TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued

March 26, 2014

Reference Number: 2014-10-017

Redaction Legend:
2 = Risk Circumvention of Agency Regulation or Statute

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

MILLIONS OF DOLLARS IN POTENTIALLY IMPROPER CLAIMS FOR THE QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS CREDIT ARE NOT PURSUED

Highlights

Final Report issued on March 26, 2014

Highlights of Reference Number: 2014-10-017 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Since Tax Year 2002, the Federal Government has provided a Qualified Retirement Savings Contributions Credit (hereafter referred to as the saver's credit) to reduce income taxes of certain low- to moderate-income workers who contribute to a qualified retirement plan. For Tax Year 2011, taxpayers received approximately $1.1 billion in saver's credits. If adequate controls are not in place to ensure compliance with all requirements of the law, the IRS may not be able to detect potentially improper saver's credits.

WHY TIGTA DID THE AUDIT

The overall objective was to determine whether IRS controls were adequate to identify improper claims for the saver's credit. This review is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

The IRS developed and implemented controls for submission processing that generally prevented taxpayers from receiving the saver's credit if they were under 18 years of age, had an income level that exceeded eligibility limits, or were claiming a credit that exceeded the statutory limit. ***************2******************* ***********************2****************************** **********************2****************************** ***********************2****************************** *****2***.

While the IRS implemented sufficient controls for submission processing, TIGTA determined that *************************2*************************** *************************2*************************** *************************2*************************** ****2****************. For Tax Year 2011, TIGTA determined that taxpayers potentially made approximately $53 million in improper claims for contributions made to a qualifying retirement account. Based on a comparison with third party data, these claims appear to be potentially either false or overstated. In the future, if the IRS identifies and addresses taxpayers who are potentially ineligible to receive the saver's credit, it could recover approximately $264 million over five years.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, develop a cost-effective strategy for improving compliance with requirements for claiming the saver's credit.

In their response to the report, IRS officials agreed that improvements could be made to increase compliance with saver's credit requirements. However, IRS officials did not agree with the recommendation because they do not believe that there are cost-effective compliance alternatives.

Given the significant number of taxpayers identified claiming potentially improper saver's credits, as well as the potential for continued noncompliance in the future, TIGTA continues to believe that the IRS should follow through with this recommendation.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

March 26, 2014

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued (Audit # 201310027)

This report presents the results of our review to determine whether Internal Revenue Service (IRS) controls were adequate to identify improper claims for the Qualified Retirement Savings Contributions Credit (hereafter referred to as the saver's credit). This review is included in our Fiscal Year 2014 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 VII.

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).

Table of Contents

Abbreviations

AGI	Adjusted Gross Income
IRA	Individual Retirement Arrangement
IRS	Internal Revenue Service
W&I	Wage and Investment

Millions of Dollars in Potentially Improper

Background

Since Tax Year[1] 2002, the Federal Government has provided a Qualified Retirement Savings Contributions Credit (hereafter referred to as the saver's credit) to reduce income taxes of certain low- to moderate-income workers who contribute to a qualified retirement plan. Figure 1 shows the number of tax returns filed by taxpayers claiming the saver's credit as well as the amount of saver's credit that taxpayers received between Tax Years 2009 and 2011.

Figure 1: Saver's Credit Claims (Tax Years 2009–2011)

Tax Year	2009	2010	2011
Tax Returns Claiming the Saver's Credit	6,373,142	6,188,650	6,395,226
Total Saver's Credit Received	$1.07 Billion	$1.05 Billion	$1.10 Billion

Source: Treasury Inspector General for Tax Administration analysis of Internal Revenue Service (IRS) tax return data.

The saver's credit supplements other tax benefits available to people who set money aside for retirement.[2] Individuals eligible for the saver's credit may reduce any Federal income taxes that would otherwise be owed, but the saver's credit is not refundable if the amount exceeds the tax liability owed. In addition, any unused credit is not eligible to be carried forward to another tax year.

Taxpayers must meet the following requirements to be eligible for the saver's credit:

- 18 years or older.
- Adjusted gross income (AGI) is not above designated income levels based on the filing status of the individual.

[1] See Appendix VI for a glossary of terms.
[2] For example, workers eligible for the saver's credit, whose earnings are not taxed until they are withdrawn in retirement, may be allowed to deduct contributions to a traditional individual retirement arrangement (IRA). Others eligible for the saver's credit may be making contributions to a Roth IRA, which is not deductible; however, qualifying withdrawals, usually made after retirement, are tax free.

- Not a full-time student.[3]
- Not claimed as a dependent on another taxpayer's tax return.

In order to claim the saver's credit on line 50 of Form 1040, *U.S. Individual Income Tax Return,*[4] taxpayers must make eligible contributions to a qualified retirement account.[5] The amount of saver's credit that a taxpayer will actually receive is based on the taxpayer's filing status, AGI, tax liability, and amount contributed to a qualifying retirement account. Qualified retirement plan contributions that are used to calculate the amount of the saver's credit are limited to $2,000 per taxpayer (if married filing jointly, the maximum contribution to a retirement account is $2,000 for each spouse).

The saver's credit provides a means for low- to moderate-income workers to help save for retirement.

Once the amount of qualified contribution is established, the amount of the saver's credit that the taxpayer will receive can be as low as 10 percent of the eligible contribution or as high as 50 percent of the eligible contribution depending on the filing status and AGI of the taxpayer. As a result, the saver's credit for single filers can never exceed $1,000, and the saver's credit for joint filers can never exceed $2,000.

In addition, taxpayers must complete and attach Form 8880, *Credit for Qualified Retirement Savings Contributions,*[6] to their Form 1040 to be able to claim the saver's credit. Form 8880 provides specific instructions on eligibility requirements and provides instructions for calculating the saver's credit. Taxpayers input the amount of contributions made to a qualifying retirement account and calculate the amount of credit on Form 8880. The IRS uses Form 8880 to mathematically verify taxpayer calculations.

The IRS Wage and Investment (W&I) Division is responsible for ensuring that taxpayers claiming the saver's credit are complying with the law. As such, the W&I Division establishes controls to check for errors or improper refunds during the processing of individual tax returns.

[3] An individual is a student if, during any part of five calendar months during the tax year, he or she was enrolled as a full-time student or took a full-time, on-farm training course given by a school or a State, county, or local government agency.
[4] Form 1040 series tax returns include Form 1040, Form 1040A, *U.S. Individual Income Tax Return*, and Form 1040NR, *U.S. Nonresident Alien Income Tax Return* (line number the credit is claimed on varies by specific type of return).
[5] Eligible contributions include: 1) contributions (other than rollover contributions) to a traditional or Roth IRA; 2) elective deferrals to a 401(k) plan, 403(b) plan, Governmental 457 plan, Simplified Employee Pension plan, or Savings Incentive Match Plan for Employees; 3) voluntary employee contributions to a qualified retirement plan as defined in Section 4974(c) (including the Federal Thrift Savings Plan); or 4) contributions to a 501(c)(18)(D) plan.
[6] See Appendix V for a copy of the Form 8880.

In addition, after the filing process has been completed, the W&I Division administers the Automated Underreporter program, which uses third-party documents (*e.g.*, Forms W-2, *Wage and Tax Statement*, and Forms 5498, *IRA Contribution Information*) to identify taxpayers who have potentially understated or overstated entries on previously processed tax returns. Differentiating between submission processing controls (automated checks applied to tax returns as they are received) and post–submission processing controls (matching of third-party documents to tax returns and examinations) is important because submission processing controls are generally less costly to operate and more effective in preventing errors.

This review was performed by interviewing and reviewing documentation from the offices of Submission Processing and the Compliance Automated Underreporter program of the W&I Division in Atlanta, Georgia, during the period April through December 2013. 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

When Information Is Available to Verify Taxpayer Eligibility, Improper Saver's Credits Are Generally Prevented

IRS controls were generally effective in preventing taxpayers from improperly receiving the saver's credit when information was available during submission processing to verify eligibility requirements. For example, the IRS developed and implemented controls for submission processing that generally prevented taxpayers from claiming the saver's credit if they were under 18 years of age, had an income level that exceeded eligibility limits, or were claiming a credit that exceeded the statutory limit. The IRS was able to implement these controls so that they are effective during submission processing because information is available either from the tax return itself or another data file that is maintained by the IRS.

> ***When sufficient information is available during submission processing, the IRS generally prevents taxpayers from receiving saver's credits for which they are not eligible.***

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*****************2******************. In these instances, the IRS relies on post-filing matching programs and other compliance programs ***********2******************
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*************2***************and, therefore, **************2*******************
**********2****************. As a result, the IRS is at risk of allowing ineligible taxpayers to receive the saver's credit, which ultimately means revenue is lost to the Federal Government.

<u>Most taxpayers under the age of 18 were prevented from receiving the saver's credit</u>

IRS submission processing controls effectively limited taxpayers from receiving the saver's credit when they were under the age of 18. For Tax Year 2011, using date of birth information maintained by the Social Security Administration, we identified that only four out of nearly 6.4 million saver's credit claims were by taxpayers who received the saver's credit when they were under the age of 18. The IRS was able to effectively limit the number of underage taxpayers receiving the saver's credit because, at the time the tax return is processed, information on the tax return is matched to date of birth information from the Social Security Administration to verify the age of the taxpayer. Tax examiners then review all instances identified by the matching application as having a high likelihood of the taxpayer being ineligible for the credit, including instances for which the date of birth showed the taxpayer to be under the age of 18.

Most taxpayers were prevented from receiving the saver's credit when their AGI exceeded established threshold limits

IRS submission processing controls effectively limited taxpayers from receiving the saver's credit when their AGI exceeded established threshold limits. For Tax Year 2011, the taxpayer's AGI must not exceed $28,250 for single, married filing separately, and qualifying widow(er) filing statuses; $42,375 for head of household filing status; or $56,500 for married filing jointly filing status. We identified that only 94 out of nearly 6.4 million saver's credit claims were by taxpayers who received the saver's credit when their AGI exceeded the maximum amount allowable based on the filing status of the taxpayer.

The IRS was able to effectively identify taxpayers exceeding AGI limitations because controls had been established to mathematically verify the accuracy of the saver's credit based on the taxpayer's AGI and filing status reported on the tax return. If the taxpayer's AGI exceeds a maximum income level that is established for each filing status, the IRS adjusts the saver's credit to zero.

Most taxpayers were prevented from receiving a saver's credit that exceeded the statutory limit

IRS submission processing controls effectively prevented taxpayers from claiming more than the maximum saver's credit. Single filers may claim a maximum saver's credit of $1,000, and married filing joint filers may claim a maximum saver's credit of $2,000. For Tax Year 2011, we identified that only seven out of nearly 6.4 million saver's credit claims were by taxpayers who received more than the maximum credit.

The IRS was able to effectively identify taxpayers who were claiming more than the maximum credit because it limited the amount of retirement account contributions that could be used to calculate the credit to $2,000 per individual taxpayer, *e.g.*, married taxpayers filing a joint tax return can contribute up to $4,000. In the event that taxpayers contributed more than this amount, the IRS adjusted the amount of contributions for purposes of calculating the saver's credit to the maximum credit allowed per taxpayer.

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2*******. The IRS would need to examine taxpayers' books and records after tax returns have been filed to identify those who are ineligible for the saver's credit ***2******

*****2*******. We attempted to test this requirement and, ***2*****, could not identify a reliable source to verify this eligibility requirement. *************2****************** *********************2*****************************, the Federal Government is at risk of losing revenue due to ineligible taxpayers improperly claiming the saver's credit.

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***************************2****************************. We determined that the IRS has implemented controls after submission processing to detect taxpayers who claimed a personal exemption and were claimed as a dependent on another tax return. Once this situation is detected, the IRS researches both tax returns and corresponds with both taxpayers[7] to assess which taxpayer should be granted the exemption. If a taxpayer who claimed the saver's credit determines that another taxpayer correctly claimed them as a dependent, the taxpayer should amend his or her tax return and would no longer be eligible for the saver's credit. We identified 2,452 tax returns on which taxpayers claimed the saver's credit and a personal exemption who were also claimed as a dependent by another taxpayer. Adjustments to the exemptions of taxpayers who claimed a personal exemption and were claimed as a dependent by another taxpayer were made while we were conducting our audit; therefore, we could not determine how many taxpayers improperly claimed the saver's credit in this manner.[8]

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[7] The IRS sends a soft notice to both taxpayers telling them that they have made a mistake and asking which taxpayer is entitled to the exemption. If the taxpayer is not entitled to the exemption, the IRS encourages the taxpayer to amend the tax return.
[8] IRS compliance programs were still performing work on Tax Year 2011 tax returns during the fieldwork portion of our audit.

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*******2*******. Taxpayers input the amount of contributions made to a qualifying retirement account and calculate the amount of the saver's credit on Form 8880. The IRS also receives third-party information on Forms 5498 and Forms W-2, which can be used to independently verify that a qualifying contribution to a retirement account has been made.[9] We used Tax Year 2011 tax return information associated with the saver's credit and compared it to retirement plan contributions reported by third parties on Forms 5498 and Forms W-2. We determined that 280,542[10] out of nearly 6.4 million saver's credit claims were by taxpayers who potentially either falsely claimed or overstated the amount of contributions made to a qualifying retirement account.

IRS officials advised us that some of the 280,542 tax accounts may have had post-filing tax adjustments as a result of the Automated Underreporter program or the taxpayer filing an amended return. We reviewed these tax accounts and determined that 20,081 (7 percent) of the 280,542 tax accounts may have had the saver's credit reduced due to a post-filing tax adjustment to the taxpayer's account.[11]

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2**.[12] In addition, they advised us that similar cases dealing with retirement issues result in tax adjustments that average approximately $850. ********2*************
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[9] Independent third-party data are available to the IRS to corroborate retirement plan contributions. Annually, the trustee or administrator of a retirement plan provides the IRS and all plan participants with Forms 5498. In addition, 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.
[10] Based on our analysis of Tax Year 2011 tax returns, Forms W-2, and Forms 5498, we identified 100,137 saver's credit claims for which taxpayers potentially overstated the amount of contributions and 180,405 saver's credit claims for which taxpayers potentially did not have any contributions.
[11] This was based on IRS data from May 2013 for taxpayers who were identified as having a post-filing adjustment. The IRS does not have data to determine the specific reason(s) for post-filing adjustments; thus, we could not determine whether the adjustment was related to the saver's credit.
[12] This dollar amount was provided by the IRS and was not verified by the Treasury Inspector General for Tax Administration. According to the IRS, this cost includes all primary and secondary costs.

Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued

*********2****************, we believe that there are other actions besides a high-cost examination that could be taken by the IRS. For instance, the IRS could use other tools to improve compliance, such as soft notices or education and outreach, that would not be as labor-intensive or expensive as a full correspondence audit. In addition, if potential compliance problems are addressed early on, voluntary compliance may improve in the future.

Figure 2 shows a distribution analysis of the 260,461 saver's credit claims by taxpayers who did not have a post-filing tax adjustment and may have improperly received the saver's credit. Potential tax adjustments ranged from $50 to $2,000, with an average adjustment of $203. If the IRS were to pursue recovery of potentially improper credits through the Automated Underreporter program, it could concentrate on the cases with the highest potential tax adjustments. For example, we noted that 3,592 cases existed with a saver's credit tax adjustment that could potentially exceed $850. In those cases for which it would not be cost beneficial to pursue recovery through the Automated Underreporter program, the IRS could consider alternative compliance or education and outreach approaches.

Figure 2: Distribution Analysis of the 260,461 Saver's Credit Claims by Taxpayers Who Claimed Potentially Improper Saver's Credits in Tax Year 2011

Saver's Credit Potential Adjustment Distribution		
Less Than $300	**$300 – $850**	**Greater Than $850**
218,557	38,312	3,592

Source: Treasury Inspector General for Tax Administration analysis of Tax Year 2011 saver's credit cases.

A cost-effective strategy to address saver's credit noncompliance could assist in recovering some of the $52.9 million dollars in potentially improper saver's credit claims from Tax Year 2011. In the future, if the IRS identifies and addresses taxpayers who are potentially ineligible to receive the saver's credit, it could recover approximately $264 million over five years.[13]

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

Recommendation

Recommendation 1: The Commissioner, W&I Division, should develop a cost-effective strategy to improve compliance with requirements for claiming the saver's credit. For example, the IRS could choose to use the Automated Underreporter program when it is cost beneficial to do so and could choose to use less expensive compliance or education and outreach approaches when use of the Automated Underreporter program would be cost prohibitive.

> **Management's Response:** The IRS did not agree with this recommendation. The IRS stated that, while improvements could be made to improve compliance with the saver's credit requirements, it does not believe that effective actions can be implemented in a cost-effective manner. The IRS stated that potential recoveries which may be realized from additional controls would be eclipsed by the lost opportunity costs of displaced work with higher potential.
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> **Office of Audit Comment:** Given the significant number of taxpayers we identified claiming potentially improper saver's credits as well as the potential for continued noncompliance in the future, we continue to believe that the IRS should follow through with this recommendation.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether IRS controls were adequate to identify improper claims for the Qualified Retirement Savings Contributions Credit[1] (hereafter referred to as the saver's credit). To accomplish this objective, we:

I. Evaluated the design of existing procedures and controls for identifying improper claims for the saver's credit.

   A. Assessed the IRS's guidelines for identifying improper saver's credit claims when tax returns are processed.

   B. Assessed guidelines for identifying improper saver's credit claims through the matching of tax return information with Forms 5498, *IRA Contribution Information*, and Forms W-2, *Wage and Tax Statement*, after tax returns are processed.

II. Identified potentially improper claims for the saver's credit on Tax Year 2011 tax returns.

   A. Determined if taxpayers may have falsely claimed or overstated the amount of contributions made to a qualifying retirement account by reviewing all Forms 1040, *U.S. Individual Income Tax Return*, and associated third-party data reported on Forms 5498 and Forms W-2 for Tax Year 2011.

      1. Compared tax return information on Forms 1040 and attached Forms 8880, *Credit for Qualified Retirement Savings Contributions*, to retirement plan contributions reported by third parties on Forms 5498 and Forms W-2.[2] We calculated the correct amount of the saver's credit and summarized the differences as potential increased revenue.

   B. Determined if taxpayers improperly received the saver's credit when they claimed more than the statutory limit based on their filing status.

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[1] See Appendix VI for a glossary of terms.

[2] To assess the reliability of computer-processed data, programmers in the Treasury Inspector General for Tax Administration Office of Strategic Data Services validated the data that were extracted. To provide additional assurance that the data received were supported by external sources, we verified the accuracy of information from Forms 5498, Forms W-2, and Forms 1040 by researching the IRS's Integrated Data Retrieval System, which is the IRS computer system capable or retrieving and updating stored taxpayer account information, for a nonrepresentative selection of seven accounts. Based on our tests, we concluded that the data were sufficiently reliable for our audit.

C. Determined if taxpayers improperly received the saver's credit when their AGI exceeded established threshold limits.[3]

D. Determined if taxpayers improperly received the saver's credit when they were under the age of 18.

E. Assessed whether taxpayers who were claimed as a dependent on another taxpayer's return improperly received the saver's credit.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices for receiving and validating saver's credit information reported on the Forms 8880 attached to taxpayers' returns. We evaluated these controls by interviewing management, reviewing Form 8880 information for which the taxpayer received a saver's credit that was inconsistent with other information on the tax return, and comparing Form 5498 and Form W-2 information with Form 8880 information.

[3] For Tax Year 2011, limits are $28,250 for taxpayers with a filing status of single, married filing separately, or qualifying widow(er); $42,375 for taxpayers with a filing status of head of household; and $56,500 for taxpayers with a filing status of married filing jointly.

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
Jeffrey R. Stieritz, Lead Auditor
Margaret A. Anketell, Senior Auditor
David M. Bueter, Auditor
Allison P. Meyer, Auditor
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
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    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 action will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $52,880,149 from 260,461 Tax Year[1] 2011 accounts identified with improper Qualified Retirement Savings Contributions Credits (hereafter referred to as the saver's credit) because the taxpayer potentially falsely claimed or overstated the amount of contributions made to a qualifying retirement account, or $264,400,745 over five years (see page 7).[2]

Methodology Used to Measure the Reported Benefit:

Using information from Tax Year 2011 Forms 1040, *U.S. Individual Income Tax Return*, we analyzed the 6,395,226 accounts for taxpayers who received the saver's credit to determine if the taxpayer potentially falsely claimed or overstated the amount of contributions made to a qualifying retirement account. Taxpayers input the amount of contributions made to a qualifying retirement account and calculate the amount of credit on Form 8880, *Credit for Qualified Retirement Savings Contributions*. The IRS also receives third-party information on Forms 5498, *IRA Contribution Information*, and Forms W-2, *Wage and Tax Statement*, which can be used to independently verify that a qualifying contribution to a retirement account has been made.[3] We used the tax return information associated with the saver's credit and compared it to retirement plan contributions reported by third parties on Forms 5498 and Forms W-2. We determined that 280,542 taxpayers potentially falsely claimed or overstated the amount of contributions made to a qualifying retirement account.

After the IRS advised us that some of the 280,542 tax accounts may have had a post-filing adjustment as a result of the Automated Underreporter program or the taxpayer filing an amended return, we eliminated those tax accounts that had a post-processing tax adjustment

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[1] See Appendix VI for a glossary of terms.
[2] The five-year forecast for the potential for increased revenue is based on multiplying the base year result by five and assumes, among other considerations, that economic conditions and tax laws do not change.
[3] Independent third-party data are available to the IRS to corroborate retirement plan contributions. Annually, the trustee or administrator of a retirement plan provides the IRS and all plan participants with Forms 5498. In addition, employers send Form W-2 documentation to the Social Security Administration. After the Social Security Administration has processed the Form W-2 documentation, it transmits the information to the IRS.

posted to the account. We determined that 20,081 (7 percent) of the 280,542 tax accounts may have had the saver's credit reduced due to post-filing adjustments.[4] Therefore, we determined that 260,461 taxpayers potentially falsely claimed or overstated the amount of contributions made to a qualifying retirement account and received $52,880,149 in saver's credits. In the future, if the IRS identifies and addresses taxpayers who are potentially ineligible to receive the saver's credit, it could recover approximately $264 million over five years.

[4] This was based on IRS data from May 2013 for taxpayers who were identified as having a post-filing adjustment (280,542 - 20,081 = 260,461). The IRS does not have data to determine the specific reason(s) for post-filing adjustments; thus, we could not determine whether the adjustments were related to the saver's credit.

Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued

Appendix V

Form 8880, Credit for Qualified Retirement Savings Contributions

Form **8880** — **Credit for Qualified Retirement Savings Contributions**

Department of the Treasury
Internal Revenue Service

► Attach to Form 1040, Form 1040A, or Form 1040NR.
► See instructions on back.

OMB No. 1545-0074
2011
Attachment Sequence No. 54

Name(s) shown on return | **Your social security number**

CAUTION

You **cannot** take this credit if **either** of the following applies.

- The amount on Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 37 is more than $28,250 ($42,375 if head of household; $56,500 if married filing jointly).
- The person(s) who made the qualified contribution or elective deferral **(a)** was born after January 1, 1994, **(b)** is claimed as a dependent on someone else's 2011 tax return, or **(c)** was a **student** (see instructions).

			(a) You	(b) Your spouse
1	Traditional and Roth IRA contributions for 2011. **Do not** include rollover contributions	1		
2	Elective deferrals to a 401(k) or other qualified employer plan, voluntary employee contributions, and 501(c)(18)(D) plan contributions for 2011 (see instructions)	2		
3	Add lines 1 and 2	3		
4	Certain distributions received **after** 2008 and **before** the due date (including extensions) of your 2011 tax return (see instructions). If married filing jointly, include **both** spouses' amounts in **both** columns. See instructions for an exception	4		
5	Subtract line 4 from line 3. If zero or less, enter -0-	5		
6	In each column, enter the **smaller** of line 5 or $2,000	6		

7 Add the amounts on line 6. If zero, **stop**; you cannot take this credit . . . 7

8 Enter the amount from Form 1040, line 38*; Form 1040A, line 22; or Form 1040NR, line 37 . . . 8

9 Enter the applicable decimal amount shown below: . . . 9 x.

If line 8 is—		And your filing status is—		
Over—	But not over—	Married filing jointly	Head of household	Single, Married filing separately, or Qualifying widow(er)
		Enter on line 9—		
---	$17,000	.5	.5	.5
$17,000	$18,250	.5	.5	.2
$18,250	$25,500	.5	.5	.1
$25,500	$27,375	.5	.2	.1
$27,375	$28,250	.5	.1	.1
$28,250	$34,000	.5	.1	.0
$34,000	$36,500	.2	.1	.0
$36,500	$42,375	.1	.1	.0
$42,375	$56,500	.1	.0	.0
$56,500	---	.0	.0	.0

Note: *If line 9 is zero,* ***stop****; you cannot take this credit.*

10 Multiply line 7 by line 9 . . . 10

11 Enter the amount from Form 1040, line 46; Form 1040A, line 28; or Form 1040NR, line 44 . . . 11

12 **1040 filers:** Enter the total of your credits from lines 47 through 49, and Schedule R, line 22.
1040A filers: Enter the total of your credits from lines 29 through 31.
1040NR filers: Enter the total of your credits from lines 45 and 46. . . . 12

13 Subtract line 12 from line 11. If zero, **stop**; you cannot take this credit . . . 13

14 **Credit for qualified retirement savings contributions.** Enter the **smaller** of line 10 or line 13 here and on Form 1040, line 50; Form 1040A, line 32; or Form 1040NR, line 47 . . . 14

*See Pub. 590 for the amount to enter if you are filing Form 2555, 2555-EZ, or 4563 or you are excluding income from Puerto Rico.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 33394D Form **8880** (2011)

Source: IRS.gov.

Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued

Appendix VI

Glossary of Terms

Term	Definition
401(k) Plan[1]	A defined contribution plan to which an employee can make contributions from his or her paycheck either before or after taxes, depending on the options offered in the plan. The contributions go into a 401(k) account, with the employee often choosing the investments based on options provided under the plan. In some plans, the employer also makes contributions, such as matching the employee's contributions up to a certain percentage.
403(b) Plan[2]	A tax-sheltered annuity retirement plan (often referred to as a 403(b) plan or a tax-deferred annuity plan) for employees of public schools and certain tax-exempt organizations. Generally, a tax-sheltered annuity plan provides retirement benefits by purchasing annuity contracts for its participants.
501(c)(18)(D) Plan	A pension plan created before June 25, 1959, that is funded entirely by employee contributions.
Adjusted Gross Income	Income after certain adjustments are made but before standard or itemized deductions and personal exemptions are subtracted.
Credit	A credit is normally preferred to a deduction because it reduces tax due dollar-for-dollar as opposed to a deduction, which decreases taxable income.
Exemptions	There are two types of exemptions—personal and dependency. Personal exemptions are limited to the taxpayer and his or her spouse, and dependency exemptions are for anyone else the taxpayer can properly claim as a dependent on a tax return. If a taxpayer can properly claim a dependent on his or her return, then the dependent taxpayer cannot claim himself or herself as a personal exemption.
Filing Status	Filing status is used to determine filing requirements, standard deduction, eligibility for certain credits and deductions, and correct tax. There are five filing statuses: single, married filing jointly, married filing separately, head of household, and qualifying widow(er) with dependent child.

[1] Internal Revenue Code § 401(k).
[2] Internal Revenue Code § 403(b).

Term	Definition
Governmental 457 Plan[3]	A retirement plan normally open to all employees working for a State or local government. Both the plan sponsor and participants are permitted to make pretax contributions.
Roth IRA	An IRA that is subject to the rules that apply to a traditional IRA, except the contributions to a Roth IRA cannot be deducted. However, the distributions are tax free if certain conditions are met.
Savings Incentive Match Plan for Employees	A plan in which a small business with 100 or fewer employees can offer retirement benefits through employee salary reductions and employer nonelective or matching contributions (similar to those found in a 401(k) plan). These plans impose few administrative burdens on employers because the IRAs are owned by the employees and the bank or financial institution receiving the funds does most of the paperwork. While each has some different features, including contribution limits and the availability of loans, required employer contributions are immediately 100 percent vested in both.
Simplified Employee Pension Plan	A plan in which an employer contributes on a tax-favored basis to the IRAs owned by its employees. If the employer meets certain conditions, it is not subject to the reporting and disclosure requirements of most retirement plans. Under a Simplified Employee Pension plan, an IRA is set up by or for an employee to accept the employer's contributions.
Soft Notice	Soft notices do not require that the taxpayer pay more tax, provide documentation, or even respond to the IRS. Although the notice requests that the taxpayer 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.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Traditional IRA	An individual account or annuity established with a financial institution, such as a bank or mutual fund company. Under Federal law, individuals may set aside personal savings up to a predetermined amount each year. The investments grow, tax deferred, over time. In addition, participants can transfer money from an employer retirement plan to an IRA when leaving an employer. Finally, the IRAs can also be an option as part of an employer plan.

[3] Internal Revenue Code § 457.

Appendix VII

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

February 12, 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Peggy Bogadi Debra S. Holland for Peggy Bogadi
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Millions of Dollars in Potentially Improper Claims for the Qualified Retirement Savings Contributions Credit Are Not Pursued (Audit # 201310027)

Thank you for the opportunity to review the subject draft report. We appreciate the recognition that controls used during tax return processing were successful in preventing substantially all improper Retirement Savings Contribution Credit (Saver's Credit) claims when corroborating data was available to determine ineligibility.

As noted in the report, the ability to address improper claims becomes more challenging when data is not available during the initial processing of the return. Despite the challenges presented by having to identify certain improper claims using post-processing analysis, we believe the controls in place do provide a reasonable assurance of detecting improper claims, when considered in the context of the materiality of the credit amount, the cost of addressing potentially improper claims, and the opportunity costs of displacing other work that yields higher productivity. As noted in the report, 280,542, or 4.4 percent, of the 6.4 million taxpayers claiming the credit appeared to improperly claim or overstate the Saver's Credit. Of that population, 20,081 were addressed by compliance functions. Of the remaining population that was not addressed, only 3,592 (0.06 percent) had a credit claim exceeding $850. With a maximum allowable credit of $1,000 ($2,000 for joint filers), the incremental benefit to be derived from expanded controls is not substantial.

Tax returns claiming the Saver's Credit may not be selected for review or examination specifically for that issue; however, that does not preclude the IRS from proposing adjustments to the credit when it is selected for other issues. Examiners are required to consider any large, unusual, or questionable item they observe on a return during its examination; and have the ability to expand the scope of the examination to include such items. Commensurately, when adjustments are made to any items that affect the computation of the Saver's Credit, such as deductions for contributions to retirement savings, other income and expenses affecting Adjusted Gross Income, or a finding that the taxpayer does not otherwise qualify, the Saver's Credit will be recalculated and adjusted accordingly.

We continue to look for ways to identify areas of noncompliance and address them within our limited resources. We agree that current controls do not identify all returns with potential Saver's Credit errors; however, additional returns identified for review would also compete for limited examination resources with other returns having a higher productivity potential. The use of soft notices to address non-compliance also consumes limited resources through increased telephone and correspondence contacts; as well ensuring adequate staff is available to follow-up on non-respondents.

Attached are our comments to your recommendation. If you have any questions, please contact me, or a member of your staff may contact Steve Klingel, Director, Reporting Compliance, Wage and Investment Division, at (404) 338-9085.

Attachment

Attachment

Recommendation

RECOMMENDATION
The Commissioner, W&I Division, should develop a cost-effective strategy to improve compliance with requirements for claiming the saver's credit. For example, the IRS could choose to use the Automated Underreporter program when it is cost beneficial to do so and could choose to use less-expensive compliance or education and outreach approaches when use of the Automated Underreporter program would be cost prohibitive.

CORRECTIVE ACTION
We agree that improvements could be made to improve compliance with the Retirement Savings Contribution Credit requirements; however, we do not believe effective actions can be implemented in a cost-effective manner. The potential recoveries that may be realized from additional controls would be eclipsed by the lost opportunity costs of displaced work with higher potential.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A