Taxpayers Were Notified About the CARES Act Retirement Plan Provisions; However, Additional Actions Could Be Taken to Identify Potential Noncompliance

July 20, 2021

Report Number: 2021-16-044

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HIGHLIGHTS: Taxpayers Were Notified About the CARES Act Retirement Plan Provisions; However, Additional Actions Could Be Taken to Identify Potential Noncompliance

Final Audit Report issued on July 20, 2021 **Report Number: 2021-16-044**

Why TIGTA Did This Audit

This audit was initiated to assess the IRS's efforts to implement the Coronavirus Aid, Relief, and Economic Security (CARES) Act provisions that provided economic relief to Americans. This included economic relief opportunities for taxpayers with retirement plans. The overall objective of this audit was to assess the IRS's efforts to oversee the relief from taxes associated with early retirement distributions and Required Minimum Distributions pursuant to the CARES Act.

Impact on Taxpayers

In March 2020, Congress passed the CARES Act. Section 2202 of the CARES Act allowed taxpayers to take coronavirus-related early distributions from their retirement plans, up to $100,000, without paying the early distribution tax. Additionally, Section 2203 of the CARES Act waived Required Minimum Distributions for taxpayers for Tax Year 2020.

What TIGTA Found

The IRS took a number of steps to oversee the retirement-related provisions of the CARES Act, including educating taxpayers and the development of high-level compliance plans to enforce taxpayer compliance with the provisions. For example, the IRS informed taxpayers about the CARES Act retirement provisions. This included creating and distributing various news releases, notices, and a tax tip to educate taxpayers of the new retirement provisions. Additionally, management developed compliance plans for Sections 2202 and 2203 to assess the impact on examination activities and outline the steps necessary to efficiently encourage and enforce taxpayer compliance. The Section 2202 Compliance Plan identified risks associated with taxpayer eligibility for and reporting of early distributions and recommended training examiners and monitoring examination work for taxpayer compliance to determine if additional study is warranted. The Section 2203 Compliance Plan did not identify any risks associated with the waiver of Required Minimum Distributions, but management took steps to notify examiners about the provision.

IRS management told us they are adding Section 2202 training to examiners' Fiscal Year 2021 Continuing Professional Education training, and they plan to add information to the Knowledge Management and Transfer program to increase tax examiner and revenue agent awareness about coronavirus-related distribution risks.

Reports from investment management companies and other news sources indicate that millions of taxpayers took coronavirus-related distributions in Tax Year 2020. Although the Section 2202 Compliance Plan assessed the effect on examination activities and outlined the steps necessary to encourage and enforce taxpayer compliance, it could be improved. For example, management could include objective criteria that would warrant a research project or a compliance initiative project. Management could also ensure assignment of a sufficient number of cases involving coronavirus-related distributions or the creation of a Section 2202 Lead Sheet.

What TIGTA Recommended

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, ensure that management has sufficient information available to assess compliance with Section 2202 of the CARES Act and consider creating a Lead Sheet to assist examiners when reviewing cases for potential noncompliance. In their response, IRS management disagreed with both recommendations. TIGTA believes these actions would help the IRS assess potential noncompliance and would assist examiners in reviewing returns with coronavirus-related distributions for potential noncompliance.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

July 20, 2021

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Taxpayers Were Notified About the CARES Act Retirement Plan Provisions; However, Additional Actions Could Be Taken to Identify Potential Noncompliance (Audit # 202110620)

This report presents the results of our review to assess the Internal Revenue Service's efforts to oversee the relief from tax associated with early retirement distributions and Required Minimum Distributions pursuant to the Coronavirus Aid, Relief, and Economic Security Act. This review is included in our Fiscal Year 2021 Annual Audit Plan and addresses the major management and performance challenges of *Implementing Tax Law Changes* and *Responding to the COVID-19 Pandemic.*

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

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

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Background

In March 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act.[1] The purpose of this legislation was to provide economic relief to Americans because of the Coronavirus Disease 2019 (COVID-19 or coronavirus) pandemic. Sections 2202 and 2203 of the Act provided economic relief opportunities for taxpayers with retirement plans. These opportunities were available only for Tax Year (TY) 2020 returns.

Section 2202

Section 2202 of the CARES Act allows taxpayers to take coronavirus-related early distributions from their retirement plans, up to $100,000, without paying the early distribution tax.[2] The CARES Act provided qualifications for taxpayers to be eligible to take these early distributions, and the Internal Revenue Service (IRS) provided supplemental guidance. A taxpayer is eligible to take the early distributions if they meet any of the qualifications listed in Figure 1.

Figure 1: Qualifications to be Eligible for Coronavirus-Related Distributions

CARES Act Qualifications	IRS Qualifications
• The individual was diagnosed with the coronavirus by a test approved by the Centers for Disease Control and Prevention (including a test authorized under the Federal Food, Drug, and Cosmetic Act). • The individual's spouse or dependent was diagnosed with the coronavirus by a test approved by the Centers for Disease Control and Prevention (including a test authorized under the Federal Food, Drug, and Cosmetic Act). • The individual experienced adverse financial consequences as a result of: ○ The individual being quarantined, being furloughed or laid off, or having work hours reduced due to the coronavirus. ○ The individual being unable to work due to lack of childcare because of the coronavirus.	• The individual experienced adverse financial consequences as a result of: ○ The individual having a reduction in pay (or self-employment income) due to the coronavirus, or having a job offer rescinded, or having the start date for a job delayed due to the coronavirus. ○ The individual's spouse or a member of the individual's household being quarantined, furloughed, or laid off or having work hours reduced due to the coronavirus; being unable to work due to lack of childcare because of the coronavirus; having a reduction in pay (or self-employment income) due to the coronavirus; or having a job offer rescinded or start date for a job delayed due to the coronavirus.[3] ○ The closing or reduced hours of a business owned or operated by the individual's spouse or a member of the

[1] Pub. L. No. 116–136, 134 Stat. 281.

[2] Generally, distributions from retirement accounts before the taxpayer reaches the age 59½ are assessed a 10 percent additional tax. There are exceptions to paying the 10 percent additional tax.

[3] A member of the individual's household is someone who shares the individual's principal residence.

CARES Act Qualifications	IRS Qualifications
○ The closing or reduced hours of a business owned or operated by the individual due to the coronavirus.	individual's household due to the coronavirus.

Source: Notice 2020-50, Guidance for Coronavirus-Related Distributions and Loans from Retirement Plans Under the CARES Act.[4]

Taxpayers can claim the full distribution on their TY 2020 tax return as additional income, or they may report it in equal amounts over the next three years. For example, if a taxpayer takes a $15,000 coronavirus-related early distribution, they can report the full $15,000 as income on their TY 2020 tax return and pay any associated taxes, or they can elect to report $5,000 a year as income and pay the taxes owed on their TYs 2020, 2021, and 2022 tax returns. In either scenario, the additional 10 percent early distribution tax does not apply.

Taxpayers are not required, and have the option, to repay their retirement accounts for the early distribution.[5] If they elect to repay it, they must do so within the three years.[6] If they repay their early distribution, they are eligible to file an amended return(s) to request a refund for any income taxes they paid on the early distribution. The repayments do not count towards that year's retirement plan contribution limits, but taxpayers may not deduct repayments from their income.

Taxpayers report qualified coronavirus-related distributions on Form 8915-E, *Qualified 2020 Disaster Retirement Plan Distributions and Repayments*.[7] If a taxpayer elects to spread the income over three years, they will need to file Form 8915-E with their return in each year. The total distributions and taxable portions of the distributions are included in the gross and taxable distribution amounts reported on the tax return(s). Third parties report distributions from retirement accounts to the IRS and taxpayers on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* The coronavirus-related distributions should be reported on this form.

Section 2203

Section 2203 of the CARES Act waived Required Minimum Distributions (RMD) for taxpayers for TY 2020.[8] Normally, taxpayers who have reached age 72 are required to take RMDs annually. These distributions are taxable income and should be reported on the taxpayer's annual tax return. If the taxpayer fails to take the RMD for a year, they are required to take the RMD as soon as they can and are assessed a 50 percent tax on the RMD amount they failed to withdraw on time.

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[4] IRS, Notice 2020-50, I.R.B. 2020-28 pp. 35–43 (July 6, 2020).

[5] Any coronavirus-related distribution (whether from an employer retirement plan or an Individual Retirement Arrangement (IRA)) paid to a qualified individual as a beneficiary of an employee or IRA owner (other than the surviving spouse of the employee or IRA owner) cannot be recontributed. An IRA is a tax-favored personal savings arrangement that allows you to set aside money for retirement.

[6] Taxpayers have until the due date of the TY 2022 tax return to recontribute to IRAs.

[7] There were 51 other declared disaster areas that qualify for tax relief in TY 2020.

[8] The waiver of RMDs is for taxpayers who participate in Defined Contribution Plans and IRAs. A Defined Contribution Plan is a retirement plan in which the employee and/or the employer contribute to the employee's individual account under the plan.

Results of Review

Management Took Steps to Notify Taxpayers About CARES Act Retirement Plan Provisions

One of the IRS's strategic goals is to empower and enable all taxpayers to meet their tax obligations by being proactive with communications to taxpayers and tax professionals. In addition, taxpayers have the right to know what is required to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence.

The IRS took a number of steps to oversee the retirement-related provisions of the CARES Act, including educating taxpayers and the development of high-level compliance plans to enforce taxpayer compliance with the provisions. For example, the IRS informed taxpayers about the CARES Act retirement provisions. This included creating and distributing various news releases, notices, and a tax tip to educate taxpayers of the new retirement provisions. The guidance described the qualifications for taking a coronavirus-related distribution, the tax consequences, and the repayment options. The IRS also educated taxpayers on RMD rules, including the waiver of TY 2020 RMDs and potential repayment options for RMDs already taken in TY 2020. Finally, the IRS created Form 8915-E for taxpayers to be able to claim the coronavirus-related distribution on their tax return.[9] The IRS's actions should help taxpayers and tax professionals comply with the retirement-related provisions of the CARES Act.

More Steps Can Be Taken to Identify Potential Noncompliance

Millions of taxpayers took coronavirus-related early retirement distributions and will have corresponding requirements for reporting these distributions and paying applicable taxes. However, the IRS could take more steps to ensure that taxpayers comply with these reporting and tax payment requirements.

The total number of taxpayers who took coronavirus-related early distributions, and amounts taken, are [redacted] However, reports from investment management companies and another news source indicate that millions of taxpayers took these distributions in TY 2020. Fidelity Investments, an investment management company, reported at the end of TY 2020 that 6.3 percent of its participants (approximately 1.6 million) took a coronavirus-related distribution, with an average distribution of $9,400.[10] Vanguard,

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[9] A new Form 8915 is created each year to report distributions received for disasters that occurred in that year. For example, Form 8915-E was created to report distributions received for disasters that occurred in TY 2020. Previous year Form 8915 series are updated yearly to report the distributions that were elected to be reported over three years.

[10] Fidelity Investments; *Fidelity Q4 2020 Retirement Analysis: Despite Ongoing Economic Uncertainty as a Result of the Pandemic, Contributions to Retirement Accounts Remained Strong, Helping Boost Account Balances to Records Levels;* https://www.businesswire.com/news/home/20210218005597/en/Fidelity%C2%AE-Q4-2020-Retirement-Analysis-Despite-Ongoing-Economic-Uncertainty-as-a-Result-of-the-Pandemic-Contributions-to-Retirement-Accounts-Remained-Strong-Helping-Boost-Account-Balances-to-Record-Levels (last visited May 19, 2021). The median amount per distribution was $2,500. Taxpayers could take multiple coronavirus-related distributions. We could not identify the average participant distribution.

another investment management company, reported at the end of TY 2020 that 5.7 percent of its participants took a coronavirus-related distribution, with an average participant distribution of $24,600.[11] Additionally, 4 percent of the Vanguard participants who took a distribution took the maximum amount of $100,000. Furthermore, *Government Executive* reported that 119,720 Federal employees took $2.9 billion in coronavirus-related distributions from their Thrift Savings Plan accounts, which is an average of more than $24,000 per participant.[12]

IRS management developed the Section 2202 Compliance Plan and the Section 2203 Compliance Plan to assess the impact the CARES Act retirement provisions would have on examination activities and to outline the steps necessary to efficiently encourage and enforce taxpayer compliance.[13] In addition to informing taxpayers about the tax law changes associated with the CARES Act retirement provisions, these compliance plans required the IRS to review its processes and procedures to identify risks associated with the retirement provisions and the need to update the Internal Revenue Manual.

The Section 2203 Compliance Plan did not identify any risks associated with the waiver of the RMD. Noncompliance with RMDs is [redacted] and management took actions to inform examiners that the RMDs are not required in TY 2020 and that they should not assess the 50 percent tax on taxpayers who did not take an RMD. IRS management also updated the Internal Revenue Manual to include references to the coronavirus-related early distribution rules and the waiver of RMDs in TY 2020.

The Section 2202 Compliance Plan identified two risks associated with taxpayer eligibility for and reporting of early distributions:

1. Taxpayers may take a coronavirus-related distribution even though they do not qualify.
2. Taxpayers may not pay taxes on the full distribution when electing to pay it over three years.

To mitigate risks associated with the early distributions, management [redacted]

If examiners identify significant errors and omissions [redacted] the IRS has the option of pursuing a research project followed by a compliance initiative project, if warranted.[14] The Section 2202 Compliance Plan also recommended including details about Section 2202 in examiners' Fiscal Year 2021 Continuing Professional Education training.

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[11] Vanguard; *Revisiting the CARES Act and its Impact on Retirement Savings;* https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/InvComRevisitCARESActImpact (last visited May 19. 2021). Of Vanguard plan sponsors, 73 percent permitted their participants to access retirement funds for coronavirus-related distributions. The median amount per participant was $13,300.

[12] Government Executive; Wagner, Erich; *Billions Flow Out of TSP Due to COVID, and More;* https://www.govexec.com/pay-benefits/2021/01/billions-flow-out-tsp-due-covid-and-more/171675/ (Jan. 27, 2021). The Thrift Savings Plan (TSP) is a tax-deferred Defined Contribution Plan similar to private sector 401(k) plans that provides Federal employees the opportunity to save for additional retirement security. A 401(k) Plan is a defined contribution plan where an employee can make contributions from his or her paycheck either before or after tax, depending on the options offered in the plan.

[13] A compliance plan is a planning process that creates a prioritized list of compliance risks and issues that can be addressed by the projected resource allocation.

[14] Compliance initiative projects are authorized activities outside of the planned strategies involving taxpayer contact for the purpose of correcting noncompliance that meet the mission, standards, and resources of the IRS.

IRS management told us that Section 2202 training is being added to the Fiscal Year 2021 Continuing Professional Education training, and optional in-depth training is expected to be available by August 2021.[15] Additionally, they told us that they plan to add Section 2202 information to the Knowledge Management and Transfer program to increase tax examiner and revenue agent awareness about coronavirus-related distributions risks.[16] Small Business/ Self-Employed Division Counsel was still reviewing the information to be added to the Knowledge Management and Transfer program at the time of our review.[17]

Although the Section 2202 Compliance Plan assessed the effect on examination activities and outlined the steps necessary to encourage and enforce taxpayer compliance, [redacted] For example, it does not:

- Establish objective criteria for the prevalence of errors and omissions that would warrant a research project or a compliance initiative project.
- [redacted]
- Include aids for examiners to review potential noncompliance identified, such as the creation of a Section 2202 Lead Sheet.[18] Lead Sheets provide suggested issue-specific audit steps during examinations.

Although the IRS employs a similar strategy to [redacted] Since 2016, the President has declared more than 210 natural disaster areas with tax consequences; however, [redacted] The number of taxpayers who take a coronavirus-related early retirement distribution has the potential to be substantially higher. Unlike other natural disasters that generally are geographically restricted, Section 2202 applies to taxpayers nationwide.

Additionally, Section 2202 does not require taxpayers to provide documentation supporting their eligibility to take a coronavirus-related distribution, and [redacted].[19] For these reasons, we believe the risk of noncompliance and abuse is potentially higher than it is for most other natural disasters. In

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[15] Information regarding coronavirus-related distributions is included in the Commerce Clearing House COVID Stimulus Bills and Tax Reform Continuing Professional Education. Optional in-depth coronavirus-related distribution Continuing Professional Education will also be available. The optional training is being created and is expected to be written by the end of June 2021 and planned to be available by August 2021.

[16] The Knowledge Manage and Transfer program uses a shared platform and standardized tools, resources, and processes to more efficiently and effectively cultivate cross–Business Operating Division collaboration and knowledge sharing. The program seeks to create a well-trained, flexible workforce that is equipped with the resources for continual learning and growth.

[17] A draft of the information was sent to Small Business/Self-Employed Division Counsel in April 2021. Once approved by that Counsel and IRS management, the information will be posted to the website.

[18] Issue Lead Sheets are used to document the adjustments, conclusions, audit steps, facts, laws, and taxpayer's positions for examined issues and to index and reference supporting workpapers.

[19] Taxpayers selected for an examination may need to provide documentation regarding their eligibility for coronavirus-related distributions.

previous years, Examination allocated resources to review new legislation and emerging issues, such as certain provisions of the *Tax Cuts and Jobs Act*, digital currencies and alternative payment systems, the marijuana industry, and the gig economy.[20] However, management has not taken similar steps for early distributions pursuant to Section 2202.

Not all distribution types qualify for coronavirus-related tax relief.[21] During the course of an examination, if an examiner identifies a taxpayer who files Form 8915-E, they can review Form 1099-R to determine if the taxpayer claimed a distribution that does not qualify for coronavirus-related relief. Similarly, for TYs 2021 and 2022 returns, examiners could check TY 2020 tax returns to identify taxpayers who took an early distribution but did not report the income when they elected to spread it out over three years.

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1: Ensure that management has sufficient information available to assess compliance with Section 2202 of the CARES Act so that they can make a judgment about the need for a research project or compliance initiative project. The reliability of such information could be enhanced by ensuring assignment of a sufficient number of cases with coronavirus-related distributions and criteria that would warrant further study.

Management's Response: The IRS disagreed with this recommendation. Under the CARES Act, taxpayers have until TY 2022 to pay the tax and TY 2023 to optionally repay the distribution. [redacted] The current Automated Underreporter program uses Form 1099-R to systemically identify, match, [redacted] select taxpayers that have potentially taxable distributions. While some returns with early distributions will be selected for examination as part of the IRS's existing compliance processes, the early distributions may or may not be coronavirus-related distributions. In addition, based on the estimated amounts provided by the Treasury Inspector General for Tax Administration, spread over a three-year period, [redacted] Limited examination resources should not be diverted away from other priorities. Additionally, assessed amounts may be difficult as this provision was enacted to mitigate financial hardship.

Office of Audit Comment: The CARES Act gives taxpayers the option to claim the full distribution on their TY 2020 tax return as additional income, or they may report it in equal amounts over the next three years. Therefore, taxpayers must report and pay at least a portion of the taxes on the distributions on their TY 2020 tax return. Investment management companies and another news source reported that millions of taxpayers took coronavirus-related distributions. Without sufficient information, the IRS may have difficulty making a judgment about the compliance risk for millions of tax returns, involving potentially billions in distributions.

[20] Pub. L. No. 115-97.

[21] For more distributions that do not qualify for coronavirus relief, please see Appendix II, Distributions That Do Not Qualify As Coronavirus-Related Distributions. These types of distributions also do not qualify for other disaster-related distributions.

Recommendation 2: Consider creating a Lead Sheet to assist examiners when reviewing cases for potential noncompliance with Section 2202 of the CARES Act.

Management's Response: The IRS disagreed with this recommendation, stating that it [redacted] Creating a new Lead Sheet is not an effective method to alert examiners to new tax issues. In general, examiners only look for an issue Lead Sheet to identify audit steps after they have already identified the tax issue.

Office of Audit Comment: A Lead Sheet for Section 2202 of the CARES Act would assist examiners when reviewing returns with coronavirus-related distributions for potential noncompliance. Like other Lead Sheets created for other identified tax issues, it would include issue-specific audit steps to follow during the examination.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the IRS's efforts to oversee the relief from taxes associated with early retirement distributions and RMDs pursuant to the CARES Act. To accomplish our objective, we:

- Assessed the planned process for ensuring that taxpayers comply with the early distribution provisions of the CARES Act and are not assessed the excise tax for failing to take RMDs in TY 2020.
- Obtained and reviewed all procedures and guidance for the implementation of the early retirement distribution and RMD provisions of the CARES Act.
- Interviewed IRS employees who will have the responsibility of implementing the early distribution and RMD provisions of the CARES Act.
- Obtained and reviewed educational materials shared with the public regarding the coronavirus-related early distribution and waiver of the RMD for TY 2020.
- Obtained and reviewed any training materials provided by the IRS to monitor tax returns related to relevant distribution provisions of the CARES Act.
- Determined if the IRS or third parties had any estimates of the number of taxpayers who will file returns with early distributions pursuant to the CARES Act.
- Determined how the IRS plans to identify and deter noncompliance by taxpayers who decide to pay back coronavirus-related early distributions over the next three years.
- Determined if there are instances for which the IRS can implement strategies to identify fraudulent coronavirus-related early distributions.

Performance of This Review

This review was performed with information obtained from IRS personnel within the Small Business/Self-Employed Division's Operations Support and Examination functions and the Wage and Investment Division's Submission Processing; Operations Support; and Customer Assistance, Relationships, and Education functions located in Washington, D.C., and Atlanta, Georgia, during the period August 2020 through March 2021. 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.

Major contributors to the report were Heather Hill, Assistant Inspector General for Audit (Management Services and Exempt Organizations); Carl Aley, Director; David Bueter, Audit Manager; John Jarvis Jr., Lead Auditor; and Allison Sollisch, Senior Auditor.

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: policies, procedures, and practices related to the CARES Act retirement plan provisions and the Form 8915 series. We evaluated these controls by reviewing source documents and interviewing IRS management and employees.

Appendix II

Distributions That Do Not Qualify As Coronavirus-Related Distributions

- Corrective distributions of elective deferrals and employee contributions that are returned to the employee (together with the income allocable thereto) in order to comply with the § 415 limitations.[1]
- Excess elective deferrals under § 402(g).[2]
- Excess contributions under § 401(k).[3]
- Excess aggregate contributions under § 401(m).[4]
- Loans that are treated as deemed distributions pursuant to § 72(p).[5]
- Dividends paid on applicable employer securities under § 404(k).[6]
- Costs of current life insurance protection.
- Distributions of premiums for accident or health insurance under § 1.402(a)-1(e)(1)(i).[7]
- Prohibited allocations that are treated as deemed distributions pursuant to § 409(p).[8]
- Distributions that are permissible withdrawals from an eligible automatic contribution arrangement within the meaning of § 414(w).[9]

[1] 26 United States Code § 415.
[2] 26 United States Code § 402.
[3] 26 United States Code § 401(k).
[4] 26 United States Code § 401(m).
[5] 26 United States Code § 72(p).
[6] 26 United States Code § 404(k).
[7] 26 Code of Federal Regulations § 1.402(a)-1(e)(1)(i).
[8] 26 United States Code § 409(p)(1).
[9] 26 United States Code § 414(w)(1).

Appendix III

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

June 23, 2021

MEMORANDUM FOR MICHAEL E. McKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: De Lon Harris
Commissioner, Small Business/Self-Employed Division
Examination

SUBJECT: Draft Audit Report – Taxpayers Were Notified About the CARES Act Retirement Plan Provisions; However, Additional Actions Could Be Taken to Identify Potential Noncompliance (Audit #202110620)

Thank you for the opportunity to review and comment on the subject draft audit report. The Coronavirus Aid, Relief and Economic Security (CARES) Act was enacted on March 27, 2020 to provide economic relief to taxpayers impacted by the coronavirus pandemic. The CARES Act includes retirement plan provisions that provide relief to taxpayers by (1) suspending any Required Minimum Distributions (RMD) for tax year 2020; (2) allowing taxpayers to take up to $100,000 of qualified distributions without having to pay an additional tax; (3) allowing taxpayers to include the qualified distributions in income over a 3-year period; and (4) allowing certain qualified distributions to be recontributed to an eligible retirement plan within three years and treated as a tax-free rollover.

We are pleased that you recognized all the steps taken to notify taxpayers about the CARES Act retirement plan provisions. Immediately after the CARES Act was signed into law, the IRS developed implementation plans to communicate important guidance about the law changes to the public, issuing news releases and a tax tip to alert taxpayers. The IRS also issued Notice 2020-50 to further explain the requirements of the provision and developed Form 8915-E, *Qualified 2020 Disaster Retirement Plan Distributions and Repayments* for taxpayers to report the distribution and tax on their 2020 - 2022 tax returns.

We believe we have successfully implemented the CARES Act retirement provisions and that the IRS is positioned to effectively and efficiently identify and address noncompliance. In developing our compliance plan, we have drawn upon our experience with implementing similar relief in the wake of other natural disasters. In addition, we are developing training and working through our Knowledge Management and Transfer program to increase tax examiner and revenue agent awareness of these specific CARES Act provisions.

TIGTA believes the risk of noncompliance and abuse is potentially higher for these provisions versus other natural disasters. However, TIGTA did not demonstrate nor has the IRS identified a higher compliance risk associated with coronavirus-related distributions for the following reasons:

- Coronavirus-related distributions are reported to the taxpayer and the IRS on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc*. Research demonstrates that the risk of noncompliance is significantly reduced when income is reported to the IRS by a third party.

- The tax treatment of coronavirus-related distributions as compared to other disaster-related distributions is nearly identical. While the population of impacted taxpayers may be larger, there is no evidence that indicates the compliance risk within this population is higher. Potential errors can be identified through established compliance procedures such as document matching and required review of prior year returns during examinations.

- This provision is only available for retirement plan distributions that occurred between January 1, 2020 and December 31, 2020.

- The draft report was issued before the tax year 2020 filing deadline and return data will not be available until later this year. Moreover, because a coronavirus-related distribution can be recontributed at any time during the 3-year period, it is not possible to accurately assess the level of noncompliance until after the 2022 filing season has concluded.

The definition of a coronavirus-related distribution is broad and generally applicable to people who were affected by the pandemic. Taxpayers self-certify to retirement plan administrators that the distribution is coronavirus-related. While there are some specific types of distributions that do not qualify for special treatment under the CARES Act and would be subject to an additional tax due to an early withdrawal, these situations are uncommon and pose little increased risk of noncompliance. The sources cited in your report indicate that the average CARES Act distribution is between $9,400 and $24,600. Taxpayers taking distributions from their retirement accounts are likely doing so as a last resort due to financial difficulties. A relatively small potential income tax adjustment (over a three-year period) does not justify the redirection of the Service’s limited compliance resources.

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Attached are our comments to your recommendations. If you have any questions, please contact me, or Scott Irick, Director, Examination Operations, Small Business/Self-Employed Division.

Attachment

Attachment

RECOMMENDATION 1: The Commissioner, Small Business/Self Employed Division, should ensure that management has sufficient information available to assess compliance with Section 2202 of the CARES Act so that they can make a judgment about the need for a research project or compliance initiative project. The reliability of such information could be enhanced by ensuring assignment of a sufficient number of cases with coronavirus-related distributions, and criteria that would warrant further study.

CORRECTIVE ACTION:
Under the CARES Act, taxpayers have until 2022 to pay the tax and 2023 to optionally repay the distribution. [redacted] The current AUR program uses the Form 1099-R to systemically identify, match, [redacted] select taxpayers that have potentially taxable distributions. While some returns with early distributions will be selected for examination as part of the IRS's existing compliance processes, the early distributions may or may not be coronavirus-related distributions. In addition, based on the estimated amounts provided by TIGTA, spread over a three-year period, [redacted] Limited examination resources should not be diverted away from other priorities. Additionally, assessed amounts may be difficult to collect as this provision was enacted to mitigate financial hardship.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

RECOMMENDATION 2: The Commissioner, Small Business/Self Employed Division, should consider creating a Lead Sheet to assist examiners when reviewing cases for potential noncompliance with Section 2202 of the CARES Act.

CORRECTIVE ACTION:
This recommendation [redacted] Creating a new lead sheet is not an effective method to alert examiners to new tax issues. In general, examiners only look for an issue lead sheet to identify audit steps after they have already identified the tax issue.

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IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL:
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A

Appendix III

Abbreviations

CARES Act	Coronavirus Aid, Relief, and Economic Security Act
COVID-19	Coronavirus Disease 2019
IRA	Individual Retirement Arrangement
IRS	Internal Revenue Service
RMD	Required Minimum Distribution
TY	Tax Year

To report fraud, waste, or abuse,
call our toll-free hotline at:

(800) 366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration

P.O. Box 589

Ben Franklin Station

Washington, D.C. 20044-0589

Information you provide is confidential, and you may remain anonymous.