\[11\] To avoid erroneously identifying taxpayers 50 years and older as having exceeded their IRA contribution limit, we used the maximum allowable amount of $4,500 for TY 2005.
Multiple Forms 5498\textsuperscript{12} also contributed to the errors identified on Forms 5498. IRS personnel explained that when more than two Forms 5498 are submitted to the IRS, the Information Reporting Program Data Assimilation Unit\textsuperscript{13} does not attempt to determine which is the accurate document (the last return submission should reflect the taxpayer's last action). The file date on the Information Return Master File is the date the information return was entered and not the date the custodian filed the information return or the date it was received by the IRS.

When multiple Forms 5498 are submitted for the same taxpayer and same IRA account, it cannot always be determined which Form 5498 was submitted last. Generally, when there are multiple amendments or corrected documents, the Information Reporting Program Data Assimilation Unit uses the original document in the matching process. The additional documents are appended to the file in the Information Returns Master File, which allows tax examiners to review all of the related taxpayer documents. (b)(7)(E)

To effectively determine whether taxpayers are making excess contributions to their traditional and Roth IRA accounts, the IRS first would need to implement procedures to identify and ensure that Forms 5498 containing obvious errors from financial custodians are corrected and to develop methods to ensure the accuracy and validity of any multiple Forms 5498 that might also be submitted by the custodians. Failure to ensure correct reporting by IRA custodians could hinder the IRS' ability to identify excess contributions.

**Recommendation**

**Recommendation 1:** The Commissioner, Wage and Investment Division, should have the Wage and Investment Research and Analysis office analyze Forms 5498 to identify the causes of the errors and possible corrective actions. The possible corrective actions could include:

- Notifying the custodians of errors identified and requesting corrected Forms 5498.
- Establishing validity checks to reject, or redirect for further analysis, Forms 5498 that are submitted with more than the maximum allowable contribution for that tax year.
- Assessing appropriate penalties against custodians who repeatedly submit erroneous Forms 5498.

**Management's Response:** The IRS agreed with this recommendation and has already begun corrective action. Specifically, the IRS plans to gather data through its National Research Program study of TY 2007 individual returns. This data will focus on noncompliance with traditional and Roth IRA contributions rules and identify potential

\textsuperscript{12} The term *multiple* includes original, corrected original, and amended Forms 5498.

\textsuperscript{13} A unit within the IRS Modernization and Information Technology Services function.
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penalty amounts for key IRA rules, as well as for taxpayers over age 70½ who do not take required minimum distributions for traditional IRAs. The IRS will also analyze Forms 5498 in an effort to identify erroneous filings and develop outreach opportunities designed to improve taxpayer reporting accuracy. Once the research data becomes available, the IRS will determine the best approach for improving taxpayer reporting behavior.

Some Taxpayers Made Contributions in Excess of the Maximum Allowable Limits

For TY 2005, IRA contribution limits were generally the smaller of $4,000 ($4,500 if age 50 or older by the end of 2005) or taxable compensation. Taxpayers could contribute to both traditional and Roth IRAs for the same year; however, the total contributions could not exceed the allowable limit. For example, a taxpayer 50 or over could contribute $3,000 to a Roth IRA and $1,500 to a traditional IRA or any other combination provided that the total contribution did not exceed $4,500. Contributions that are in excess of the limits and not properly withdrawn are subject to a 6 percent excise tax.

After eliminating the Forms 5498 that appeared to be in error, we performed an analysis of the remaining 51,109 taxpayer accounts with likely excess contributions. Some examples of these excess contributions include:

Of the 51,109 taxpayer accounts remaining, we were able to identify $110.1 million in excess contributions above the allowable $4,500 limit for each of these taxpayers. The $110.1 million amount equates to an IRS revenue loss of more than $6.6 million in unreported excise taxes. Figure 3 illustrates this loss of revenue and estimates the amount of excise taxes that would not

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14 We also eliminated 6,644 taxpayer accounts where it appeared that no excess contributions were made.
15 Contributions greater than the $4,500 maximum allowable contribution limit for TY 2005 are defined as "excess" IRA contributions.
be collected over 5 years would be approximately $33 million. This estimate is based on the probability that these taxpayers will continue to make the same excess contributions over the next 5 years.

**Figure 3: Potential Revenue Loss From Unreported Excise Taxes**

<table>
<thead>
<tr>
<th>Taxpayers With Unallowable IRA Accounts</th>
<th>51,109</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Contributions in TY 2005</strong></td>
<td>$340,133,373</td>
</tr>
<tr>
<td>Less 1 Allowable $4,500 Contribution</td>
<td>-$229,990,500</td>
</tr>
<tr>
<td><strong>Total Excess Contributions for TY 2005</strong></td>
<td>$110,142,873</td>
</tr>
<tr>
<td><strong>Total Unreported Excise Taxes for 2005 (6%)</strong></td>
<td>$6,608,572</td>
</tr>
<tr>
<td><strong>Potential Unreported Excise Taxes Over 5 Years</strong></td>
<td>$33,042,860</td>
</tr>
</tbody>
</table>


Taxpayers who exceed the contribution limits have an unfair advantage over compliant taxpayers in that they can earn tax-free interest on excess contributions to Roth IRA accounts. Traditional IRAs are subject to the required minimum distribution rules so that excess contributions, and earnings thereon, would eventually have to be distributed and included in taxable income. However, Roth IRAs are not subject to the required minimum distribution rules. Excess Roth contributions, and the earnings thereon, could continue to grow tax free.

In addition to the $6.6 million loss in excise taxes for TY 2005, Figure 4 shows the potential future compound interest effect from the $110.1 million as it relates to revenue loss from unreported interest over the next 30 years using a 7 percent interest rate and 15 percent tax rate. A single occurrence in TY 2005 would equate to a cumulative $109.2 million revenue loss. However, assuming a repetitive occurrence each year with an equal or larger amount of excess contributions could raise the potential loss to more than $1.1 billion in 30 years due to the compounding interest factor.

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16 There are some exceptions. For example, the required minimum distribution rules that apply to traditional IRAs apply to beneficiaries of Roth IRAs.
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Figure 4: Potential Revenue Loss From Unreported Interest

<table>
<thead>
<tr>
<th></th>
<th>Interest @ 7% in 5 years</th>
<th>Interest @ 7% in 10 years</th>
<th>Interest @ 7% in 30 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unreported Interest if</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compounded Only on the</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess Contributions of</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$110.1 Million From TY 2005</td>
<td>$44,338,204</td>
<td>$106,524,829</td>
<td>$728,292,767</td>
</tr>
<tr>
<td>Revenue Loss @ 15% Effective Tax Rate</td>
<td>$6,650,731</td>
<td>$15,978,724</td>
<td>$109,243,915</td>
</tr>
<tr>
<td>Unreported Interest if</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compounded on Excess</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions Repeatedly</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Made in Each Tax Year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>From 2005 to 2034</td>
<td>$127,026,756</td>
<td>$526,879,372</td>
<td>$7,828,188,969</td>
</tr>
<tr>
<td>Revenue Loss @ 15% Effective Tax Rate</td>
<td>$19,054,013</td>
<td>$79,031,906</td>
<td>$1,174,228,345</td>
</tr>
</tbody>
</table>


The Government Accountability Office recently reviewed this area\textsuperscript{17} and cited a high degree of noncompliance with Roth IRA contribution rules. It reported that the enforcement gap for Roth IRA contributions results in penalty dollars forgone in the near term and exposes the Federal Government to potentially sizeable permanent future losses, because earnings on Roth IRA contributions are generally tax-free.

In 2005, Roth IRA assets totaled an estimated $147 billion. Because of the ramifications of abuse in this area and the importance of ensuring that the tax law is applied fairly, the IRS should ensure that taxpayers comply with the tax rules for IRA contributions. Lack of proper oversight and administration of these rules could result in potential abuses and risk of revenue loss in the billions of dollars in future years.

\textsuperscript{17} Individual Retirement Accounts: IRS Enforces Some but Not All Key Rules, and Opportunities Exist to Strengthen Taxpayer Compliance (GAO-07-1059SU, dated September 2007).
Recommendation

**Recommendation 2:** The Commissioner, Wage and Investment Division, should develop and implement strategies to bring noncompliant taxpayers back into compliance. These strategies could include:

- Revising the AUR program so that excess contributions made by taxpayers can be assessed.
- Creating special extracts of Form 5498 data from the Information Returns Master File and send notices to taxpayers who appear to have made excess contributions to their IRAs, explaining that the taxpayers need to withdraw any excess contributions or pay the required excise taxes.

**Management’s Response:** The IRS agreed with this recommendation and has already begun corrective action. Specifically, the IRS plans to conduct a study to determine the volume of excess contributions and identify trends related to noncompliant Roth IRA contributions. The IRS will expand the analysis to include traditional IRA contributions information. Once the study is completed and excess contribution amounts are stratified, the IRS will identify cost-effective methods to address taxpayer accounts that are not compliant with Roth IRA contribution rules. One possible outcome may be a soft notice initiative, where every taxpayer meeting certain criteria is sent a notice.

IRS management did not agree with the projected outcomes associated with the recommendation to develop and implement strategies to bring non-compliant taxpayers back into compliance, because management does not believe that the outcome measures will be realized if the IRS chooses to take a different route based on the results of its study.

**Office of Audit Comment:** We are concerned with the IRS’ stated disagreement with the proposed outcome measures associated with this recommendation. These measures were projected over a 5-year period to show the significance of the potential revenue loss that might occur beyond the actual loss determined from a 100 percent computer analysis of 51,109 taxpayers in TY 2005. Our review of the TY 2005 data clearly indicates a combined revenue loss of $13.3 million and represents the base year figure used to project the combined 5-year outcome measurements of $52 million.
Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance

We advised them that the detailed data used to compile the 100 percent computer analysis could be made available to the IRS to enable it to analyze the 51,109 taxpayer accounts identified in TY 2005 and determine the level of subsequent year noncompliance by these taxpayers. This could be used to complement the IRS' planned compliance study.

Taxpayers Are Not Taking Required Minimum Distributions

We performed computer analyses on 7.2 million TY 2004 Forms 5498 of taxpayers who were required to take minimum distributions in TY 2005 and identified 471,383 taxpayers (more than 6 percent) who did not report any distributions. We reviewed a judgmental sample of 30 taxpayer accounts and determined that 5 taxpayers (17 percent) did not take any or all of their TY 2005 required minimum distributions. We determined that $188,852 (72 percent) of $261,447 total estimated required minimum distributions for the 5 taxpayers were not taken. The 50 percent excise tax that was not reported on this income totaled $94,426. Our limited sample was not intended to provide an overall estimate of revenue loss. However, for perspective, if there are a similar proportion of taxpayers who did not take all of their TY 2005 required distributions, the potential revenue loss from unreported excise taxes could total as much as $1.5 billion for 1 year.\(^\text{18}\)

We could not determine for 4 deceased taxpayers (13 percent) whether the beneficiaries took the required minimum distribution. The IRS does not have access to beneficiary information and cannot verify that required minimum distributions of deceased taxpayers are taken by the beneficiaries.\(^\text{19}\)

We also found obvious errors with custodians' reporting of the required minimum distributions. Some examples include:

- Four taxpayers had erroneous Forms 5498 that were issued by the same custodian. We determined that the four taxpayers were not subject to required minimum distributions for TY 2005.
- Five taxpayers took their 2005 required minimum distributions. However, the custodians neglected to check the "IRA/SEP/SIMPLE" box on Form 1099-R.

\(^\text{18}\) We calculated this excise tax by averaging the $188,852 estimated required distributions that were not taken by the 5 taxpayers identified in our sample ($37,770) and multiplied it by 17 percent of the 471,383 taxpayers (80,135), which equaled $3,026,698,950 in minimum required distributions that were not taken. The 50 percent excise tax that would be due on this income totals $1,513,349,475.

\(^\text{19}\) No reporting of required minimum distributions with respect to beneficiaries is required at this time.
Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance

When a taxpayer reaches age 70½, yearly minimum distributions from traditional IRA accounts are required. Roth IRA accounts are not subject to the required minimum distribution rules. IRA custodians are required to identify on Form 5498 if a taxpayer is required to take a minimum distribution for the next year, but the amount of the distribution is not reported. Individual Retirement Arrangements (IRAs) (Publication 590) contains life expectancy tables to assist taxpayers in calculating their minimum required distributions for the year. Any portion of the required minimum distribution not taken by a taxpayer by the end of the year may be subject to a 50 percent excise tax which is reported on line 60 of the individual income tax return.

Taxpayers are required to report taxable traditional IRA distributions on line 15 of their individual income tax return. The taxpayer’s copies of Forms 5498 and 1099-R are not required to be attached to the tax return unless Federal income tax is withheld and reported on 1099-R. Custodians are given two alternatives for reporting to the taxpayer that a minimum distribution is required. They can compute the amount of the required minimum distribution and provide this amount to the taxpayer, or they can inform the taxpayer that a minimum distribution is required and offer to compute the amount at the taxpayer’s request. However, the custodian does not report this amount to the IRS.

While our analysis is based on a limited sample of cases, it shows that the IRS does not ensure that taxpayers and custodians are complying with the required minimum distribution rules. When the IRS issued the final regulations for required minimum distributions in 2002, it expressed concerns about the overall level of compliance in this area. The IRS indicated that it intended to monitor the effect of the reporting requirements for minimum distributions on compliance to determine whether it would be appropriate to modify the process in the future. We did not find any evidence of IRS monitoring during our review. In addition, there are no reporting requirements for required minimum distributions with respect to beneficiaries. As a greater percentage of taxpayers reach the age when they are required to start receiving distributions from their IRAs, the potential for compliance problems becomes even larger. In 2005, traditional IRA assets totaled an estimated $3.26 trillion. Noncompliant taxpayers not taking required minimum distributions could result in billions of dollars in uncollected taxes.

Recommendations

The Commissioner, Wage and Investment Division, should:

**Recommendation 3**: Consider using the indicator shown on Form 5498, Box 11, to identify taxpayers who are subject to required minimum distributions. This data could be compiled into a

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20 In some instances, taxpayers may be able to waive the penalty due to reasonable cause.
file when received and later compared against the returns processed during the subsequent filing season\(^2\) to determine whether taxpayers reported their required minimum distribution.

**Management's Response:** The IRS agreed with this recommendation and has already begun corrective action. Specifically, the IRS has requested that Box 11 data from Form 5498 be included in the study mentioned in their response to Recommendations 1 and 2. The results of the study will dictate what actions, if any, the IRS will take related to Box 11 Form 5498 data.

**Recommendation 4:** Consider requiring custodians to report estimated required minimum distribution amounts on Form 5498 in the blank box to the left of Box 10. This data could then be combined with the indicator from Box 11 and used as part of the AUR program to prioritize noncompliant taxpayers who fail to report their required minimum distributions.

**Management's Response:** The IRS agreed with this recommendation and has already begun corrective action. Specifically, the IRS will include this information request in the design of the data collection instrument for the National Research Program study of TY 2007 individual returns. (b)(7)(E)

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\(^2\) The period from January through mid-April when most individual income tax returns are filed.
Appendix I

**Detailed Objective, Scope, and Methodology**

Initially, we planned to examine several tax issues affecting older taxpayers, but due to resource constraints, we revised our overall objective to determine whether the Wage and Investment Division is adequately planning for and addressing tax issues related to IRAs. The audit focused on the following issues for traditional or Roth IRAs: contributions in excess of the maximum allowable limit of $4,500 for TY 2005; errors reported on IRA Contribution Information (Form 5498); and required minimum distributions from traditional IRAs. To accomplish our objective, we:

I. Identified the number of taxpayers with IRA contributions in excess of the $4,500 maximum limit for TY 2005 and estimated the total excess contributions for the taxpayers.

   A. Obtained computer extracts from the Information Returns Master File1 of traditional and Roth IRA contributions reported by custodians on Form 5498 for TY 2005. Our extract criterion for traditional IRA data was all Forms 5498 with an amount in Box 1 (traditional IRA contribution) and "IRA" checked in Box 7. Our extract criterion for Roth IRA data was all Forms 5498 with an amount in Box 10 (Roth IRA contribution) and "Roth IRA" checked in Box 7. The Treasury Inspector General for Tax Administration Office of Information Technology staff provided the computer extracts.

   B. Evaluated the reliability of computer-processed data in both extracts and ensured that the records were accurate by selecting several records and researching them on the Integrated Data Retrieval System.2

   C. Analyzed the data to identify taxpayers with IRA contributions exceeding the $4,500 maximum limit for TY 2005.

   D. Estimated the sum of the excess IRA contributions for the taxpayers identified in Step C. above and calculated the 6 percent excise tax on the combined excess contributions.

II. Identified the number of TY 2005 Forms 5498 with apparent incorrect IRA contributions.

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1 The Information Returns Master File contains tax information reported from third parties for the current and prior 5 tax years.

2 The IRS computer system capable of retrieving or updating stored information, which works in conjunction with a taxpayer’s account records.
Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance

A. Analyzed the computer data extracts from Step I.A. to identify IRA contributions of $900,000 or more.

B. Analyzed the computer data extracts from Step I.A. to identify IRA contributions between $10,000 and $899,999.

III. Identified taxpayers who were required to take a minimum distribution for TY 2005 but did not take a distribution during 2005.

A. Obtained a computer extract from the Information Returns Master File of TY 2004 Forms 5498 with a check in Box 11, which indicated that the taxpayer was required to take a minimum distribution for TY 2005. We obtained a computer extract from the Information Returns Master File of TY 2005 Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (Form 1099-R) with an amount in Box 1 (gross distribution) and distribution codes 4 (death) or 7 (normal distribution) in Box 7 (distribution codes), and an “X” in the IRA/SEP/SIMPLE box next to Box 7.

B. Evaluated the reliability of computer-processed data in both extracts and ensured that the records were accurate by selecting several records and researching them on the Integrated Data Retrieval System.

C. Compared the taxpayers in the first extract (TY 2004 Forms 5498) to the taxpayers in the second extract (TY 2005 Forms 1099-R). We identified 471,383 taxpayers who were required to take minimum distributions in 2005 but did not have a 2005 Form 1099-R indicating a distribution was taken.

D. Reviewed a judgmental sample of 30 of the 471,383 taxpayer accounts to determine why they did not take a minimum distribution in TY 2005. A judgmental sample of 30 taxpayer accounts was considered sufficient to demonstrate the potential effect of inadequate controls over required minimum distributions.
Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Strategy and Finance, Wage and Investment Division SE:W:S
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Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI
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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: Senior Operations Advisor, Wage and Investment Division SE:W:S
Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

**Type and Value of Outcome Measure:**

- Increased Revenue – Potential: $33,042,860 in excise taxes over 5 years due to 51,109 taxpayers not reporting more than $110,142,873 of excess contributions to IRAs (see page 7).

**Methodology Used to Measure the Reported Benefit:**

We performed computer analyses on more than 13.7 million IRA Contribution Information (Form 5498) showing IRA contributions in TY 2005 and identified 107,129 taxpayer accounts that appeared to have exceeded the $4,500 maximum allowable IRA contribution limit for TY 2005 and did not report excise taxes on these excess contributions. In an effort to validate our analysis of actual instances of excess contributions, we eliminated as obvious errors all Forms 5498 that showed an IRA contribution greater than the maximum allowable of $4,500. Our results effectively reduced the 107,129 taxpayer accounts that we had initially identified to 51,109.

These 51,109 taxpayers had total contributions in 2005 of $340,133,373. Because these taxpayers should have only been allowed one $4,500 contribution totaling $229,990,500, we identified $110,142,873 in excess contributions above the allowable $4,500 limit for each of these taxpayers. The total unreported 6 percent excise taxes on the $110,142,873 would be $6,608,572 in TY 2005.

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1 To avoid erroneously identifying taxpayers 50 years and older as having exceeded their IRA contribution limit, we used the maximum allowable amount of $4,500 for TY 2005.
2 We considered these contributions as obvious errors, given that financial custodians would be aware of the contribution limitations and amounts reported more than $4,500 would in all probability be errors.
3 We also eliminated 6,644 taxpayer accounts where it appeared that no excess contributions were made.
4 Contributions greater than the $4,500 maximum allowable contribution limit for TY 2005 are defined as “excess” IRA contributions.
We believe that these taxpayers could continue to make the same excess contributions in subsequent years and estimated that over 5 years the amount of tentative excise taxes that would not be collected would be approximately $33,042,860.

**Type and Value of Outcome Measure:**
- Increased Revenue – Potential; $19,054,013 in tax over 5 years on an estimated cumulative amount of $127,026,756 in unreported interest on excess contributions to IRAs (see page 7).

**Methodology Used to Measure the Reported Benefit:**
In addition to the $6,608,572 loss in excise taxes for TY 2005, there is a potential future compound interest effect from the $110,142,873 as it relates to revenue loss from unreported interest over the next 5 years. Our calculations were made using future value annuities formulas.

We calculated the compounded unreported interest on the excess contributions of $110,142,873 identified for TY 2005 using an interest rate of 7 percent. We identified an estimated cumulative amount of $127,026,756 in unreported interest if the excess contributions were made repeatedly each year for the next 5 years. We used the assumption that if the taxpayer made an unallowable contribution in TY 2005, this unallowable contribution would be recurring in future years.

In addition, we applied a 15 percent tax rate and determined that $19,054,013 in potential tax could be unreported over the next 5 years on the $127,026,756.

**Type and Value of Outcome Measure:**
- Increased Revenue – Potential; $94,426 in excise taxes for required minimum distributions that were not taken by 5 taxpayers from their IRAs (see page 11).

**Methodology Used to Measure the Reported Benefit:**
We performed an analysis of taxpayers who were required to take minimum distributions in TY 2005 and identified 471,383 taxpayers who were required to take minimum distributions, but no distributions were reported. We reviewed a judgmental sample of 30 taxpayer accounts and determined that 5 taxpayers (17 percent) did not take any or all of their 2005 required minimum distributions. We determined that $188,852 (72 percent) of the $261,447 total estimated required minimum distributions for the 5 taxpayers was not taken. The 50 percent excise tax that was not reported on this income totaled $94,426.
### IRA Contribution Information (Form 5498)

Figure 1 shows Copy A of a blank Form 5498 for TY 2005. Copy A is filed with the IRS. Not shown are Copy B, which is provided to the IRA owner, and Copy C, which is kept by the IRA custodian who prepared the Form 5498.

**Figure 1: Form 5498**

<table>
<thead>
<tr>
<th>2628</th>
<th>VOID</th>
<th>CORRECTED</th>
</tr>
</thead>
<tbody>
<tr>
<td>TRUSTEE's or Beneficiary's name, street address, city, state, and ZIP code</td>
<td>1</td>
<td>IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Payment conclusion</td>
</tr>
<tr>
<td>PARTICIPANT'S name</td>
<td>3</td>
<td>Roth IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Roth IRA contributions</td>
</tr>
<tr>
<td>Social Security number</td>
<td>5</td>
<td>IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
<tr>
<td>Postal Address (including apt. no.)</td>
<td>6</td>
<td>IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
<tr>
<td>City, state, and ZIP code</td>
<td>7</td>
<td>IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
<tr>
<td>Account number and instructions</td>
<td>8</td>
<td>IRA contributions, if any, made in prior years, less amounts included in gross income.</td>
</tr>
</tbody>
</table>

**Source:** TY 2005 Form 5498.

**Traditional IRA** – Custodians must report the amount of contributions to a traditional IRA in Box 1 and may check “IRA” in Box 7.

**Roth IRA** – Custodians must report the amount of contributions to a Roth IRA in Box 10 and may check “Roth IRA” in Box 7.

**Required Minimum Distributions** – Custodians must check Box 11 if the IRA owner is required to take a minimum distribution for the new tax year. The custodian is not required to report the amount to the IRS.
**Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance**

**Appendix VI**

**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (Form 1099-R)**

Figure 1 shows Copy A of a blank Form 1099-R for TY 2005. Copy A is filed with the IRS. Not shown are Copies 1 and 2, which are provided to be filed with a State, city, or local income tax return; Copies B and C, which are provided to the IRA owner; and Copy D, which is kept by the IRA custodian who prepared the Form 1099-R.

**Figure 1: Form 1099-R**

<table>
<thead>
<tr>
<th>Box</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Gross distribution</td>
</tr>
<tr>
<td>2a</td>
<td>Taxable amount</td>
</tr>
<tr>
<td>2b</td>
<td>Taxable amount not determined</td>
</tr>
<tr>
<td>3</td>
<td>Capital gain included in Box 2a</td>
</tr>
<tr>
<td>4</td>
<td>Federal income tax withheld</td>
</tr>
<tr>
<td>5</td>
<td>Total distribution</td>
</tr>
<tr>
<td>6</td>
<td>Employee contributions of insurance providers</td>
</tr>
<tr>
<td>7</td>
<td>Notional contributions of employee's beneficiaries</td>
</tr>
<tr>
<td>8</td>
<td>Other</td>
</tr>
<tr>
<td>9a</td>
<td>Taxable amount 1</td>
</tr>
<tr>
<td>9b</td>
<td>Taxable amount 2</td>
</tr>
</tbody>
</table>

**Source:** TY 2005 Form 1099-R.

**Required Minimum Distributions from Traditional IRAs** — Custodians must report a traditional IRA distribution in Boxes 1 and 2a, regardless of the amount. Generally, they are not required to compute the taxable amount of the distribution. However, they must still report the total distribution amount in Box 2a and check Box 2b, even though the taxable amount was not determined.
Custodians should check the “IRA/SEP/SIMPLE” checkbox and enter the appropriate distribution code in Box 7. A Guide to Distribution Codes is included in the IRS’ TY 2005 Instructions for Forms 1099-R and 5498.
MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report — Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored To Ensure Tax Compliance (Audit # 200740010)

I reviewed the subject draft report and believe it accurately identifies the difficulty the IRS faces in addressing Individual Retirement Accounts (IRA) compliance. I appreciate your recommendations to strengthen our position regarding taxpayers who are noncompliant with the IRA rules. The recent Government Accountability Office (GAO) audit report entitled, Individual Retirement Accounts: IRS Enforcement Some but Not All Key Rules, and Opportunities Exist to Strengthen Taxpayer Compliance. (GAO-07-1059SU), dated September 2007, addressed many of the same IRA issues identified in your report. In response to that report, we agreed to conduct a study to determine volume and trends related to noncompliant taxpayers making Roth IRA contributions. Once the research data becomes available, the IRS will conduct an analysis to determine the best approach to improve taxpayer compliance.

Your report also addresses the various custodian errors on the Form 5498, IRA Contribution Information. We agree with your concern and have requested our Wage and Investment Research and Analysis office analyze Forms 5498 to identify the causes of errors and look for possible corrective actions. Combined, these two studies will provide much needed additional research and assist in developing the framework for future compliance initiatives in this area.

Attached are our specific comments to your recommendations. We do not agree with the proposed outcome measures because we cannot substantiate the dollar amounts based on the assumption that taxpayers will continue the same behavior over time. We don't believe that the outcome measures will be realized if the IRS chooses to take a different route based on the results of the study. We will rely on the results of our

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planned research to determine both the appropriate options to address compliance and corresponding measures to gauge our success. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Peter J. Stipek, Director, Customer Account Services, at (404) 338-8910.

Attachment
Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance

Attachment

RECOMMENDATION 1
The Commissioner, Wage and Investment Division, should have the Wage and Investment Research and Analysis office analyze Forms 5498 to identify the causes of the errors and possible corrective actions. The possible corrective actions could include:

- Notifying the custodians of errors identified and requesting corrected Forms 5498.
- Establishing validity checks to reject, or redirect for further analysis, Forms 5498 that are submitted with more than the maximum allowable contribution for that tax year.
- Assessing appropriate penalties against custodians who repeatedly submit erroneous Forms 5498.

CORRECTIVE ACTION
We agree with your recommendation and have already begun our corrective action in response to similar recommendations (Recommendations 3 and 4 in the recent Government Accountability Office audit report entitled, Individual Retirement Accounts: IRS Enforces Some but Not All Key Rules, and Opportunities Exist to Strengthen Taxpayer Compliance, (GAO-07-1059SU)). In that response, we outlined our plans to gather data through our National Research Program study of Tax Year 2007 individual returns. This data will focus on non-compliance with traditional and Roth IRA contributions rules, and identify potential penalty amounts for key IRA rules, as well as for taxpayers over ages 70½ who do not take required minimum distributions for traditional IRAs. We will also analyze Forms 5498 in an effort to identify erroneous filings and develop outreach opportunities designed to improve payer reporting accuracy. Once the research data becomes available, the IRS will determine the best approach to improving payer reporting behavior.

IMPLEMENTATION DATES
December 15, 2011

RESPONSIBLE OFFICIAL
Director, Research and Analysis, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2
The Commissioner, Wage and Investment Division, should develop and implement strategies to bring noncompliant taxpayers back into compliance. These strategies could include:

- [Further details provided]
Individual Retirement Account Contributions and Distributions
Are Not Adequately Monitored to Ensure Tax Compliance

CORRECTIVE ACTION
We agree with your recommendation and have already begun our corrective action in response to a similar recommendation (Recommendation 1 in the previously referenced GAO report). In that response, we outlined our plans to conduct a study to determine volume of excess contributions and identify trends related to noncompliant Roth IRA contributions. We will expand the analysis to include traditional IRA contributions information. Once the study is completed and excess contribution amounts are stratified, we will identify cost-effective methods to address taxpayer accounts that are not compliant with Roth IRA contribution rules. One possible outcome may be a soft notice initiative, where every taxpayer meeting certain criteria is sent a notice. These actions should also satisfy the intent and purpose of your recommendation.

IMPLEMENTATION DATE
January 15, 2010

RESPONSIBLE OFFICIAL
Director, Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3
The Commissioner, Wage and Investment Division, should consider using the indicator shown on Form 5498, Box 11, to identify taxpayers who are subject to required minimum distributions. This data could be compiled into a file when received and later compared against the returns processed during the subsequent filing season to determine whether taxpayers reported their required minimum distribution.
CORRECTIVE ACTION
As cited above, we previously responded to GAO regarding the same subject. We have specifically requested Box 11 data from Form 5498 be included in the study mentioned above. The results of the study will dictate what actions, if any, we will take related to Box 11 Form 5498 data.

IMPLEMENTATION DATE
January 15, 2010

RESPONSIBLE OFFICIAL
Director, Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, should consider requiring custodians to report estimated required minimum distribution amounts on Form 5498 in the blank box to the left of Box 10. This data could then be combined with the indicator from Box 11 and used as part of the AUR program to prioritize noncompliant taxpayers who fail to report their required minimum distributions.

CORRECTIVE ACTION
We previously responded to GAO regarding the same subject. The IRS will include this information request in the design of the data collection instrument for the National Research Program study of Tax Year 2007 individual returns.

IMPLEMENTATION DATE
March 15, 2011

RESPONSIBLE OFFICIAL
Director, Research, Analysis & Statistics

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.