GAO Highlights

Highlights of GAO-20-210, a report to the Ranking Member, Committee on Finance, U.S. Senate

Why GAO Did This Study

Unconventional IRA investments—such as real estate, certain precious metals, private equity, and virtual currency—can introduce risks to account owners who assume greater responsibility for navigating the complex rules that govern tax-favored retirement savings. IRS enforces tax rules relating to IRAs and can assess additional taxes.

GAO was asked to examine the challenges associated with enforcing rules governing IRAs invested in unconventional assets. This report examines (1) the extent to which IRS offers guidance to help taxpayers understand the rules governing unconventional IRA assets; and (2) the challenges IRS faces in enforcing those rules. GAO identified and analyzed IRS information to help taxpayers understand four compliance areas. GAO reviewed IRS analysis of nonmarket IRA assets reported by IRA custodians, and IRS audit procedures and training materials; and interviewed relevant IRS officials to identify enforcement challenges.

What GAO Recommends

GAO is recommending that IRS (1) assess options for updating its IRA publications to provide more information for taxpayers with unconventional assets, (2) evaluate the feasibility of requiring disclosure for high-risk IRA asset types associated with abusive tax schemes, and (3) develop auditor resources (such as training materials or job aids) that explain how IRAs with unconventional assets can generate unrelated business income tax. IRS generally agreed with GAO's recommendations.

View GAO-20-210. For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov, or Charles A. Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

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INDIVIDUAL RETIREMENT ACCOUNTS

IRS Could Better Inform Taxpayers about and Detect Noncompliance Related to Unconventional Assets

What GAO Found

The Internal Revenue Service's (IRS) Publications 590-A and 590-B serve as a general handbook for millions of taxpayers with individual retirement accounts (IRA). However, the two-part publication provides limited information for IRA owners with unconventional assets surrounding complex tax rules in four compliance areas: (1) barred investments, (2) prohibited transactions, (3) unrelated business income, and (4) fair market value. GAO found other limited information about these topics on IRS's website. With only about 2 percent of IRAs invested in unconventional assets, adding more pages to Publications 590-A and 590-B may not be practical. By assessing options for informing IRA owners investing in unconventional assets, such as directing them to web pages with specialized information and technical regulations, IRS could better help them comply.

Noncompliance involving unconventional IRA assets is difficult to detect and time consuming for IRS to pursue. Whereas IRS relies on automated enforcement for IRAs invested in conventional assets held by custodians and trustees, enforcement for IRAs invested in unconventional assets or under IRA owner control requires labor-intensive audits of individual taxpayers. Using newly compiled information, IRS identified about 2 million IRAs that held certain types of hard-to-value assets as of 2016; however, about 20 percent of the forms were missing fair market value amounts for these assets (see fig.).

Numbers of IRAs Reporting Certain Types of Unconventional Assets and Reporting Their Value (Tax Year 2016)

Data element from IRS Form 5498	Number of forms reporting (in millions)
Certain types of unconventional nonmarket assets	2.0
Fair market value of specified assets	1.6

Source: GAO analysis of IRS data. | GAO-20-210

IRS officials said this type of reporting alone may be inadequate for audit selection and identifying potentially abusive IRAs. When IRS lacks sufficient data to detect abusive transactions, IRS can require taxpayers to self-report certain transactions that have been used by other taxpayers to avoid taxes. Additional taxpayer or custodian disclosure of potentially abusive IRA transactions coupled with IRS analysis of reported details may help IRS to select IRA owner tax returns to audit.

Fragmented responsibility among IRS divisions creates challenges for examiners who need to share expertise and collaborate on IRA enforcement. The division responsible for tax-exempt entities trains its examiners on how to determine if an employee retirement plan has engaged in business activities subject to taxation. However, examiners in the division that audits complex individual tax returns, including those involving IRAs, do not receive such training. Training for those examiners could help improve collaboration on IRA enforcement.