GAO Highlights

Highlights of GAO-17-102, a report to the Ranking Member, Committee on Finance, U.S. Senate

December 2016

RETIREMENT SECURITY

Improved Guidance Could Help Account Owners Understand the Risks of Investing in Unconventional Assets

Why GAO Did This Study

Federal law places few restrictions on the types of investments allowable in tax-favored retirement accounts, such as IRAs or employer-sponsored 401(k) plans. Recent federal and state investigations and litigation have raised questions as to whether investing in unconventional assets may jeopardize the accounts' tax-favored status, placing account owners' retirement security at risk. GAO was asked to examine issues related to the potential risks and responsibilities associated with investments in unconventional assets.

GAO examined: (1) what is known about the prevalence of accounts that invest in unconventional assets; (2) how these accounts are managed; and (3) what challenges are associated with administering these retirement accounts. GAO reviewed relevant federal laws, regulations, and guidance; analyzed data collected from the retirement industry; analyzed available industry documents; and reviewed 334 related consumer complaints collected from three federal agencies and two independent entities.

What GAO Recommends

GAO is making three recommendations to the Commissioner of Internal Revenue to, among other things, improve guidance for account owners with unconventional assets on monitoring for ongoing federal tax liability and to clarify how to determine the fair market value of hard-to-value unconventional assets. IRS generally agreed with these recommendations.

View GAO-17-102. For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeckc@gao.gov , or James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov.

What GAO Found

Federal data collection efforts to date have captured little information on retirement accounts holding unconventional assets—such as real estate, precious metals, private equity, and virtual currency—making the prevalence of such accounts unknown. In tax year 2015, the Internal Revenue Service (IRS) began requiring that custodians or trustees of individual retirement accounts (IRA)—including banks or other institutions approved to hold account assets—report selected information on unconventional assets in their clients' accounts to IRS. As of November 2016, IRS plans to begin compiling the new IRA asset data in 2017, but has not specified when the new IRA asset data will be available for analysis. Seventeen of the 26 custodians, who GAO identified as allowing retirement accounts with unconventional assets and who participated in GAO's data collection effort, reported having nearly half a million of these accounts in their custody at the end of calendar year 2015. IRAs made up the vast majority of accounts and assets reported.

An IRA owner's decision to invest in unconventional assets can expand their role and responsibilities substantially. GAO's review of industry documents found that individuals wanting to invest in unconventional assets through their IRA generally agree to be responsible for overseeing the selection, management, and monitoring of account investments and shoulder the consequences of most decisions affecting their accounts. For example, owners of such accounts assume a fiduciary role, which makes them assume greater responsibility for overseeing the selection, management, and monitoring of account investments, and shoulder the consequences of most decisions affecting their accounts.

Current IRS guidance provides little information to help IRA owners understand their expanded responsibilities and potential challenges associated with investing in unconventional assets. Targeted IRS guidance for these IRA owners may help them navigate the potential compliance challenges associated with certain types of unconventional assets. For example, GAO found that some IRA owners can experience challenges in the following areas:

- **Monitoring for ongoing federal tax liability**: IRA owners are not always aware of the need to monitor the gross income from certain unconventional assets in their accounts for ongoing federal tax liability. For example, IRA owners who invest in active businesses or debt-financed properties need to monitor their accounts for ongoing tax liability that must be paid from the IRA. Failure to do so can result in underpayment penalties.
- **Obtaining annual fair market valuations for nonpublicly traded assets**: IRA owners investing in hard-to-value unconventional assets can face challenges meeting their responsibilities to provide updated fair market value information to their custodian to meet IRS's annual reporting requirement. Failure to provide an updated fair market value in a timely manner can result in a custodian prematurely distributing account assets to the owner at a fair market value that is not current, potentially incorrect, and which could lead to a loss of tax-favored status for their retirement savings.