



*Improvements Can Be Made to
Educate and Notify Taxpayers of
Required Minimum Distribution
Requirements From Individual
Retirement Arrangements*

May 29, 2015

Reference Number: 2015-10-042

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

2 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

IMPROVEMENTS CAN BE MADE TO EDUCATE AND NOTIFY TAXPAYERS OF REQUIRED MINIMUM DISTRIBUTION REQUIREMENTS FROM INDIVIDUAL RETIREMENT ARRANGEMENTS

Highlights

Final Report issued on May 29, 2015

Highlights of Reference Number: 2015-10-042 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Individual Retirement Arrangements (IRA) are a key method for individuals to save for retirement. Some types of IRAs require taxpayers to begin withdrawing a minimum amount when they reach age 70½. When taxpayers do not make these withdrawals, there is a loss of revenue to the Government because taxpayers are sheltering IRA funds from taxation.

WHY TIGTA DID THE AUDIT

As a result of previous audits, TIGTA recommended that the IRS develop a strategy to address retirement provision noncompliance. In addition, there is congressional interest in educating taxpayers with respect to IRA provisions and not unreasonably penalizing them for innocent mistakes. The overall objective of this audit was to determine whether IRS processes provide reasonable assurance that taxpayers are complying with provisions for taking required minimum distributions from their IRAs.

WHAT TIGTA FOUND

In response to prior TIGTA recommendations, the IRS developed a broad-based strategy that focuses on educating tax preparers and individuals about IRA rules and notifying potentially noncompliant taxpayers of the minimum distribution requirement. This is a significant improvement from our prior reporting. However, the IRS could also take steps to improve its strategy.

As part of its strategy, the IRS developed educational materials for taxpayers and tax preparers. However, TIGTA believes taxpayers required to take distributions could benefit from more direct methods of communication. For example, informing taxpayers when they reach the age of 70½ that they are required to take a distribution could raise awareness and prevent significant penalties associated with noncompliance.

As part of its strategy, the IRS also sent notices to nearly 1,500 potentially noncompliant taxpayers. The IRS is still in the process of evaluating the results of the sample of notices it distributed. If the IRS expands its notice program, TIGTA found that the IRS could enhance the methodology it uses and identify substantially more potentially noncompliant taxpayers. Expanding the number of taxpayers notified could increase revenue to the Federal Government.

WHAT TIGTA RECOMMENDED

TIGTA recommended that, when evaluating the IRA strategy going forward, the Commissioner, Wage and Investment Division, should consider 1) directly communicating with taxpayers required to take a distribution and informing them about the distribution rules using easily understood language and 2) if the notice program is expanded, modifying the methodology for the required minimum distribution notices to identify additional noncompliant individuals.

In its response, the IRS partially agreed with the first recommendation and agreed with the second recommendation. The IRS stated that it recently added small business IRAs to its sample notice population. However, due to budget limitations, the IRS is not expanding its use of notices. In addition, the IRS agreed that direct communication with taxpayers reaching the age of 70½ would be helpful, but it is not implementing this program due to budget constraints. The IRS did not agree to inform estates of distribution rules associated with IRA inheritances. TIGTA continues to believe it would be beneficial to inform estates of inherited distribution requirements.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 29, 2015

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements Can Be Made to Educate and Notify Taxpayers of Required Minimum Distribution Requirements From Individual Retirement Arrangements (Audit # 201410015)

This report presents the results of our review on whether Internal Revenue Service (IRS) processes provide reasonable assurance that taxpayers are complying with provisions for taking required minimum distributions from their Individual Retirement Arrangements (IRA). Following previous audits regarding IRA noncompliance, the Treasury Inspector General for Tax Administration recommended that the IRS develop a strategy to address retirement provision noncompliance.¹ As part of this audit, we followed up on the prior audit's findings. In addition, we considered a congressional request to ensure that the IRS is educating taxpayers with respect to IRA provisions and not unreasonably penalizing them for innocent mistakes. This audit is included in our Fiscal Year 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 VIII.

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 Treasury Inspector General for Tax Administration, 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).



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Abbreviations

FMV	Fair Market Value
IRA	Individual Retirement Arrangement
IRS	Internal Revenue Service
RMD	Required Minimum Distribution
SEP	Simplified Employee Pension
SIMPLE	Savings Incentive Match Plan for Employees
TIGTA	Treasury Inspector General for Tax Administration



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Background

Prior to 1974, workers primarily received retirement benefits through a pension that guaranteed a certain amount of income upon retirement. The amount of employees' retirement was determined by a formula as stated in the pension plan document. However, with the passing of several acts in the 1970s and 1980s including the Employee Retirement Income Security Act¹ and the Revenue Act of 1978,² there was a rise in the number of defined contribution plans. Instead of relying on the employer for retirement, employees funded and gained more flexibility and control over their own retirement.

This shift transitioned retirement savings responsibility for many from employers to employees. For example, employees could choose how much to save and where to invest their retirement funds. However, there was concern that taxpayers were using these retirement vehicles as a means to accumulate tax-free wealth rather than a means to ensure an adequate retirement income. To address this issue, legislation³ was passed requiring taxpayers to take a minimum distribution for tax-deferred defined contribution plans upon reaching a specified age.

There are many types of defined contribution retirement vehicles available to taxpayers. Options include employer-sponsored plans such as 401(k),⁴ 403(b),⁵ and the Federal Government's Thrift Saving Plan as well as Individual Retirement Arrangements (IRA). In 2012, the Investment Company Institute reported that IRAs have been one of the fastest growing components of the U.S. retirement market during the past decade. Totaling \$5.4 trillion in assets at the end of the fourth quarter of 2012, IRA assets were estimated to represent more than one-quarter of the \$19.5 trillion U.S. retirement market.

***With an estimated \$5.4 trillion
in assets at the end of
Calendar Year 2012, IRAs
represented more than
one-quarter of total
retirement market assets
in the United States.***

IRAs are a key tax-preferred way for individuals to save for retirement and an increasingly important way for individuals to roll over savings from pension plans. In addition, funds put into IRAs can grow faster than a typical investment account because earnings are tax deferred.

¹ Pub. L. No.93-406, 88 Stat. 829.

² Pub. L. No. 95-600 92 Stat. 2763.

³ Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

⁴ Plan in which employees have individual accounts to which the employee, employer, or both make contributions. Benefits are based on contributions and investment returns (gains and losses) on the accounts.

⁵ Plan designed for public education and tax-exempt entities. Both the plan sponsor and employees can make pretax contributions.



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There are four types of IRAs: Traditional, Simplified Employee Pension (SEP), Savings Incentive Match Plan for Employees (SIMPLE), and Roth. Specific characteristics of each type are as follows.

- **Traditional IRA:** The traditional IRA, within certain income limits and other eligibility factors, allows individuals to deduct the amount of their IRA contribution from their taxable income and defer the payment of taxes until it is used in retirement. Individuals reaching age 70½ must begin to withdraw required minimum distributions (RMD) and pay taxes on the amount withdrawn. The RMD must be taken by April 1 following the calendar year in which the individual reaches age 70½ and by December 31 for all subsequent years. The amount required to be distributed depends on the account balances of all traditional IRAs owned by the individual at the end of the preceding tax year and the individual's life expectancy. These distributions are generally taxed as ordinary income.
- **SEP IRA:** The SEP IRA is an employer-based plan that allows employers and employees associated with small businesses to make tax-deferred contributions toward their retirement without setting up more complex qualified plans. The rules for RMDs follow those of traditional IRAs.
- **SIMPLE IRA:** A SIMPLE IRA is a small business employer-based plan that allows employers and employees to make tax-deferred contributions to provide future retirement income. The rules for RMDs are the same as for traditional IRAs.
- **Roth IRA:** Roth IRA contributions are not tax deductible, and qualified distributions from Roth IRAs are tax free. There is no requirement for taking RMDs from this type of plan.

The RMD amount is determined by taking the fair market value (FMV) of all IRAs subject to RMD requirements on December 31 of the tax year before the RMD is due and dividing it by the IRA owner's life expectancy.⁶ A change in the ownership of the IRA to a beneficiary can change the distribution period or life expectancy calculations.

IRA trustees report the FMV of IRAs on Form 5498, *IRA Contribution Information*,⁷ which includes a check box to report individuals required to take an RMD. The amount the taxpayer removes from the IRA is reported by the IRA trustee on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*⁸ The

⁶ The IRS provides life expectancy tables in Appendix C of IRS Publication 590, *Individual Retirement Arrangements (IRAs)*.

⁷ See Appendix V.

⁸ See Appendix VI.



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trustee should check Box 7 to differentiate an IRA distribution from other types of distributions reported on Form 1099-R.⁹

If a taxpayer does not take an RMD, he or she may be subject to a 50 percent excise tax on any undistributed amounts. He or she must file Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, to pay or request a waiver of the excise tax.

The Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office have conducted several reviews regarding Internal Revenue Service (IRS) processes for educating taxpayers and ensuring compliance with RMDs.¹⁰ The most recent TIGTA audit report was released in Fiscal Year 2010 and included a recommendation that the IRS develop an IRS-wide strategy to address retirement plan noncompliance, including the development of processes to identify noncompliant individuals. In addition, a congressional inquiry was made requesting that the IRS educate taxpayers with respect to RMD provisions and not unreasonably penalize them for innocent mistakes.

This review was performed with information obtained through the IRS Wage and Investment Division offices in Atlanta, Georgia, and Austin, Texas, during the period May 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.

⁹ 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).

¹⁰ TIGTA, Ref. No. 2008-40-087, *Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance* (Mar. 2008); 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); Government Accountability Office, GAO-07-1059SU, *INDIVIDUAL RETIREMENT ACCOUNTS: IRS Enforces Some but Not All Key Rules, and Opportunities Exist to Strengthen Taxpayer Compliance* (Sept. 2007); Government Accountability Office, GAO-08-654, *INDIVIDUAL RETIREMENT ACCOUNTS: Additional IRS Actions Could Help Taxpayers Facing Challenges in Complying with Key Tax Rules* (Aug. 2008).



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Results of Review

Educational Materials Were Made Available to Taxpayers and Return Preparers; However, Direct Communication Methods Are Not Used to Inform Taxpayers of Minimum Distribution Requirements

In response to recommendations in prior TIGTA audit reports, the IRS developed a broad-based strategy to address RMD noncompliance with retirement plan provisions, which is an improvement from our prior reporting. Part of the IRS's newly developed strategy for IRAs involves educating taxpayers and tax preparers about IRA rules and provisions associated with RMDs, which is consistent with the IRS's mission to provide America's taxpayers with top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all. The strategy includes developing IRS tax publications that have information devoted specifically to tax rules associated with IRAs, including instructions for calculating any amounts of required distributions. These publications are all available on the IRS website. In addition to website publications, the IRS increased awareness of minimum distribution requirements by writing several articles that were made available to online media as well as writing articles that were distributed to tax preparer publications and other print media. The articles generally outlined the rules associated with IRAs and specifically addressed rules associated with RMDs.

While the IRS has increased its efforts to educate taxpayers and tax preparers, some taxpayers are not taking distributions as required. Our analyses identified nearly 639,000 taxpayers with IRAs worth \$40.4 billion who may not have taken required distributions in Tax Year 2012.¹¹ While there could be many reasons for these taxpayers not taking the distribution, taxpayer feedback received by the IRS¹² indicates that some of them did not take the distribution as required because they were simply unaware of the rules.

Another example in which taxpayers could be unaware of requirements for minimum distributions from IRAs deals with excise taxes associated with RMDs. TIGTA identified nearly 6,500 taxpayers who submitted Form 5329 to self-report that they did not take the RMD on a previous tax return. These self-reporting taxpayers paid excise taxes totaling \$6.2 million, and nearly 3,000 of the taxpayers paid an excise tax of at least \$500. This is significant because the excise tax is calculated at 50 percent of the minimum distribution amount, meaning that the

¹¹ The \$40.4 billion amount represents the total FMV of IRAs owned by taxpayers with an RMD due. The actual amount of tax associated with the RMD will be substantially less because taxpayers are not required to have their entire account distributed when taking their annual RMD.

¹² This feedback was received as part of the IRS's testing of a process to send notices to potentially noncompliant taxpayers. Details on this process are discussed in the next section of this report.



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amount of the required distribution totaled at least \$1,000. Subsequent to self-reporting the excise tax, 335 taxpayers received a full abatement¹³ of the excise tax because they acknowledged the mistake in not taking the required distribution and submitted a request for the excise tax to be abated.

While progress has been made in creating awareness, the forms of communication used may not reach a significant number of these taxpayers. Additionally, while IRA trustees indicate on the Form 5498 that an RMD is due, the IRS has not used more direct methods for proactively communicating with a segment of the population that is usually elderly. In addition, Forms 5498 are not always accurate, and a significant number of taxpayers are not complying with distribution requirements.¹⁴ Conducting more direct outreach by the IRS with taxpayers before the RMD is due could prevent them from making innocent mistakes and incurring a penalty.

Under existing processes, the IRS plans to send notices to taxpayers whom it detects as being noncompliant after the RMD is past due. Our analysis of this part of the strategy is presented in the following section of this report. The IRS does not use more proactive techniques that could prevent noncompliance from occurring in the first place. However, the IRS has access to date of birth information from the Social Security Administration. This could be used to directly notify taxpayers who have IRAs and are turning 70½ or older of the distribution requirements associated with IRAs. In addition, the IRS could use date of death information to notify the estates of deceased individuals of distribution rules associated with IRA inheritances, which would increase the likelihood of beneficiaries complying with tax obligations associated with the inheritance of an IRA. If the IRS does not proactively reach out to taxpayers with RMD requirements, taxpayers may continue to forgo required distributions and be subject to excise taxes.

Recommendation

Recommendation 1: When evaluating the IRA strategy going forward, the Commissioner, Wage and Investment Division, should consider developing two direct notifications for taxpayers who may be required to take an RMD. The first notification could be sent to any taxpayer turning 70½ or older with a traditional IRA or IRAs related to small businesses,¹⁵ and the second could be sent to estates of deceased taxpayers. The notifications should inform taxpayers of their tax obligations associated with RMDs, including references for obtaining more detailed instructions as well as procedures for requesting abatement of the excise tax assessed for not taking an RMD.

¹³ Abatements are reductions in the amount of taxes owed. They can occur for a variety of reasons, such as to correct errors made by the IRS or taxpayers or to provide relief from interest and penalties.

¹⁴ See the next section of this report for further details on Form 5498 inaccuracies and taxpayer noncompliance.

¹⁵ SEP and SIMPLE IRAs are IRAs related to small businesses.



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Management's Response: The IRS agreed that providing direct notification of RMD rules to individuals approaching the age of 70½ would provide an opportunity to educate taxpayers with respect to IRA provisions. Due to budgetary constraints, however, the IRS does not intend to implement the program at this time. The IRS disagreed with the recommendation to notify the estates of deceased individuals as the beneficiaries of the inherited IRA accounts are not known to the IRS and disbursement of decedent IRAs is done by the custodian, according to the beneficiary designation on file with the custodian.

Office of Audit Comment: We continue to believe the IRS should notify estates of deceased taxpayers to explain the rules associated with IRAs for decedents and increase assurance that beneficiaries are aware of any actions needed on their part. Estates may be named as the beneficiary of IRAs or estates may be aware of who is inheriting IRAs. In either case, making estates and potential beneficiaries (through estates) aware of distribution rules associated with inherited IRAs may increase voluntary compliance and decrease the chances that those that are inheriting IRAs will be subject to excise taxes.

The Methodology for Identifying and Notifying Noncompliant Taxpayers Could Be Enhanced

Another key piece of the IRS strategy to address the requirement for taking minimum distributions from IRAs is to notify noncompliant taxpayers through a soft notice¹⁶ program that they were not compliant in a prior tax year and are required to take distributions from their IRA. The IRS is in the process of reviewing the effectiveness of this methodology with the intent of possibly expanding the number of notices it sends to taxpayers who may not have taken a distribution as required. To test the methodology, the IRS sent 1,498 soft notices to taxpayers who the IRS determined may not have taken a required distribution in Tax Years 2011 and 2012. The soft notice advised taxpayers that they may not have taken a required distribution from their IRA and needed to take it or they could be subject to a more detailed review by the IRS.¹⁷ It also provided a telephone number for IRS customer service and advised the taxpayer to call the IRS with any questions.

The IRS identified taxpayers who were likely required to take distributions from their traditional IRAs by analyzing information on Form 5498 and comparing it to their Forms 1040, *U.S. Individual Income Tax Return*, and Forms 1099-R. This process included the following steps:

- Identifying taxpayers who owned traditional IRAs and had an RMD due by analyzing information submitted on Form 5498.

¹⁶ A soft notice is a written notice from the IRS that requires no action on the taxpayer's part but encourages the taxpayers to check their tax return for errors, serving as an educational tool and improving voluntary compliance.

¹⁷ See Appendix VII.



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- Analyzing tax return information and third-party income documents that identified 10,817 taxpayers who filed tax returns for Tax Years 2011 and 2012 but showed no evidence of taking a distribution on their Form 1099-R.
- Selecting a stratified sample of 1,498 of the previously mentioned taxpayers to receive soft notices with an emphasis on taxpayers who would potentially have the greatest tax consequence.¹⁸

The IRS's efforts to identify taxpayer noncompliance with RMD rules are hindered by erroneous third-party payer documents submitted by IRA trustees. For example, payer documents reviewed in conjunction with the samples selected by TIGTA during this audit determined that 47 (15.7 percent) of 300 taxpayers received third-party payer documents containing information that appeared erroneous. Similar errors were also found during the TIGTA audit of IRA excess contributions, which was performed concurrently with this audit.¹⁹ As part of that audit, TIGTA recommended that the IRS contact IRA trustees and inform them of common mistakes so they can take action to submit accurate information documents.

In addition to improving the accuracy of forms submitted by IRA trustees, we determined that improvements could be made to the IRS's methodology for identifying noncompliant taxpayers. While the IRS stated that it only intended to identify a suitable sample population for its test, these improvements would increase assurance that a more complete population of noncompliant taxpayers is evaluated if the program is expanded.

We evaluated the IRS's methodology and determined that the IRS could identify a more complete population of noncompliant taxpayers because its methodology excluded: 1) taxpayers with IRAs designed specifically for small businesses; 2) *****2*****; *****; and 3) *****2*****. Each of these areas is discussed further in the report. By refining its criteria for identifying noncompliant taxpayers to mirror that used in TIGTA's analysis, the IRS methodology could have identified more than 623,000 additional potentially noncompliant taxpayers. The FMV of these IRAs was approximately \$40.4 billion.

Because there was a considerable variance in the value of taxpayers' IRAs, TIGTA stratified the population based on the FMV of the IRAs and selected two statistically valid random samples²⁰ of 150 taxpayers each (one sample for traditional IRAs and another sample for IRAs associated with small businesses) to estimate the impact on tax administration of not taking RMDs. TIGTA

¹⁸ The 1,498 taxpayers were a sample from the population of 10,817 taxpayers who the IRS identified as being noncompliant with RMD rules. If the IRS determines that soft notices are an effective outreach, it may expand the population of taxpayers who receive a soft notice.

¹⁹ TIGTA, *Actions Can Be Taken to Further Improve the Strategy for Addressing Excess Contributions to Individual Retirement Arrangements* (Mar. 2015).

²⁰ See Appendix I for our sampling methodology.



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determined that 28 percent of the potentially noncompliant taxpayers with traditional IRAs made errors calculating their distribution amounts or did not take the distribution.²¹

If the IRS determines that the test of its methodology to notify a sample of taxpayers via soft notices was successful, it could expand its efforts by utilizing the methodology employed by TIGTA. If the IRS were to expand and enhance its criteria for identifying noncompliance, we estimate that more than \$103.6 million²² in additional taxes that are legally due could be collected. TIGTA also determined that 40 percent of the potentially noncompliant small business taxpayers made errors calculating the distribution amounts or did not take the distribution altogether.²³ If the IRS were to expand from notifying a sample of taxpayers to notifying these additional taxpayers with small businesses, we estimate more than \$25.7 million in additional taxes that are legally due could be collected.²⁴

The methodology for identifying potentially noncompliant taxpayers excluded IRAs designed specifically for small businesses

The IRS's methodology for identifying potentially noncompliant taxpayers did not include IRAs developed for small businesses whose taxpayers were not serviced by the Wage and Investment

²¹ Approximately 3 percent were compliant based on information returns for subsequent tax years. We could not determine whether approximately 69 percent of the taxpayers in our sample were compliant due to IRA trustee errors or lack of beneficiary information for inherited IRAs. We computed the overall error rate of 28 percent by dividing total errors from our sample by the population of cases reviewed. Because the stratified sample included a higher number of cases from some strata, TIGTA's contract statistician computed an average overall error rate of 33.6 percent.

²² See Appendix IV. The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between \$57,961,672 and \$149,285,648. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal in issuing these notices is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.

²³ Approximately 23 percent of the taxpayers in our sample were compliant based on information returns for subsequent tax years. We could not determine whether 37 percent of the taxpayers in our sample were compliant due to IRA trustee errors or lack of beneficiary information for inherited IRAs. We computed the overall error rate of 40 percent by dividing total errors from our sample by the population of cases reviewed. Because the stratified sample included a higher number of cases from some strata, TIGTA's contract statistician computed an average overall error rate of 47.2 percent.

²⁴ See Appendix IV. The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between \$3,361,739 and \$48,154,454. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.



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Division.²⁵ These taxpayers were not included even though the distribution rules are the same for both traditional IRAs and IRAs associated with small businesses. By not including these plans in its analysis, the population used by the IRS to select its sample excluded more than 23,000 potentially noncompliant taxpayers with a FMV in their IRAs of approximately \$1.3 billion.²⁶ As a result of this omission, the IRS did not consider an entire segment of taxpayers who are required to take distributions for its sample. If the IRS decides to continue compliance efforts based on its test, having a more complete population of potentially noncompliant taxpayers would help IRS management select the most productive cases to pursue with limited compliance resources.

Payer documents were not fully utilized to determine the population of potentially noncompliant taxpayers

In addition to excluding some types of IRAs, the IRS methodology *****2*****
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*****2*****. Using this methodology would identify an additional 300,300 taxpayers who may have been required to take a distribution. The FMV of these IRAs exceeded \$19.6 billion, but the taxpayers were eliminated from the IRS population despite that there is no evidence they had taken an RMD for Tax Year 2012.²⁷

Social Security Administration data were not used to better identify noncompliant taxpayers

Finally, we conducted a test to determine if the IRS could use payer documents as a source for identifying noncompliance with RMD due dates. Using data from the Social Security Administration, we identified more than 41,000 individuals age 70½ or older who had a minimum FMV of at least a \$1,000 in their IRA. *****2*****

²⁵ Taxpayers serviced by multiple IRS business operating divisions may contribute to IRAs. For example, a taxpayer who only receives wages reported on a Form W-2, *Wage and Tax Statement*, is serviced by the Wage and Investment Division, while a taxpayer 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.

²⁶ The \$1.3 billion amount represents the total FMV of IRAs associated with small businesses owned by taxpayers with an RMD due. The actual amount of tax associated with the RMD will be substantially less because taxpayers are not required to have their entire account distributed when taking their annual RMD.

²⁷ The actual amount of tax associated with the RMD will be substantially less because taxpayers are not required to have their entire account distributed when taking their annual RMD.



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*****2*****. The total FMV of the IRA accounts for these taxpayers was approximately \$2.7 billion.²⁸

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Recommendation

Recommendation 2: If the IRS expands the RMD notification program, the Commissioner, Wage and Investment Division, should consider modifying the methodology for the RMD notification strategy to a) include taxpayers with SEP or SIMPLE IRAs that were required to take an RMD and did not, b) *****2*****
*****2*****, and c) *****2*****
*****2*****.

Management’s Response: The IRS agreed with the recommendation. In December 2014, the IRS included taxpayers with SEP plans and SIMPLE arrangements in the soft notice sample population, informing them of potential RMD obligations. Due to budgetary limitations, the IRS does not intend to expand the soft notice pilot.

²⁸ The \$2.7 billion amount represents the total FMV of the IRAs owned by taxpayers *****2*****
*****2*****. The actual amount of tax associated with the RMD will be substantially less because taxpayers are not required to have their entire account distributed when taking their annual RMD.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether IRS processes provide reasonable assurance that taxpayers are complying with provisions for taking RMDs from their IRAs. To accomplish our objective, we:

- I. Evaluated actions the IRS had taken to address prior audit report recommendations and to implement a new strategy for RMD compliance.
 - A. Evaluated the new IRS strategy to determine whether it included provisions for improving RMD compliance by assessing whether the scope addressed potential RMD noncompliance, such as SEP and SIMPLE IRAs.
 - B. Assessed the outreach and education components of the new IRS strategy to identify the steps included to assist taxpayers and tax practitioners with improving their knowledge of RMD rules.
 1. Determined whether the IRS was taking action to directly communicate with taxpayers who are required to take distributions.
 2. Identified IRS media outlets, such as the AARP or social media, for providing RMD information to selected audiences and researched websites for these media to determine if they contained RMD-related information.
 - C. Determined whether the IRS had sufficient information to determine if taxpayers who were required to take an RMD did not do so.
 - D. Determined whether the IRS had data showing the number and total value of excise taxes assessed on taxpayers who did not take their RMD and completed any analyses to identify common causes for any noncompliance.
- II. Determined whether taxpayers made RMDs from their IRAs in Tax Year 2012.
 - A. Identified taxpayers who should have taken an RMD on their traditional, SEP, or SIMPLE IRAs.
 1. Obtained an extract from TIGTA's Strategic Data Services of Form 5498, *IRA Contribution Information*, data for Tax Year 2011 to identify taxpayers who should have taken an RMD in Tax Year 2012.
 2. Obtained an extract from TIGTA's Strategic Data Services of Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans*,



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IRAs, Insurance Contracts, etc., data for Tax Year 2012 to identify taxpayers who had distributions from their IRAs.

3. Created a file that included all data in Steps II.A.1. and 2. For each of the files created in these steps, we validated¹ the accuracy of the data using the Integrated Data Retrieval System.²
 4. Queried Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, information at the TIGTA Data Center Warehouse³ to identify taxpayers who reported excise tax or requested a waiver for not taking an RMD from the previous year.
- B. Using Forms 5498, identified individuals who owned a traditional IRA and were required to take an RMD from their IRA the following tax year. We compared these taxpayers with those receiving Forms 1099-R the following tax year to determine if they took a distribution.
1. Selected and reviewed a statistically valid sample of 150 taxpayers from a population of 614,743 taxpayers who may not have taken an RMD from their traditional IRA in Tax Year 2012. A statistical 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 using a 95 percent confidence level, a ± 5 percent precision, and a 10 percent estimated error rate.
 2. Our review of the sample identified 42 taxpayers who appeared to be noncompliant and did not take a distribution. This resulted in a 28⁴ percent error rate with a standard error deviation of $\pm 60,330$ ⁵ and potential increased revenue

¹ To assess the reliability of computer-processed data, programmers in TIGTA's 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, and the National Account Profile by researching the IRS's Integrated Data Retrieval System for a nonrepresentative selection of 10 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.

² IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

³ The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.

⁴ We computed the overall error rate of 28 percent by dividing total errors from our sample by the population of cases reviewed. Because the stratified sample included a higher number of cases from some strata, TIGTA's contract statistician computed an average overall error rate of 33.6 percent.

⁵ These numbers are from the two-sided 95 percent confidence interval for the total number of potentially noncompliant taxpayers. This means that the total number of errors is between 146,416 and 267,076.



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of \$103,624,000.⁶ We used the Integrated Data Retrieval System to verify that these taxpayers did not take the RMD from their traditional IRAs and calculated the amount of the RMD as well as any additional tax due.

- C. Using Forms 5498, identified individuals who owned a SEP or SIMPLE IRA and were required to take an RMD the following tax year. We compared these taxpayers with those receiving Forms 1099-R the following tax year to determine if they took an RMD.
1. Selected and reviewed a statistically valid sample of 150 taxpayers from a population of 23,777 taxpayers who may not have taken an RMD from their IRAs related to small businesses in Tax Year 2012. A statistical 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 using a 95 percent confidence level, a ± 5 percent precision, and a 10 percent estimated error rate.
 2. Our review of the sample identified 60 taxpayers who appeared to be noncompliant and did not take a distribution. This resulted in a 40 percent error rate⁷ with a standard error deviation of $\pm 2,454$ ⁸ and potential increased revenue of \$25,758,000.⁹ We used the Integrated Data Retrieval System to verify that these taxpayers did not take the RMD from their IRAs associated with small businesses and calculated the amount of the RMD as well as any additional tax due.

⁶ We are 95 percent confident that the point estimate is between \$57,961,672 and \$149,285,648. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.

⁷ We computed the overall error rate of 40 percent by dividing total errors from our sample by the population of cases reviewed. Because the stratified sample included a higher number of cases from some strata, TIGTA's contract statistician computed an average overall error rate of 47.2 percent.

⁸ These numbers are from the two-sided 95 percent confidence interval for the total number of potentially noncompliant taxpayers. This means that the total number of errors is between 9,373 and 14,281.

⁹ The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between \$3,361,739 and \$48,154,454. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.



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Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices for processing Forms 5498 and 1099-R and, more specifically, the traditional IRA and IRAs associated with small businesses reporting requirements. We evaluated these controls by interviewing management, reviewing the IRS's RMD strategy, and analyzing data for traditional IRAs and IRAs associated with small businesses reported on Forms 5498 and 1099-R.



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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

John M. Jarvis, Lead Auditor

Melinda H. Dowdy, Senior Auditor

Steve T. Myers, Senior Auditor

Erika D. Axelson, Information Technology Specialist

Donald J. Meyer, Information Technology Specialist

Steven E. Vandergriff, Information Technology Specialist



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Appendix III

Report Distribution List

Commissioner C

Office of the Commissioner – Attn: Chief of Staff C

Deputy Commissioner for Services and Enforcement SE

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

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



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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:

- Increased Revenue – Potential; \$103,624,000¹ for 121,419 taxpayers in Tax Year 2012² who may not have taken an RMD from their traditional IRA or \$518,120,000³ forecast over five years (see page 6).

Methodology Used to Measure the Reported Benefit:

TIGTA obtained data for all Tax Year 2011 Forms 5498, *IRA Contribution Information*, to identify taxpayers having a traditional IRA and not taking an RMD. To do so, TIGTA staff completed the following computer analyses:

- Obtained data from TIGTA's Strategic Data Services for all Tax Year 2011 Forms 5498.
- Identified all Forms 5498 having a check in Box 11 (*If checked, required minimum distribution for 2012*).
- Eliminated any taxpayer who did not have a traditional IRA box checked in Box 7 of Form 5498.
- Obtained data from TIGTA's Strategic Data Services for all Tax Year 2012 Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

¹ We are 95 percent confident that the point estimate is between \$57,961,672 and \$149,285,648. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.

² TIGTA's sample included taxpayers who may not have taken their first RMD for Tax Year 2012. Because a taxpayer's first RMD is not due until April 1 of the following year, in those cases TIGTA also reviewed Tax Year 2013 Forms 1099-R to verify that the distribution was made.

³ The five-year forecast for potential increased revenue is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The five-year forecast was rounded to the nearest \$1,000.



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- Eliminated any Forms 1099-R for which a) there was no check in Box 7, *Distribution code(s), IRA/SEP/SIMPLE*, to indicate that the distribution was from an IRA and b) the Distribution Code was not equal to 7 (*Normal distribution*).
- Compared remaining taxpayers from the Forms 5498 population to those remaining from the Forms 1099-R population and eliminated all taxpayers having a normal distribution from an IRA, *i.e.*, RMD box checked and Distribution Code is 7.
- Determined the total value of all IRAs attributable to a taxpayer’s Social Security Number using Box 5, *Fair market value of account*, from Form 5498.
- Removed all taxpayers with IRAs having a FMV below \$1,000.

After completing the previously discussed steps, there were 614,743 taxpayers with a traditional IRA who may not have taken their RMD. For the traditional IRA population, TIGTA selected a stratified random sample of 150 taxpayer accounts based on the FMV, as shown in Figure 1.

Figure 1: Stratified Population and Sample Sizes for Traditional IRAs

FMV Range		Population	Sample Size
Low	High		
\$1,000	<\$100,000	527,687	**1**
\$100,000	<\$500,000	76,469	**1**
\$500,000	<\$1,000,000	7,317	**1**
\$1,000,000		3,270	**1**
Totals		614,743	150

Source: TIGTA analysis of tax return information and information documents for Tax Years 2011 and 2012.

After reviewing each case, TIGTA identified taxpayers within the sample who did not take the correct amount for their RMD. For each of these cases, TIGTA determined any additional tax due.

The results of our statistically valid sample of 150 individuals with traditional IRAs are as follows:⁴

- 42 individuals (28 percent) did not take RMDs.⁵
- 34 individuals (23 percent) had erroneous information reported by trustees.

⁴ Percentages do not equal 100 percent due to rounding.

⁵ Population sizes and dollar amounts varied by strata; therefore, our contract statistician computed an estimated error rate of 33.6 percent for the population.



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- 70 individuals (47 percent) were either deceased and beneficiary information was not available to assess compliance for inherited IRAs or information was not available for us to determine compliance.
- 4 individuals (3 percent) were compliant. For example, we determined that some individuals took their RMDs in the calendar year following the year in which they reached age 70½.

Figure 2 shows the results of our sample by FMV range.

Figure 2: Sample Results – Traditional IRAs

FMV Range		Sample Cases	Taxpayer Errors	Trustee Errors	Taxpayer Deceased	No Error (Taxpayer Took RMD by 4/1/13)
Low	High					
\$1,000	<\$100,000	**1**	25	11	33	**1**
\$100,000	<\$500,000	**1**	11	16	21	**1**
\$500,000	<\$1,000,000	**1**	3	3	9	**1**
\$1,000,000		**1**	3	3	7	**1**
Totals		150	42	33	70	5

Source: TIGTA analysis of tax return information and information documents for Tax Years 2011, 2012, and 2013.

Using the Traditional IRA sample results, our contract statistician determined average taxpayer error rates and tax effect per strata. Our contract statistician then used those numbers to determine the estimated total number of taxpayers who potentially did not take their RMD within the entire population (121,419 taxpayers), as well as the total tax effect (\$103,624,000).



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Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$25,758,000⁶ for 11,827 taxpayers who may not have taken an RMD from their SEP or SIMPLE IRAs in Tax Year 2012⁷ or \$128,790,000⁸ forecast over five years (see page 6).

Methodology Used to Measure the Reported Benefit:

TIGTA obtained data for all Tax Year 2011 Forms 5498 to identify taxpayers having an IRA associated with a small business and not taking their RMD. To do so, TIGTA staff completed the following computer analyses:

- Obtained data from TIGTA's Strategic Data Services for all Tax Year 2011 Forms 5498.
- Identified all Forms 5498 having a check in Box 11.
- Eliminated any taxpayer who did not have a SEP or SIMPLE IRA box checked in Box 7 of Form 5498.
- Obtained data from TIGTA's Strategic Data Services for all Tax Year 2012 Forms 1099-R.
- Eliminated any Forms 1099-R for which a) there was no check in Box 7 to indicate the distribution was from an IRA and b) the Distribution Code was not equal to 7.
- Compared remaining taxpayers from the previously discussed Form 5498 population to those remaining from the previously discussed Form 1099-R population and eliminated all taxpayers having a normal distribution from a SEP or SIMPLE IRA, *i.e.*, RMD box checked and Distribution Code is 7.
- Determined the total value of all SEP or SIMPLE IRAs attributable to a taxpayer's Social Security Number using Box 5 from Form 5498.
- Removed all taxpayers with SEP or SIMPLE IRAs having a FMV below \$1,000.

⁶ The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between \$3,361,739 and \$48,154,454. This figure also assumes that all potentially noncompliant taxpayers are actually noncompliant and that the IRS would assess and collect 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 that its goal is to change individual behavior rather than to collect additional tax. Therefore, the actual amount of taxes collected could be substantially less.

⁷ TIGTA's sample included taxpayers who may not have taken their first RMD for Tax Year 2012. Because a taxpayer's first RMD is not due until April 1 of the following year, TIGTA also reviewed Tax Year 2013 Forms 1099-R for applicable taxpayers to verify the distribution was made.

⁸ The five-year forecast for potential increased revenue is based on multiplying the base year by five and assumes, among other considerations, that economic conditions and tax laws do not change. The five-year forecast was rounded to the nearest \$1,000.



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After completing the previously discussed steps, there were 23,777 taxpayers with a SEP or SIMPLE IRA who may not have taken their RMD. For the SEP or SIMPLE IRA population, TIGTA selected a stratified random sample of 150 taxpayer accounts based on the FMV, as shown in Figure 3.

**Figure 3: Stratified Population and Sample Sizes for
SEP and SIMPLE IRAs**

FMV Range		Population	Sample Size
Low	High		
\$1,000	<\$100,000	20,565	**1**
\$100,000	<\$500,000	2,914	**1**
\$500,000	<\$1,000,000	227	**1**
\$1,000,000		71	**1**
Totals		23,777	150

*Source: TIGTA analysis of tax return information and information documents for
Tax Years 2011 and 2012.*

After reviewing each case, TIGTA identified taxpayers within the sample who did not take the correct amount for their RMD according to information return documents. For each of these cases, TIGTA determined any additional tax due.

The results of our statistically valid sample of 150 individuals with IRAs associated with small businesses are as follows:

- 60 individuals (40 percent) did not take RMDs.⁹
- 13 individuals (9 percent) had erroneous information reported by trustees.
- 44 individuals (29 percent) were either deceased and beneficiary information was not available to assess compliance for inherited IRAs or information was not available for us to determine compliance.
- 33 individuals (22 percent) were compliant. For example, we determined that some individuals took their RMDs in the calendar year following the year in which they reached age 70½.

⁹ Population sizes and dollar amounts varied by strata; therefore, our contract statistician computed an estimated error rate of 47.2 percent for the population.



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Figure 4 shows the results of our sample by FMV range.

Figure 4: Sample Results – SEP and SIMPLE IRAs

FMV Range		Sample Cases	Taxpayer Errors	Trustee Errors	Taxpayer Deceased	No Error (Taxpayer Took RMD by 4/1/13)
High	Low					
\$1,000	<\$100,000	**1**	34	6	15	**1**
\$100,000	<\$500,000	**1**	20	3	15	**1**
\$500,000	<\$1,000,000	**1**	4	**1**	4	6
\$1,000,000		**1**	**1**	**1**	10	**1**
Totals		150	**1**	**1**	44	**1**

Source: TIGTA analysis of tax return information and information documents for Tax Years 2011, 2012, and 2013.

Using the SEP and SIMPLE IRA sample results, our contract statistician determined average taxpayer error rates and tax effect per strata. Our contract statistician then used those numbers to determine the total number of taxpayers who potentially did not take their RMD within the entire population (11,827) as well as the total tax effect (\$25,758,000).



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Appendix V

Form 5498, IRA Contribution Information

IRA custodians provide Forms 5498, *IRA Contribution Information*, to the IRS and taxpayers annually. Key information for determining whether a distribution is required and the amount of the required distribution is in Boxes 5, 7, and 11.

Box 5 – FMV of account

Box 7 – IRA check box to identify IRA type

Box 11 – RMD Box – check if RMD due in 2012

2828 VOID

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code

2011

Form 5498

IRA Contribution Information

Copy A For Internal Revenue Service Center

File with Form 1096.

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

Form 5498 Do Not Cut or Separate Forms on This Page

Department of the Treasury - Internal Revenue Service

Cat. No. 50010C

1	TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	2	Roll-over contributions	3	Roth IRA conversion amount	4	Recharacterized contributions	5	Fair market value of account	6	Life insurance cost included in box 1	
7	PARTICIPANT'S name		8	SEP contributions	9	SIMPLE contributions	10	Roth IRA contributions	11	Check if RMD for 2012		
	Street address (including apt. no.)		12a	RMD date	12b	RMD amount	13a	Postponed contribution	13b	Year	13c	Code
	City, state, and ZIP code		14a	Repayments	14b	Code						
	Account number (see instructions)											



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Appendix VI

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

IRA custodians provide Forms 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit Sharing Plan, IRAs, Insurance Contracts, etc.*, to the IRS and taxpayers annually. Key information on whether a distribution is related to an IRA is in Box 7.

7878 VOID CORRECTED
PAYER'S name, street address, city, state, and ZIP code
OMB No. 1545-0119
2011
Form 1099-R
Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice, see the 2011 General Instructions for Certain Information Returns.

1	Gross distribution	\$	
2a	Taxable amount	\$	
2b	Taxable amount not determined	<input type="checkbox"/>	Total distribution <input type="checkbox"/>
3	Capital gain (included in box 2a)	\$	
4	Federal income tax withheld	\$	
5	Employee contributions / Designated Roth contributions or insurance premiums	\$	
6	Net unrealized appreciation in employer's securities	\$	
7	Distribution code(s)	IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other %
9a	Your percentage of total distribution	%	9b Total employee contributions %
10	Amount allocable to RRR within 5 years	\$	
11	1st year of desig. Roth contrib.	\$	
12	State tax withheld	\$	
13	State/Payer's state no.		
14	State distribution	\$	
15	Local tax withheld	\$	
16	Name of locality		
17	Local distribution	\$	

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\$ Page — Do Not Cut or Separate Forms on This Page
Department of the Treasury - Internal Revenue Service

Box 7 – Distribution Codes

Box 7 – IRA/SEP/SIMPLE check box – check if the distribution was from an IRA



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Appendix VII

*Notice Sent to Taxpayers Identified As
Not Taking a Required Minimum Distribution*



Department of the Treasury
Internal Revenue Service

Date:

Taxpayer ID number:

Contact number:

Contact hours:

Dear

Our records show that you own a traditional individual retirement account (IRA), are at least 70 ½ years old, and may not have taken minimum distributions (withdrawals) from your IRA as required by law. Owners of traditional IRAs must begin taking IRA distributions no later than April 1 of the year after the year they turn 70 ½. Individuals who don't take the required minimum distributions (RMDs) from their IRAs may pay an additional 50% tax on the amount not distributed as required.

Owners of Roth IRAs have different rules for receiving distributions. Roth IRAs don't have RMDs as long as the owner is still living. Publication 590, *Individual Retirement Arrangements (IRAs)*, explains the distribution rules for traditional and Roth IRAs.

To calculate your RMD, you can use the worksheets in Appendix A of Publication 590. At the end of the tax year, if your IRA has any amount not distributed as required, use Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts*, to report the undistributed amount and calculate the 50% tax. Attach the completed Form 5329 to your annual tax return.

If you take distributions from a traditional IRA to which you ever made nondeductible contributions or from a Roth IRA, you must also complete and submit Form 8606, *Nondeductible IRAs*.

You may want to consult your plan administrator for assistance. If you haven't taken your RMDs and you don't correct the problem, your tax return may be subject to a more detailed review to ensure you are complying with all applicable legal requirements, including Internal Revenue Code Section 4974, Excise Tax on Certain Accumulations in Qualified Retirement Plans. If you can show that your failure to take RMDs was due to reasonable error and that you are taking reasonable steps to correct the error, we can consider waiving the additional 50% tax.

Letter 5221 (11-2013)
Catalog Number 63868A



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You can find Publication 590, Form 5329, and Form 8606 on our website at www.irs.gov/Forms-&-Pubs.
If you have questions about your RMDs, you can find information on our website at www.irs.gov,
search term "RMD," or you can call the number listed above.

Thank you for your cooperation.

Sincerely,

Letter 5221 (11-2013)
Catalog Number 63868A



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Appendix VIII

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

APR 22 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Improvements Can Be Made to Educate
and Notify Taxpayers of Required Minimum Distribution
Requirements From Individual Retirement Arrangements
(Audit # 201410015)

Thank you for the opportunity to review the subject draft audit report and provide comments. Since passage of the Employee Retirement Income Security Act of 1974, that established the Individual Retirement Arrangement (IRA) as a vehicle by which individuals could save for retirement, millions of individuals have made tax-free or taxable contributions to their IRAs and enjoyed the benefits of growth through untaxed earnings. Subsequent legislation has modified and enhanced the IRA landscape; however, those changes have also introduced challenges in administering the tax provisions associated with retirement savings. The IRS has responded to these challenges through educational outreach that includes traditional methods such as providing content in form instructions and publications, and has expanded to include targeted news releases, practitioner outreach, and directed communication through the use of soft notices.

We agree that more direct outreach to taxpayers could reduce errors made by those who are unaware of the requirement to take required minimum distributions (RMD) from accounts subject to the RMD provisions. As reported, the IRS piloted a soft notice project intended to reach, for testing and evaluative purposes, a small segment of the taxpayer population that appeared not to have taken a required distribution. The purpose of the pilot was to evaluate the effectiveness of the soft notices in changing future behavior by educating taxpayers of the requirement for taking the RMD and to determine if they began taking RMDs in subsequent periods. We also expanded the pilot population in December 2014, to include in the sample those taxpayers who may have been required to take RMDs from Simplified Employee Pension (SEP) plans and Savings Incentive Match Plans for Employees (SIMPLE).



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2

The current outreach strategy for educating taxpayers of the requirements for taking required distributions is one of the most cost-effective approaches the IRS can leverage in striking a balance between improving voluntary compliance and expending limited resources that must also be used to address other, more significant, areas of tax non-compliance. It should be noted that, using the potential outcomes estimated by the Treasury Inspector General for Tax Administration, the average amount of additional tax revenue attributable to RMDs that were not taken is \$971 per taxpayer¹. We must balance this potential outcome with other compliance priorities within our limited resources.

We agree that a direct notification process for taxpayers approaching the age of 70½ years would be helpful in educating and informing them of their pending RMD requirements; however, limited budgetary resources significantly constrain our ability to devote the human and automation resources necessary to implement such a process and, more significantly, to devote requisite compliance resources to address those taxpayers who remain non-compliant. We disagree that the IRS should attempt to inform the estates of deceased individuals of distribution rules associated with IRA inheritances. The custodians of IRAs are required to follow the instructions of the most recent beneficiary designation when disbursing IRAs of decedents. The beneficiary designation is filed with the custodian and is not information available to the IRS.

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, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (404) 338-8961.

Attachment

¹ Appendix IV, *Outcome Measures*, Potential Increased Revenue; sum of \$103,624,000 attributed to traditional IRAs plus \$25,758,000 attributed to SEP and SIMPLE plans, divided by 133,246 taxpayers.



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Attachment

Recommendation

RECOMMENDATION 1

When evaluating the IRA strategy going forward, the Commissioner, Wage and Investment Division, should consider developing two direct notifications for taxpayers who may be required to take an RMD. The first notification could be sent to any taxpayer turning 70 1/2 or older with a traditional IRA or IRAs related to small businesses, and the second could be sent to estates of deceased taxpayers. The notifications should inform taxpayers of their tax obligations associated with RMDs, including references for obtaining more detailed instructions as well as procedures for requesting abatement of the excise tax assessed for not taking an RMD.

CORRECTIVE ACTION

We agree that providing direct notification of required minimum distribution (RMD) rules to individuals approaching the age of 70 1/2 years would provide an opportunity to educate taxpayers with respect to IRA provisions. Due to budgetary constraints, however, we do not intend to implement the program at this time. We disagree with the recommendation to notify the estates of deceased individuals as the beneficiaries of the inherited Individual Retirement Arrangement accounts are not known to the IRS and disbursement of decedent IRAs is done by the custodian, according to the beneficiary designation on file with the custodian.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendation

RECOMMENDATION 2

If the IRS expands the RMD notification program, the Commissioner, Wage and Investment Division, should consider modifying the methodology for the RMD notification strategy to (a) include taxpayers with SEP or SIMPLE IRAs that were required to take an RMD and did not, (b)*****2*****, and (c) *****2*****.

CORRECTIVE ACTION

In December 2014, the IRS included taxpayers with Simplified Employee Pension (SEP) plans and Savings Incentive Match Plan for Employee (SIMPLE) arrangements in the



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soft notice sample population, informing them of potential RMD obligations. Due to budgetary limitations, we do not intend to expand the soft notice pilot.

IMPLEMENTATION DATE

Implemented – Inclusion of SEP and SIMPLE accounts
N/A – Expanded consideration of Forms 1099-R and 5498

RESPONSIBLE OFFICIAL

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

CORRECTIVE ACTION MONITORING PLAN

N/A