Actions Can Be Taken to Further Improve the Strategy for Addressing Excess Contributions to Individual Retirement Arrangements

March 17, 2015

Reference Number: 2015-10-020

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:
1 = Tax Return/Return Information

Phone Number / 202-622-6500
E-mail Address / TIGTACommunications@tigta.treas.gov
Website / http://www.treasury.gov/tigta

ACTIONS CAN BE TAKEN TO FURTHER IMPROVE THE STRATEGY FOR ADDRESSING EXCESS CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ARRANGEMENTS

Highlights

Final Report issued on March 17, 2015

Highlights of Reference Number: 2015-10-020 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

According to the Government Accountability Office, an estimated 43 million individuals had Individual Retirement Arrangements (IRA) in Tax Year 2011 with a fair market value of $5.2 trillion. IRAs are a key tax-preferred way for individuals to save for retirement; however, there are rules that limit the amount individuals can contribute to IRAs in a tax year. Individual noncompliance with excess IRA contribution rules results in revenue loss to the Federal Government.

WHY TIGTA DID THE AUDIT

In Fiscal Years 2008 and 2010, TIGTA performed audits concerning compliance with IRA rules and recommended that the IRS develop a strategy to address retirement provision noncompliance. The overall objective of this audit was to determine whether the IRS has an effective strategy to identify and address excess contributions made to IRAs.

WHAT TIGTA FOUND

In response to prior TIGTA recommendations, the IRS developed and implemented a broad-based strategy that focuses on educating tax preparers and individuals about IRA rules and notifying individuals when they have potentially exceeded contribution limits. Although the IRS did not have results from the 2011 Filing Season strategy initiatives as our audit concluded, it has taken positive steps toward testing its strategy by adding controls to identify and address excess IRA contributions.

While the IRS has taken action to address prior recommendations, TIGTA determined that additional improvements could be made. For example, the IRS developed education materials for individuals and tax preparers but did not consider education materials for IRA custodians. TIGTA identified a significant number of inaccurate IRA information documents submitted by IRA custodians. Including outreach to IRA custodians should improve the accuracy of information documents sent to the IRS.

The IRS tested a methodology to identify and notify individuals with potentially excessive IRA contributions. While the IRS states it only intended to identify a suitable sample population for its test, TIGTA identified a significant number of potentially noncompliant individuals who were not included in the universe from which the IRS selected its sample. If the IRS decides to continue compliance efforts based on its test, having a more complete and accurate population of potentially noncompliant taxpayers would help IRS management select the most productive cases to pursue with limited compliance resources. Improved methods of identifying noncompliance could also protect revenue and reduce taxpayer burden.

WHAT TIGTA RECOMMENDED

TIGTA recommended that, when evaluating future efforts related to the IRA strategy, the Commissioner, Wage and Investment Division, should consider: 1) developing education materials for IRA custodians informing them of common mistakes made on information documents and the importance of submitting accurate information documents and 2) identifying a more complete and accurate universe of individuals who potentially made excess contributions from which to select potentially productive cases.

In their response, IRS officials stated that they plan to continue to inform IRA custodians of issues and errors affecting the administration of IRAs from a taxation perspective. Additionally, the IRS agreed to identify a more complete and accurate universe of individuals who potentially made excess contributions as it is a logical next step in expanding the IRA soft notice program from its current pilot state.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 17, 2015

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Actions Can Be Taken to Further Improve the Strategy for Addressing Excess Contributions to Individual Retirement Arrangements (Audit # 201410008)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has an effective strategy to identify and address excess contributions made to Individual Retirement Arrangements. This review is included in our Fiscal Year[1] 2015 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 IX.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

[1] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Table of Contents

Abbreviations

IRA	Individual Retirement Arrangement
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

Background

Individual Retirement Arrangements (IRA) are a key tax-preferred way for individuals to save for retirement and are an increasingly important way for individuals to roll over savings from both defined benefit[1] and defined contribution[2] plans. There are two main types of IRAs we will discuss in this report,[3] a traditional IRA and a Roth IRA.

- **Traditional IRA –** The traditional IRA, within certain income limits and other eligibility factors,[4] allows individuals to deduct the amount of their IRA contribution from their taxable income and defer payment of taxes until funds are withdrawn in retirement. When an individual reaches age 70½, individuals can no longer contribute to a traditional IRA.
- **Roth IRA –** Roth IRA contributions are not tax deductible, but qualified distributions from Roth IRAs are tax free. There is no age limit for making contributions to Roth IRAs, *i.e.*, individuals may continue to contribute eligible compensation to Roth IRAs after reaching age 70½.

For Tax Year (TY)[5] 2011, individuals were permitted to contribute a total of $5,000 ($6,000 if age 50 or older) to traditional or Roth IRAs. According to the Government Accountability Office,[6] an estimated 43 million individuals had IRA accounts in TY 2011 with a fair market value of $5.2 trillion.

An estimated 43 million individuals had IRAs in TY 2011 with a fair market value of $5.2 trillion.

[1] Defined benefit plans are traditionally set up so benefits are calculated by a set formula. Upon retirement, workers typically receive benefits based on years worked for an employer and earnings in years prior to retirement. Under this type of plan, the employer is generally responsible for making all or a portion of the contributions to fund the promised benefits.

[2] Defined contribution plans enable workers to contribute to individual accounts which are tax-advantaged in that contributions are typically excluded from current taxable income and earnings on balances grow tax-deferred until they are withdrawn. An employer may also make contributions, either by matching employee's contributions up to plan or legal limits, or on a noncontingent basis.

[3] As part of this audit, we did not consider Simplified Employee Pensions or Savings Incentive Match Plans for Employees due to differing contribution limits.

[4] Eligibility takes into account whether the individual has taxable compensation, age at the end of the year, and income limits and filing status if the individual or spouse had an employer-sponsored retirement account.

[5] A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individuals, the tax year is synonymous with the calendar year.

[6] Government Accountability Office, GAO-14-878T, *Individual Retirement Accounts, Preliminary Information on IRA Balances Accumulated as of 2011* (Sept. 2014).

Traditional and Roth IRA contributions are reported by IRA custodians on Form 5498, *IRA Contribution Information*.[7] An individual has made an excess contribution for any amounts contributed to traditional or Roth IRAs for the year that exceed the annual contribution limit, any amount contributed to a traditional IRA by an individual who has reached age 70½, or any amount contributed by an individual who does not earn eligible compensation.[8] If individuals discover they have made excess IRA contributions, they can take the excess amount out of their IRAs by the due date of the tax return without penalty. Distributions resulting from excess contributions are reported by IRA custodians on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*,[9] which includes a requirement to provide an appropriate distribution code explaining specific details surrounding the distribution. There is a 6 percent excise tax associated with excess contributions not withdrawn by the due date of the tax return, including extensions. Individuals report the 6 percent excise tax on Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.*[10]

IRA custodians are required to report information on Forms 5498 and Forms 1099-R to the Internal Revenue Service (IRS) and provide copies to IRA owners. A separate Form 5498 should be filed for each IRA held by an individual, and a separate Form 1099-R should be filed for distributions from each IRA or account held by an individual.

The Treasury Inspector General for Tax Administration (TIGTA) performed two prior audits involving excess contributions to IRAs. In Fiscal Year[11] 2008, we identified problems with information reported by third parties on Form 5498 and recommended that the IRS identify the cause of the errors and possible corrective actions.[12] Additionally, we recommended that the IRS develop and implement strategies to bring noncompliant individuals back into compliance. The IRS agreed with both recommendations.

In Fiscal Year 2010, we found that approximately 300,000 individuals potentially contributed more than $3.9 billion of unreported excess contributions to IRAs in TYs 2006 and 2007.[13] We recommended that the IRS develop an IRS-wide strategy to address retirement provision noncompliance. We recommended that the strategy include the development of processes to

[7] See Appendix V.
[8] Publication 590, *Individual Retirement Arrangements (IRAs)*.
[9] See Appendix VI.
[10] Additional taxes on excess contributions to traditional IRAs are reported in Part III of Form 5329, on Line 17. Additional taxes on excess contributions to Roth IRAs are reported in Part IV of Form 5329, on Line 25.
[11] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[12] TIGTA, Ref. No. 2008-40-087, *Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance* (Mar. 2008).
[13] TIGTA, Ref. No. 2010-40-043, *A Service-wide Strategy Is Needed to Address Growing Noncompliance With Individual Retirement Account Contribution and Distribution Requirements* (Mar. 2010).

identify individuals who do not comply with retirement plan provisions, along with efforts to address the noncompliance. The IRS agreed with our recommendation.

This review was performed with information obtained from the Wage and Investment Division offices located in Atlanta, Georgia, and Austin, Texas, and the Tax Exempt and Government Entities Division Employee Plans function offices located in Washington, D.C., during the period January through October 2014. 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.

Results of Review

Progress Has Been Made to Educate Individuals and Return Preparers, but Outreach to Individual Retirement Arrangement Custodians Has Not Occurred

In response to our previous recommendations, the IRS developed a broad-based strategy to address noncompliance with retirement plan provisions. As part of the strategy, the IRS developed and provided educational materials to individuals and tax return preparers explaining IRA rules and providing guidance if an individual is noncompliant with IRA rules. Access to these educational materials is provided through newsletters, the Internet, e-mail, publications, and Twitter®. Some examples include e-News articles directed to tax preparers reminding them of the need to ensure that excess contributions are avoided when preparing a client's tax return and a Social Security Administration/IRS quarterly newsletter providing guidance to individuals on the prevention of excess contributions. Additionally, the IRS sent Twitter messages to individuals directing them to IRA websites for guidance.

While the IRS was proactive in developing education materials for individual and tax preparers, the IRS did not develop education materials for IRA custodians.[14] IRA custodians serve a key function to assist individuals, return preparers, and the IRS in identifying excess IRA contributions by providing Forms 5498 showing contributions made to IRAs by individuals. When analyzing TY 2011 Forms 5498 for excess contributions, we determined that approximately 834,000 (7 percent) of 11.9 million[15] Forms 5498 filed by IRA custodians appeared to be inaccurate.[16] For example, IRA custodians are instructed to report information associated with Roth and traditional IRAs on separate Forms 5498, yet, we found instances in which Roth IRA and traditional IRA information from the same custodian were reported on the same Form 5498. When IRA custodians combine Roth and traditional IRA information on one form, it hinders the IRS's ability to identify excess contributions. If an individual has established more than one IRA plan with the same trustee, a separate Form 5498 must be filed for each plan. In addition, we found instances in which the IRA custodian appeared to mistakenly include rollovers from other IRAs in the "IRA contribution" box on Form 5498. Reporting a rollover as a contribution could result in the IRS believing that an individual has violated rules concerning excess IRA contributions. In addition to our analysis of Forms 5498, we noted that individuals

[14] During the fieldwork portion of our audit, the Tax Exempt and Government Entities Division published an article in its newsletter explaining problems associated with erroneous Forms 5498.
[15] The 11.9 million represents Forms 5498 that reported a traditional or Roth IRA contribution.
[16] We could only identify Forms 5498 with obvious errors. Additional errors regarding items such as the amount contributed to an IRA and the tax year to which a contribution applies cannot be easily identified.

responding to notices sent as part of the IRS's broad-based strategy to address noncompliance with retirement plan provisions sometimes stated that Forms 5498 received from the IRA custodian were erroneous. For example, some individuals communicated that the IRA custodian reported an incorrect IRA contribution amount.

Prior to developing its broad-based strategy, the IRS analyzed Forms 5498 and determined that 9 percent were inaccurate, but it decided that no additional action was necessary. Now that the IRS is using Forms 5498 to identify and notify individuals with potential excess contributions, it is important that IRA custodians report IRA contributions on Forms 5498 as accurately as possible. Without outreach to IRA custodians, erroneous Forms 5498 may continue to be submitted to the IRS. Because the IRS uses Forms 5498 to identify excess IRA contributions, erroneous Forms 5498 could result in the IRS contacting compliant individuals or not contacting noncompliant individuals.

Improvements Have Been Made to Identify and Notify Individuals Who Potentially Make Excess Contributions; However, the Methodology for Identifying Noncompliance Could Be Improved

As part of its broad-based strategy to address noncompliance with retirement plan provisions, the IRS implemented processes to send soft notices[17] to a sample of individuals whom the IRS identified as having potentially made excess IRA contributions in TY 2011. As our audit concluded, the IRS was in the process of evaluating whether these notices are affecting individuals' compliance with IRA rules. In our prior review, we found that the IRS did not have controls in place to identify and address individuals who potentially made excess IRA contributions. While the IRS's evaluation of the results of the TY 2011 soft notice sample is not complete, the IRS has taken positive steps toward testing its strategy by adding controls to identify and address retirement provision noncompliance.

The IRS has made strides in identifying and notifying individuals who have potentially made excess contributions; however, its methodology for identifying noncompliance could be improved. While the IRS states that it only intended to identify a suitable sample population for its test, we identified a significant number of individuals that the IRS did not identify who potentially made excess contributions. In addition, we determined that the IRS did not use all available information to eliminate individuals who may not have made an excess contribution from the sample population so that they would not receive a notice.

[17] Soft notices do not require that the individual pay more tax, provide documentation, or even respond to the IRS. Although the notice requests that the individual file an amended tax return if appropriate, it is not required. Instead, the notices are designed to serve as an educational tool, encourage self-correction, and improve voluntary compliance.

The IRS is testing a strategy that is designed to send notices to individuals when data indicate they have made excess contributions. The notice[18] advises individuals that IRS records indicate they may have made excess IRA contributions. For TY 2011, the IRS identified 22,634 individuals with potential excess IRA contributions, and the IRS developed additional criteria to stratify the population based on unique characteristics that were designed to identify individuals who were highly likely to have made excess IRA contributions.[19] The IRS selected a sample of 1,502 individuals to send a notice. Figure 1 shows details on each of the five characteristics the IRS used to send notices.

Figure 1: IRS IRA Excess Contribution Soft Notice Sample Selection Methodology

Characteristic Used to Identify Individuals for Notices	Notices Sent
Single individuals who had contributions to an IRA exceeding $10,000 or, if married filing jointly, contributions exceeded $23,000.	955
Single individuals who had contributions totaling at least $12,000 to more than one Roth IRA, and married filing jointly individuals who had contributions totaling at least $16,000 to more than two Roth IRAs.	374
Individuals who had IRA contributions for TY 2011 that were more than the fair market value of the traditional or Roth IRA at the end of both 2011 and 2012.	118
Individuals over the age of 70½ in TY 2011 who made contributions totaling at least $2,000 to a traditional IRA.	35
Individuals under age 15 who had aggregate contributions to Roth IRAs totaling at least $10,000.	20
Total Notices Sent	**1,502**

Source: IRS documentation.

The IRS could improve its identification methodology and increase the number of likely noncompliant individuals and decrease the number of individuals who are already likely

[18] Individuals received soft notice Letter 5222, *IRA – Taxpayers Who Have Made Excess Contributions*.
[19] See Appendix VII for the IRS's criteria.

compliant by using information that is readily available.[20] For example, the methodology the IRS developed to identify individuals who potentially made excess IRA contributions:

- Did not consider whether individuals had compensation (earned income) that would make them eligible to make an IRA contribution.
- Excluded all individuals who received a retirement plan distribution regardless of the type of distribution[21] or were serviced by a business operating division other than the Wage and Investment Division.[22]
- Identified likely compliant individuals because it did not analyze amended Forms 5498, individuals with post-processing adjustments to their tax accounts, and certain IRA distribution information reported on Form 1099-R.

If the IRS decides to continue compliance efforts based on its test, having a more complete and accurate population of potentially noncompliant taxpayers would help IRS management select the most productive cases to pursue with limited compliance resources. Improved methods of identifying noncompliance could also protect revenue and reduce taxpayer burden.

The methodology did not consider lack of compensation to help identify individuals with potential excess contributions

The IRS developed a methodology that did not fully consider whether individuals had compensation (earned income) that would make them eligible for tax preferences associated with an IRA. The IRS states that it only intended to identify a suitable sample population for its test. In addition, lack of sufficient time to develop and implement the criteria prior to the filing season[23] may have contributed to the IRS not considering compensation when creating criteria to identify potential excess IRA contributions.[24] IRA provisions require that contributions to IRAs

[20] For example, TIGTA's methodology identified additional individuals who were potentially noncompliant with excess contribution rules and excluded individuals who appeared to be compliant. See Appendix VIII for details.
[21] Distributions from both IRA sources and non-IRA sources are reported on Form 1099-R. An example of a distribution from a non-IRA source is Distribution Code 6 – Section 1035 exchange (a tax-free exchange of life insurance, annuity, qualified long-term care insurance, or endowment contracts).
[22] There are five major business operating divisions within the IRS: 1) Wage and Investment Division; 2) Small Business/Self-Employed Division; 3) Large Business and International Division; 4) Tax Exempt and Government Entities Division; and 5) Criminal Investigation.
[23] The period from January through mid-April when most individual income tax returns are filed.
[24] IRS officials noted that less time was available to prepare for the filing season due to the Government shutdown in October 2013.

are to be made from money earned from working.[25] We determined that more than 57,000 individuals[26] contributed more than $125 million in contributions to traditional or Roth IRAs in TY 2011 that are potentially improper because the individuals did not have eligible compensation reported to the IRS.

Any contribution to an IRA from an individual who does not have eligible compensation should be considered an excess contribution which is subject to a 6 percent excise tax. If the IRS were to incorporate a check for compensation in its criteria for identifying potential excess contributions, it would identify a substantially larger universe of potentially noncompliant individuals. While some of the potentially excess contributions were small (less than $1,000), others were substantial (greater than $3,000 in one tax year). In addition, these figures are for one tax year. Noncompliance can recur year after year if the IRS does not appropriately address excess IRA contributions. Figure 2 shows a distribution analysis of the amount of potential excess contributions made by the 57,484 individuals we identified who did not have compensation eligible for an IRA contribution.

Figure 2: Distribution Analysis of Individuals Who Made Potential Excess Contributions Due to Lack of Eligible Compensation (TY 2011)

Range of Excess Contributions	Number of Individuals
$1 – $1,000	28,415
$1,001 – $3,000	12,573
Greater Than $3,000	16,496
Total of All Ranges	**57,484**

Source: TIGTA analysis of tax return information and information documents for TY 2011.

A cost-effective strategy to address individuals who potentially improperly contributed to an IRA due to the lack of eligible compensation could assist in recovering some of the approximately

[25] For the purpose of retirement savings, Internal Revenue Code § 219 states that the term "compensation" includes earned income. The term "compensation" does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation. Publication 590 defines compensation as what you earn from working. For example, this includes wages, salaries, commissions, self-employed income, alimony, and nontaxable combat pay. However, compensation does not include earnings and profits from property, interest and dividend income, pension or annuity income, *etc*.

[26] Of the 57,484 individuals, 19,574 filed a tax return in TY 2011 and did not have compensation eligible for an IRA and 37,910 did not file a tax return for TY 2011. For the 57,484 individuals, we reviewed Forms W-2, *Wage and Tax Statement*, and Forms 1099-MISC, *Miscellaneous Income*, to make sure there was no eligible compensation for each individual.

$7.5 million[27] in unreported excise taxes from TY 2011. In the future, if the IRS identifies and addresses individuals potentially making improper IRA contributions due to the lack of eligible compensation, it could recover more than $37 million over five years in additional excise taxes.[28]

Additionally, if the IRS were to incorporate analysis of compensation into its methodology, it could concentrate on cases in which it appears parents are improperly funding IRAs in their children's names. We determined that more than 14,000 (approximately 25 percent) of the 57,000 individuals who potentially made excess IRA contributions because they did not have eligible compensation were claimed as a dependent on another tax return. Figure 3 stratifies the age of the dependents and shows that 2,585 of these dependents were under the age of 10.

Figure 3: Distribution Analysis of the Dependents Who Potentially Made Excess Contributions and Did Not File a Tax Return (TY 2011)

Age of Dependent	Quantity	Percentage
Less Than 10	2,585	18 Percent
10 to 18	5,652	40 Percent
More Than 18	5,844	42 Percent
Total All Ages	**14,081**	**100 Percent**

Source: TIGTA analysis of tax return information and information documents for TY 2011.

If parents set up IRAs for their children who have not earned compensation, taxes are improperly avoided and revenue is lost to the Federal Government.

The methodology excluded individuals who potentially made excess contributions

Our analysis identified approximately 23,000 additional individuals who potentially made an excess contribution to their IRA account who were excluded by the IRS in its analysis. The 23,000 individuals contributed more than the maximum allowable limit of $6,000 in TY 2011 and did not report excise tax on the excess contributions.

---

[27] The $7.5 million represents the amount of excise taxes associated with individuals who did not have eligible compensation. This figure assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect excise taxes from all potentially noncompliant taxpayers identified. However, the IRS is currently using soft notices for a small sample of potentially noncompliant individuals and has not completed its evaluation of the results. In addition, the IRS states its goal is to change individual behavior instead of collecting additional tax. Therefore, the actual amount of excise taxes collected could be substantially less.

[28] See Appendix IV. The five-year forecast for the potential revenue protection is based on multiplying the base year result by five and assumes, among other considerations, that economic conditions and tax laws do not change.

Individuals are permitted to legally withdraw excess contributions up until the due date of the tax return, plus extensions to file, without penalty. Distributions from both IRA sources and non-IRA sources are reported on Form 1099-R. However, the population of noncompliant individuals identified using the IRS methodology excluded any individual who received a Form 1099-R. By itself, receiving a Form 1099-R distribution document does not mean that a distribution was necessarily made from an IRA, or consequently, that an individual is compliant with IRA rules. IRS officials stated that they excluded all Form 1099-R distributions from the test population to arrive at a more manageable sample size. In addition to excluding individuals who received a Form 1099-R, the IRS methodology did not include tax returns for individuals who were serviced by different IRS business operating divisions.[29] Instead, the IRS included tax returns for individuals who were assigned to the Wage and Investment Division and excluded small business individuals who are assigned to a different business operating division.

Individuals with excess contributions are subject to a 6 percent excise tax on the excess amount. The potential revenue loss resulting from these excess contributions is approximately $6.9 million in unreported excise tax. Figure 4 provides a breakdown of the individuals excluded by the IRS methodology.

Figure 4: Distribution Analysis of Individuals Who Potentially Made Excess Contributions but Were Excluded by the IRS Methodology (TY 2011)

Amount of Potential Excess Contribution	Number of Individuals
$1 – $1,000	6,788
$1,001 – $14,000	15,742
Greater Than $14,000	499
Total	**23,029**

Source: TIGTA analysis of tax return information and information documents for TY 2011.

Detailed analysis of the amounts of potential excess contributions identified more than 16,000 individuals who had excess contributions exceeding $1,000, including nearly 500 individuals who had excess contributions exceeding $14,000.

[29] Individuals serviced by multiple business operating divisions may contribute to IRAs. For example, an individual who only receives wages reported on a Form W-2 is serviced by the Wage and Investment Division, while an individual who owns and operates a self-employed business or farm may be serviced by the Small Business/ Self-Employed Division. During the time period of our audit, the IRS announced that it was merging the compliance functions of multiple business operating divisions.

The IRS methodology included a test of individuals who possessed more than one Roth IRA. However, by not incorporating Form 1099-R or individuals serviced by other business operating divisions into its analysis, the IRS excluded 6,701 individuals who had contributions to Roth IRAs that were more than $6,000. These individuals had total Roth contributions totaling more than $71.5 million. We reviewed a judgmental sample[30] of five of these accounts in which the individuals had contributed to multiple Roth IRA accounts and assessed the impact their excess contributions have on tax administration. Figure 5 details the contributions made to the multiple Roth IRAs for these five individuals with significant excess contributions.

Figure 5: Individuals Who Potentially Made Excess Contributions to Multiple Roth IRA Accounts (TY 2011)

Individual	Number of Roth IRA Accounts	Roth IRA Contributions
1	**1**	**1**
1	**1**	**1**
1	**1**	**1**
1	**1**	**1**
1	**1**	**1**

Source: TIGTA analysis of individuals with potential excess IRA contributions in TY 2011.

Since individuals claim a deduction for a traditional IRA on their tax return, the IRS is able to more easily identify individuals who make an excess contribution to traditional IRAs. However, Roth IRAs have no tax return reporting requirement and thus can only be verified by analyzing third-party documents. The lack of a control to easily identify excess contributions to Roth IRAs is significant because Roth IRA contributions generally grow tax-free and are not subject to the payment of any income taxes upon distribution. If individuals who are potentially contributing more than the annual limit to IRAs are not notified, they may continue to make excess contributions, compounding the problem and resulting in lost revenue to the Federal Government.

Individuals are being sent erroneous or unclear notices

After tax returns and information documents are filed with the IRS, adjustments can be made to individuals' accounts and documents to remedy errors; however, the IRS methodology did not

[30] A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

account for some of these adjustments when identifying excess contributions to IRAs. In addition, individuals are allowed to withdraw excess contributions up until the due date of the tax return; however, the IRS methodology did not account for this. These withdrawals are reported on the following tax year's Form 1099-R.

We independently identified and compared our own population of individuals who potentially made excess contributions to the 1,502 individuals who were sent notices during the IRS test and found 328 individuals who were sent notices but were not identified using our methodology. We analyzed a random sample of these individuals and determined that 18 (36 percent) of 50 individuals appeared to be compliant with IRA rules[31] because they withdrew the excess contribution by the due date of the tax return plus extensions to file. For example, some individuals received a notice for contributing more than the maximum allowable limit in TY 2011 but withdrew the excess contribution before the due date of the return (April 17, 2012, plus approved extensions of time to file). In addition to the legal withdrawals, we found that five (10 percent) of the 50 individuals received an unclear notice because it identified the wrong spouse for married filing jointly tax returns. In these cases, the notices were sent to only the primary taxpayers when the excess contribution was associated with the IRA account of the spouse. IRS officials stated that in the future, they will have a field in the notice stating the IRA account owner's information. Sending individuals erroneous or unclear notices may lead to confusion, causing unnecessary taxpayer burden.

Based on our review of our random sample, we estimate that 151 (10 percent) of the 1,502 individuals who were sent a notice by the IRS received a potentially erroneous notice.[32] If the IRS decides to move forward with its existing methodology and expand the process of notifying noncompliant individuals to the entire population, the number of potential erroneous notices could increase.

Recommendations

When evaluating future efforts related to the IRA strategy, the Commissioner, Wage and Investment Division, should consider:

Recommendation 1: Developing education materials for IRA custodians informing them of common mistakes made on information documents and the importance of submitting accurate information documents.

---

[31] TIGTA's criteria were not designed to capture all noncompliant individuals. For example, in TY 2011, some individuals could only contribute $5,000 to an IRA, while others could contribute up to $6,000. Our analyses identified any contributions of more than $6,000 as an excess contribution. Therefore, some of the individuals we reviewed as part of our sample were identified correctly by the IRS as potentially noncompliant.

[32] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident the point estimate is between 109 and 193.

Management's Response: The IRS agreed with this recommendation and will continue to inform IRA custodians of issues and errors affecting the administration of IRAs from a taxation perspective. Communications, such as those provided in the IRS's *Employee Plans News,* will continue to be coordinated with stakeholders to ensure that the message content and delivery modes are effective for addressing and reducing common IRA reporting errors by custodians.

Recommendation 2: Identifying a more complete and accurate universe of individuals who potentially made excess contributions from which to select potentially productive cases.

Management's Response: The IRS agreed with this recommendation as it is the logical next step in expanding the IRA soft notice program from its current pilot state. As the scale of the notice program is increased, the IRS will use the findings from the analysis of the pilot project results to expand the scope of notice recipients. However, the IRS will continue to evaluate the pilot from a budget perspective.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether the IRS has an effective strategy to identify and address excess contributions made to IRAs. To accomplish our objective, we:

I. Evaluated the IRS strategy to determine if education and outreach and compliance plans are reasonably comprehensive to address excess IRA contributions.

   A. Assessed the education and outreach component of the IRS strategy to assist individuals and external stakeholders with improving their knowledge of excess contribution rules.

   B. Evaluated the scope of the soft notice[1] program in the IRS strategy to determine whether it will address all aspects of the population of individuals with potential excess contributions.

      1. Compared the IRS sample of 1,502 soft notices sent to individuals we independently identified as potentially having made excess contributions. We identified 328 individuals who received soft notices but were not identified in our analysis.

      2. Selected and reviewed a statistically valid sample of 50 individuals from the population of 328 individuals identified in Step I.B.1. A statistically valid sample was used to allow the results to be projected to the overall population. We relied on TIGTA's contract statistician to verify our sampling methods. We selected our sample of 50 based upon a 95 percent confidence level, a ± 10.31 percent precision rate, and a 20 percent expected error rate. Our review of the sample identified 23 individuals who potentially received an erroneous notice for excess contributions. This resulted in a 46 percent error rate. Based upon a 95 percent confidence level, we estimate the number of potentially erroneous notices in the population of 328 to be 151, with a precision of 42 notices. We are 95 percent confident that the true number of potentially erroneous notices is between 109 and 193.

[1] Soft notices do not require that the individual pay more tax, provide documentation, or even respond to the IRS. Although the notice requests that the individual file an amended tax return if appropriate, it is not required. Instead, the notices are designed to serve as an educational tool, encourage self-correction, and improve voluntary compliance.

II. Identified individuals who had potentially made excess IRA contributions.

A. Performed computer analyses to determine if individuals potentially made excess contributions to their IRA(s) by obtaining all Forms 5498, *IRA Contribution Information*; Forms 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*; Forms W-2, *Wage and Tax Statement*; and Forms 1099-Misc, *Miscellaneous Income*, for TY 2011 and Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, for TY 2011 and TY 2012 that were submitted to the IRS as of February 20, 2014.[2]

B. Determined if individuals with reported TY 2011 IRA contributions were in excess of the maximum annual limit of $6,000.[3] As part of this analysis, we determined if individuals had excess contributions to multiple Roth IRA accounts.

C. Determined if individuals who contributed to traditional or Roth IRAs in TY 2011 had eligible compensation. We calculated the excess contribution, applied the 6 percent penalty, and summarized the total as potential revenue protection.[4]

D. Discussed individuals with potential excess IRA contributions with IRS officials. Additionally, we discussed our methodology and the feasibility of revising the IRS's methodology with IRS officials.

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 that the following internal controls were relevant to our audit objective: education and outreach as well

---

[2] To assess the reliability of computer-processed data, programmers in the TIGTA Office of Strategic Data Services validated all extracted data. To provide additional assurance that the data received were supported by external sources, we verified the accuracy of information from Forms 5498, Forms 1099-R, Forms 5329, Forms W-2, Forms 1099-Misc, and the National Account Profile by researching the IRS's Integrated Data Retrieval System, which is the IRS computer system capable of retrieving and updating stored taxpayer account information, for a nonrepresentative selection of at least seven accounts. The National Account Profile is a compilation of selected entity data from various master files and the Social Security Administration. Based on our tests, we concluded that the data were sufficiently reliable for our audit.

[3] For consistency with the prior Fiscal Year 2010 audit, we used the maximum limit of $6,000 in our analysis. IRA contributions are limited to $5,000 per year ($6,000 if age 50 or older) for TY 2011.

[4] For the purpose of retirement savings, Internal Revenue Code § 219 states that the term "compensation" includes earned income. The term compensation does not include any amount received as a pension or annuity and does not include any amount received as deferred compensation. Publication 590, *Individual Retirement Arrangements (IRAs)*, defines compensation as what you earn from working. For example, this includes wages, salaries, commissions, self-employed income, alimony, and nontaxable combat pay. However, compensation does not include earnings and profits from property, interest and dividend income, pension or annuity income, *etc*.

as the soft notice program within the IRS-wide strategy to detect and address individuals who have excess contributions to traditional or Roth IRAs. We evaluated these controls by interviewing personnel, reviewing available documentation, and reviewing data for individuals who contributed to traditional or Roth IRAs in TY 2011.

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
James V. Westcott, Audit Manager
David M. Bueter, Lead Auditor
Jeffrey R. Stieritz, Senior Auditor
Michael A. McGovern, Auditor
Erika D. Axelson, Information Technology Specialist
Steve E. Vandigriff, Information Technology Specialist

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
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
Audit Liaisons:
    Commissioner, Wage and Investment Division SE:W
    Director, Communications and Liaison, Tax Exempt and Government Entities Division SE:T:CL

Appendix IV

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:

- Revenue Protection – Potential; $7,525,935 in excise tax for TY 2011 due to 57,484 individuals potentially contributing to an IRA without eligible compensation, or $37,629,675 over five years (see page 5).

Methodology Used to Measure the Reported Benefit:

Using information from TY 2011 Forms 5498, *IRA Contribution Information*, we identified 11,057,222 individuals who contributed to a Roth or traditional IRA. We analyzed associated TY 2011 tax returns and information documents on wages (Forms W-2, *Wage and Tax Statement*) and miscellaneous income (Forms 1099-MISC, *Miscellaneous Income*)[1] to determine if the individuals had appropriate compensation in order to contribute to an IRA. After we identified the population of individuals who did not have proper compensation, we removed individuals who had an IRA distribution from TY 2011 or 2012 on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, individuals who self-reported an excise tax on Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, or had a post-processing adjustment to their tax account.

We determined that 57,484 individuals potentially made $125,432,255 in improper IRA contributions due to the lack of proper compensation. We calculated that the unreported 6 percent excise tax on each individual's excess contributions totaled $7,525,935.[2] In the future, if the IRS identifies and addresses individuals potentially making improper IRA contributions

[1] Independent third-party data are available to the IRS. Annually, employers send Form W-2 documentation to the Social Security Administration. After the Social Security Administration has processed Form W-2 documentation, it transmits the information to the IRS. In addition, the IRS requires those engaged in a trade or business to annually file accurate miscellaneous income statements to report payments for services of $600 or more made to individuals who are not their employees, *e.g.*, independent contractors.

[2] This figure assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect excise taxes from all potentially noncompliant taxpayers identified. However, the IRS is currently using soft notices for a small sample of potentially noncompliant individuals and has not completed its evaluation of the results. In addition, the IRS states its goal is to change individual behavior instead of collecting additional tax. Therefore, the actual amount of excise taxes collected could be substantially less.

because of ineligible compensation, it could recover more than $37 million over five years in additional excise taxes.[3]

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 151 individuals who potentially received an erroneous notice (see page 5).

Methodology Used to Measure the Reported Benefit:

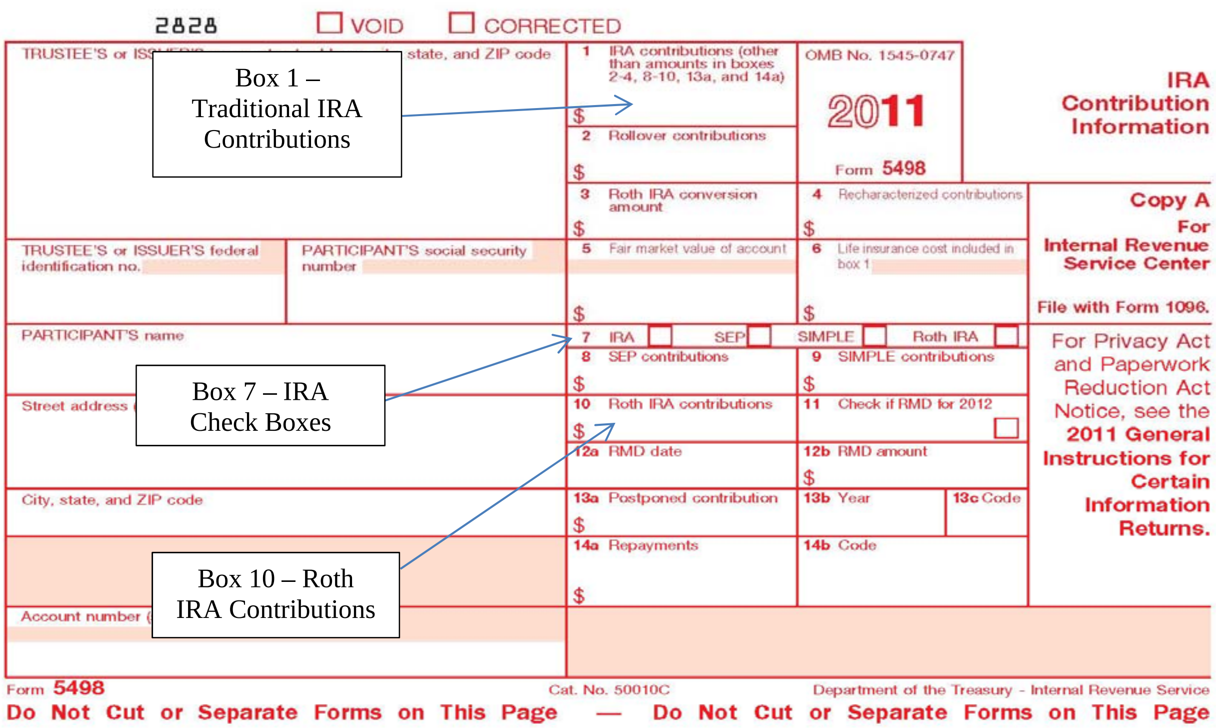
The IRS sent 1,502 individuals a notice for potentially making excess IRA contributions in TY 2011. We independently identified our own population of individuals who potentially made excess contributions as described in Appendix VIII and compared our population with the 1,502 individuals who were sent notices and found 328 individuals whom we did not identify. We analyzed a random sample of these 328 individuals and determined that 18 (36 percent) of 50 individuals appeared to be compliant with IRA rules because they legally withdrew the excess contribution by the due date of the tax return plus extensions to file. In addition to the legal withdrawals, we found that five (10 percent) of the 50 individuals received an improper notice because it was sent to the wrong spouse for married filing jointly tax returns. In these cases, the notices were sent to only the primary taxpayers when the excess contribution was associated with the IRA account of the spouse. Based on these results, we estimate that 151 (10 percent) of the 1,502 individuals who were sent a notice by the IRS received a potentially erroneous notice.[4] If the IRS decides to expand the notification strategy, the number of potential erroneous notices could increase exponentially.

[3] The five-year forecast for the potential for revenue protection is based on multiplying the base year result by five and assumes, among other considerations, that economic conditions and tax laws do not change.
[4] The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident the point estimate is between 109 and 193.

Appendix V

Form 5498, IRA Contribution Information

IRA custodians provide Forms 5498 to the IRS and individuals annually. Key information on IRA contributions can be found in boxes 1, 7, and 10.



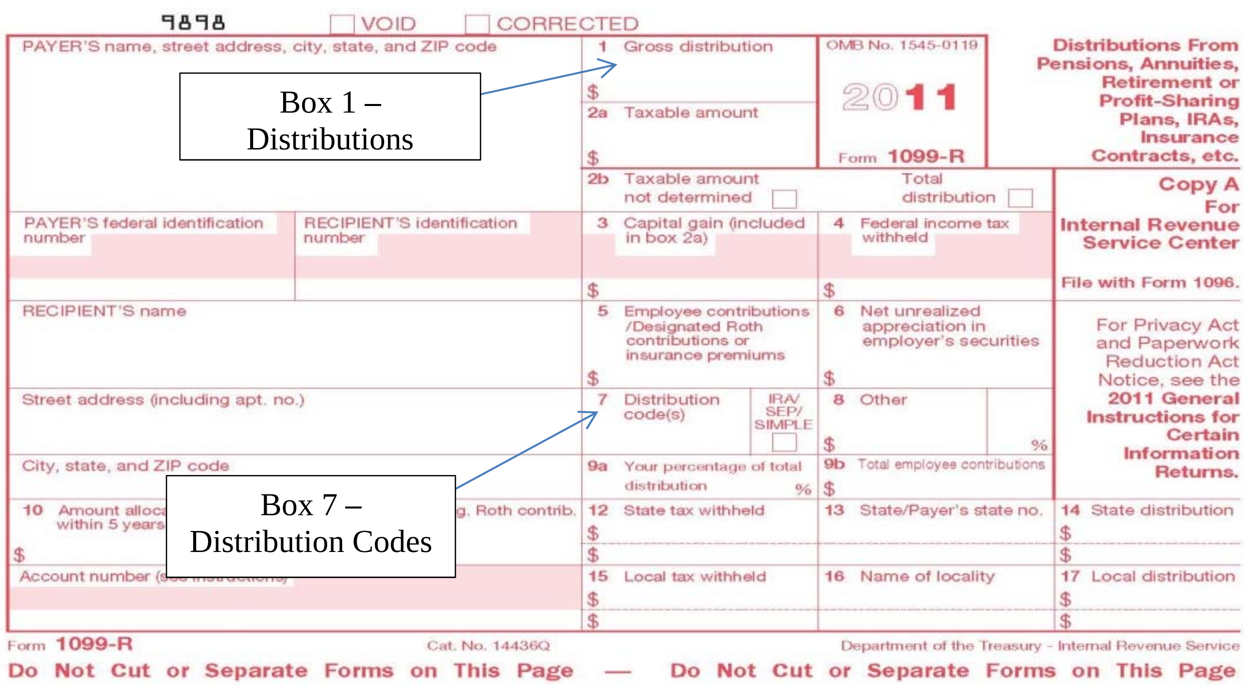
2828 VOID CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city or town, state, and ZIP code
1 IRA contributions (other than amounts in boxes 2-4, 8-10, 13a, and 14a) $
2 Rollover contributions $
OMB No. 1545-0747
2011
Form 5498
IRA Contribution Information
3 Roth IRA conversion amount $
4 Recharacterized contributions $
Copy A For Internal Revenue Service Center
TRUSTEE'S or ISSUER'S federal identification no.
PARTICIPANT'S social security number
5 Fair market value of account $
6 Life insurance cost included in box 1 $
File with Form 1096.
PARTICIPANT'S name
7 IRA SEP SIMPLE Roth IRA
8 SEP contributions $
9 SIMPLE contributions $
Street address
10 Roth IRA contributions $
11 Check if RMD for 2012
12a RMD date
12b RMD amount $
City, state, and ZIP code
13a Postponed contribution $
13b Year
13c Code
14a Repayments $
14b Code
Account number
For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.
Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service
Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Appendix VI

Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, Etc.

IRA custodians provide Forms 1099-R to the IRS and individuals annually. Key information on distributions and whether the distribution is related to an IRA can be found in boxes 1 and 7.



9898 VOID CORRECTED

PAYER'S name, street address, city, state, and ZIP code

Box 1 – Distributions

1 Gross distribution $

2a Taxable amount $

OMB No. 1545-0119

2011

Form 1099-R

Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

2b Taxable amount not determined

Total distribution

Copy A For Internal Revenue Service Center

PAYER'S federal identification number

RECIPIENT'S identification number

3 Capital gain (included in box 2a) $

4 Federal income tax withheld $

File with Form 1096.

RECIPIENT'S name

5 Employee contributions /Designated Roth contributions or insurance premiums $

6 Net unrealized appreciation in employer's securities $

For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.

Street address (including apt. no.)

7 Distribution code(s)

IRA/ SEP/ SIMPLE

8 Other $ %

City, state, and ZIP code

9a Your percentage of total distribution %

9b Total employee contributions $

Box 7 – Distribution Codes

10 Amount alloc... within 5 years $

...g. Roth contrib.

12 State tax withheld $ $

13 State/Payer's state no.

14 State distribution $ $

Account number (see instructions)

15 Local tax withheld $ $

16 Name of locality

17 Local distribution $ $

Form 1099-R Cat. No. 14436Q Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Appendix VII

Internal Revenue Service Methodology to Identify Individuals With Excess Contributions

The following presents the IRS's methodology for identifying individuals with potential excess IRA contributions.

The excess contribution[1] population consists of:

1. Age 70½ or older and contributed an amount greater than $0 to an IRA account.
2. Age 50 or older, but younger than 70½, and contributed greater than $6,000 to an IRA account.
3. Younger than age 50 and contributed an amount greater than $5,000 to an IRA account.

This logic applies to an individual having any combination of one or more traditional or Roth IRAs.

Methodology

Individuals were selected from the Information Returns Master File[2] table Form 5498, *IRA Contribution Information*. The following is a list of qualifying criteria:

1. Individuals met the age and contribution requirements listed above for TY 2011.
2. Form 5498 for each of these individuals specified that the account was a traditional or Roth IRA (Box 7 – IRA or Roth IRA checked).

   Note: If both traditional and Roth for Box 7 was checked, the case was excluded.
3. Business operating division code is Wage and Investment Division only.
4. Individual must have filed a TY 2011 tax return.
5. No decedents.
6. No TY 2011 Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, of any kind present.

[1] Excess contributions due to an improper rollover, spousal contribution, contribution exceeding total compensation, and contribution exceeding reduced limit based on modified adjusted gross income (Roth IRA) were not incorporated into the IRS's methodology.
[2] IRS database that contains third-party information documents for individuals.

7. Individuals could not have an amount greater than $0 for Line 17, *Additional Tax on Excess Contributions to Traditional IRAs*, or Line 25, *Additional Tax on Excess Contributions to Roth IRAs*, of Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.

Population

The population that meets the aforementioned criteria totals 22,634 individuals. Unlike the required minimum distribution methodology, Wage and Investment Division's Research and Analysis function was unable to identify if this noncompliant behavior was exhibited or corrected in TY 2012 because there are no Forms 5498 available via the Compliance Data Warehouse for that tax year yet. The IRS was also unable to identify a suitable proxy.

Appendix VIII

Treasury Inspector General for Tax Administration Methodology to Identify Individuals With Excess Contributions

This appendix details TIGTA's data analysis methodology used to identify individuals with the highest likelihood of potentially having excess IRA contributions for TY 2011. While our analysis is similar to the IRS Wage and Investment Division methodology[1] to identify individuals with excess IRA contributions, there are several key differences.

The following information describes how we identified 80,513[2] individuals above the maximum limit of $6,000 or without appropriate compensation.

- Identified 115,098,422 Form 5498, *IRA Contribution Information*, information returns filed with the IRS for TY 2011. We eliminated the following from the population of 115,098,422 Forms 5498:
  - Forms 5498 reporting both traditional and Roth IRA contributions. This was eliminated because it appears to be a reporting error.
  - Forms 5498 that did not report a traditional or Roth IRA contribution. Forms 5498 are used to report other IRA transactions, *e.g.*, rollover contributions, recharacterized contributions, *etc*.
  - Forms 5498 that had a rollover contribution in the same amount as a traditional IRA and Roth IRA contribution. This could potentially be a rollover inappropriately reported as a contribution.
  - Forms 5498 that had a recharacterization amount and Roth IRA conversion amount in the same amount as a traditional IRA and Roth IRA contribution. This could potentially be a recharacterization inappropriately reported as a contribution.
  - Forms 5498 containing a case amended indicator of 'G' (amended) or 'C' (corrected).
- Analyzed the remaining 11,057,222 Forms 5498 that reported a traditional IRA entry in Box 1 and an entry in Box 7 with the IRA box checked or Box 10 Roth IRA contribution and Box 7 with the Roth IRA box checked.

[1] See Appendix VII.
[2] The 80,513 individuals consist of 23,029 individuals who contributed more than the maximum amount of $6,000 and 57,484 individuals who did not have eligible compensation.

- Eliminated individuals who appeared to be voluntarily compliant by withdrawing the excess contributions through a distribution on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, for TY 2011 or TY 2012.
- Eliminated individuals who reported an amount on Line 17, *Additional Tax on Excess Contributions to Traditional IRAs,* or Line 25, *Additional Tax on Excess Contributions to Roth IRAs,* of Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*.
- Eliminated individuals who had a post-processing adjustment posted to their tax account.

Appendix IX

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

FEB 26 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland *Debra Holland*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Actions Can Be Taken to Further Improve the Strategy for Addressing Excess Contributions to Individual Retirement Arrangements (Audit # 201410008)

We appreciate the opportunity to review and comment on the subject draft report. This review was performed on a limited scope pilot project undertaken by the IRS to gain insights on how we can best leverage our limited compliance resources in addressing the challenges presented by non-compliance with Individual Retirement Arrangement (IRA) contribution limits. Taxpayer and tax return preparer education has been a primary objective of our efforts to improve IRA reporting compliance; however, we believe improvements can be made by expanding our outreach to improve third-party reporting by IRA custodians.

One of the most significant challenges faced by the IRS in administering provisions of the tax code governing IRAs is the level of complexity that may be present with various taxpayer situations, preventing the formulation of a generic approach that would adequately and accurately address all situations. Traditionally, these issues have been addressed through the examination process, which is the most costly and time consuming treatment for addressing compliance issues. Because our limited compliance resources must also address other issues of equal or higher priority than excess IRA contributions, we are exploring the viability of improving compliance through the use of soft notices. We also note that the average potential excise tax deficiency reported by the Treasury Inspector General for Tax Administration, associated with excess IRA contributions, is only $131 per taxpayer[1]. Such a comparatively low yield, when considering the cost of resources needed to address the issue, supports shifting compliance activities to a more economical education and outreach approach afforded by the soft notice process.

[1] Potential Revenue Protection; $7,525,935 in excise tax for 57,484 individuals potentially contributing to an IRA without eligible compensation. Appendix IV, Outcome Measures.

The IRS has had success with using soft notices for alerting taxpayers to potential errors in their treatment of specific issues and in achieving improved compliance rates in subsequent periods; however, that success is predicated on developing effective messaging and supplemental materials to inform and educate the intended recipients. Because poorly designed soft notices could generate increased telephone and correspondence contacts by taxpayers, it is critical that the message conveyed by them is appropriately tested and refined prior to widespread deployment. For this reason, the population of taxpayers to whom the pilot notices would be sent was set at a manageable level. While the report suggests certain segments of the taxpayer population were omitted, it is important to understand that part of the testing process is receiving and responding to taxpayer inquiries. At the time of the pilot, taxpayers having income from businesses or sole proprietorships were excluded because compliance personnel supporting the pilot had not been trained to address the issues found on the returns of that taxpayer segment. Since then, as a result of organizational change unrelated to the soft notice pilot, the Wage and Investment Division has received the appropriate training and future phases of the soft notice testing will include all taxpayer populations. As we refine the soft notice process for potential non-compliance with IRA contribution limits, we will consider the findings included in this report along with the results of our data analysis.

Attached is our response to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Return Integrity and Compliance Services, Wage and Investment Division, at (404) 338-8961.

Attachment

Attachment

Recommendations

When evaluating future efforts related to the IRA strategy, the Commissioner, Wage and Investment Division, should consider:

RECOMMENDATION 1
Developing education materials for IRA custodians informing them of common mistakes made on information documents and the importance of submitting accurate information documents.

CORRECTIVE ACTION
We will continue to inform Individual Retirement Arrangement (IRA) custodians of issues and errors affecting the administration of IRAs from a taxation perspective. Communications, such as those provided in the IRS' *Employee Plans News* will continue to be coordinated with stakeholders to ensure the message content and delivery modes are effective for addressing and reducing common IRA reporting errors by custodians.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Communications and Liaison, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
Identifying a more complete and accurate universe of individuals who potentially made excess contributions from which to select potentially productive cases.

CORRECTIVE ACTION
We agree with this recommendation as it is a logical next step in expanding the IRA soft notice program from its current pilot state. As the scale of the notice program is increased, we will use the findings from the analysis of the pilot project results to expand the scope of notice recipients. However, we will continue to evaluate the pilot from a budget perspective.

IMPLEMENTATION DATE
October 15, 2016

RESPONSIBLE OFFICIAL
Director, Refundable Credits Policy and Program Management, Return Integrity and Compliance Services, Wage and Investment Division

2

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.