

REPORT BY THE
Comptroller General
 OF THE UNITED STATES

9279

Internal Revenue Service Efforts And Plans To Enforce The Employee Retirement Income Security Act

The Internal Revenue Service enforces the Employee Retirement Income Security Act, which regulates the private pension system for providing millions of Americans with retirement income.

The Internal Revenue Service has reviewed provisions of over 400,000 pension plans to determine whether they comply with the act's requirements. However, the Internal Revenue Service has made little effort to determine that the plans actually operate according to the act's requirements. Further, the Internal Revenue Service's national office has limited its quality review efforts, which assure the quality of determinations that plan provisions comply with the act.

Consequently, Internal Revenue Service officials plan to

- increase the number of examinations of plan operations,
- develop criteria to measure overall compliance with the act and an objective approach to selecting plans for examination, and
- upgrade efforts to assure the quality of Internal Revenue Service determinations that plan provisions meet act requirements.

This report is in response to a request from the Joint Committee on Taxation.



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GAO 00190

HRD-79-55
 MARCH 28, 1979





COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164292

To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

We have reviewed the Internal Revenue Service's (IRS') efforts to enforce the provisions of the Employee Retirement Income Security Act (ERISA) in response to your Committee's March 16, 1978, request. Our work was performed at the IRS national office in Washington, D.C., and its San Francisco regional and district offices. We examined enforcement efforts and plans and interviewed management and enforcement personnel. The matters in this report were discussed with agency officials. Their comments are included in the report, where appropriate.

BACKGROUND

ERISA, enacted on September 2, 1974, is the first comprehensive Federal legislation to regulate private pension plan systems that provide working Americans with retirement income. ERISA was enacted because of indications that pension plan misuse was causing lost pension benefits to workers--even those with many years of service. ERISA established comprehensive minimum standards and requirements to help assure that workers have an equitable right to and receive benefits promised by employers through private pension plans.

IRS estimates that there are about 990,000 pension plans that have 55 million participants.

IRS is responsible for enforcing ERISA minimum standards and requirements that specify

- how employees become eligible to participate in pension plans (participation standards),
- how employees earn a nonforfeitable right to pension benefits (vesting standards), and
- how the plans are funded (funding standards).

Favorable tax treatment is provided to pension plans, their sponsors, and participants, if the plans meet ERISA and related Internal Revenue Code requirements. Qualifying for favorable tax treatment means that business contributions to pension plans are generally tax deductible, earnings on the business contributions held by a pension plan are not taxed, and employees do not pay taxes on their benefits until they are received.

To further assure compliance with ERISA and Internal Revenue Code provisions, IRS can impose taxes if certain ERISA requirements are not met. Cases involving fraud or related criminal violations are to be referred to the Department of Justice for prosecution consideration.

Within IRS headquarters, the Assistant Commissioner, Employee Plans and Exempt Organizations, has overall responsibility for enforcing ERISA provisions. Within Employee Plans and Exempt Organizations, the Employee Plans Division provides guidance and direction to, and evaluates the activities of, the staff assigned to ERISA activities in the 7 regional and 19 key district offices throughout the United States. 1/

In the regions, the Assistant Regional Commissioner (Examination), under the jurisdiction of the Regional Commissioner, is responsible for planning, coordinating, and evaluating the employee plans activities of the district offices.

IRS had 1,568 staff years to administer and enforce ERISA and related Internal Revenue Code provisions during fiscal year 1978, of which 259 were allocated to headquarters operations and 1,309 to field operations.

IRS PLANS TO EXAMINE MORE PENSION PLAN OPERATIONS
TO ASSURE COMPLIANCE WITH ERISA

Because of the requirements imposed by ERISA, IRS has concentrated most of its enforcement efforts on assuring that the provisions of private pension plans comply with ERISA participation and vesting requirements. Little

1/Although IRS has 58 district offices, employee plan activities are primarily carried out by 19 offices which are referred to as "key" district offices.

effort has been spent on examining the operation of plans to assure that (1) they are implemented in accordance with the written provisions and (2) ERISA's minimum funding standards are met so that money will be available to pay participants' benefits. IRS recognizes the need to increase its examination effort and plans to do so.

Enforcement strategy: determinations and examinations

IRS' general strategy for enforcing ERISA is to encourage voluntary compliance through determinations and examinations (audits). A determination is an IRS review of plan documents to assure that they comply with ERISA requirements so as to qualify for favorable tax treatment. Emphasis is placed on ERISA's participation and vesting requirements during the determination process.

Determinations are made at the request of plan administrators, but they are not required before the plans and their sponsors and participants can receive favorable tax treatment. Plan administrators can apply for a determination for new, amended, and terminated plans. ERISA provides that a plan sponsor, plan administrator, or employee can petition the U.S. Tax Court for a declaratory judgment concerning the qualification of a plan if IRS fails to rule on the application within 270 days of its submission.

Examinations are initiated by IRS and can include reviews of both plan design and operations to assure that the plans are written and operate in accordance with ERISA requirements (including the funding provisions).

IRS gives highest priority to processing determination applications. Although determinations can be revoked or modified by IRS, they help give IRS, employers, and employees assurance that plans, as written, meet ERISA requirements and qualify for favorable tax treatment. Failure by IRS to rule on a determination application within 270 days could result in a petition for a declaratory judgment which would add to the workload of IRS, the U.S. Tax Court, and the petitioner.

Emphasis on determinations

According to IRS, most pension plans had applied for determinations before ERISA was enacted. The new requirements plans had to meet after ERISA's enactment, however, resulted in a flood of determination applications. As of September 30, 1978, IRS had received applications for determinations for 459,353 plans, 1/ of which 291,741 (63.5 percent) were for plan amendments, 133,161 (29 percent) were for new plans, and 34,451 (7.5 percent) were for plan terminations.

Because of this influx of determination applications, and IRS' policy of giving highest priority to processing requests for determinations, IRS, during the 4 years since enactment of ERISA, has spent most of its direct technical field time (staff time available less management, support, leave, and miscellaneous time) processing determinations. During fiscal year 1978, IRS spent about 92 percent of its direct time on processing determinations and only about 8 percent on examinations.

IRS had processed 416,317 (91 percent) of the 459,353 determination requests at the close of fiscal year 1978, leaving 43,036 requests pending. According to IRS, about 590,000 of the estimated 990,000 plans have less than 100 participants and are sponsored by self-employed individuals for themselves and their employees (Keogh plans). An IRS official told us that most of these plans were established by adopting plans that had already been approved by the IRS national office and, therefore, do not require individual determinations.

According to IRS, 12,461 pension plan examinations were completed during fiscal year 1978, which was about 70 percent less than the 42,152 examinations IRS completed during the fiscal year ERISA was enacted.

1/This figure does not represent the total number of plans that have applied for a determination because it can include separate determination applications for the establishment of, amendment(s) to, and termination of the same plan.

IRS efforts to assure that plans are written properly have played a primary role in selecting plans for examination. Of the 12,461 examinations completed during fiscal year 1978, 10,391 (83 percent) were selected because of IRS' Special Questionnaire Mailout Program. The remaining examinations resulted from plan sponsors being selected for an income tax audit (1,681--14 percent), or from referrals for examination from such sources as the determination process (389--3 percent).

The Special Questionnaire Mailout Program was started by IRS in September 1977, when a questionnaire was sent to 305,357 employers who had pension plans before ERISA and for which IRS had no record of an application for a determination that the plans met ERISA requirements. Using the questionnaire results as a base, IRS started examining those plans which would not voluntarily apply for a determination.

Information was not available on the number of responses to the questionnaires that resulted in examinations of both plan provisions and operations. An IRS official stated, however, that if the examination of a plan's provisions indicated that the plan may not be operating in accordance with ERISA requirements, the scope of the examination was broadened to determine whether the plan was operating properly.

More examinations planned

IRS recognizes the need to perform more examinations of pension plans in operation and plans to do so. IRS plans to spend 34 percent of its direct technical field staff years on 32,000 examinations during fiscal year 1979. The Special Questionnaire Mailout Program results are expected to be the major source for selecting plans for examination. Other major sources for selecting plans include plan funding deficiencies indicated by annual report information filed by pension plans and referrals from IRS personnel based on income tax audits. An IRS official stated that, no matter how the pension plans are selected for examination, the scope of the examination will be sufficient to determine whether the plans are written and operated in accordance with ERISA requirements.

As shown in the following table, IRS' 5-year enforcement plans for ERISA covering fiscal years 1979 through 1983 provide for continued examination emphasis. However, IRS expects to use from 49 to 66 percent of direct field time to process an average of about 130,000 determination applications annually.

Fiscal year	Total direct technical staff years (note a)	Determinations		Examinations	
		Number	Percent of staff years	Number	Percent of staff years
1979	419	180,214	66	32,000	34
1980	386	111,250	49	25,130	51
1981	386	118,025	52	20,920	48
1982	333	119,000	61	21,510	39
1983	333	125,075	64	19,930	36

a/A direct technical staff year is equivalent to 252 staff days. Excludes indirect time such as management, support, training, and leave.

The 5-year estimates of determination workload assumes that the inventory of pending determinations will be reduced from about 43,000 to about 30,000 and continue thereafter at the 30,000 level. IRS also estimates that the number of new plans will increase, 5 percent of existing plans will be amended annually, and the number of plan terminations will gradually decline.

Although IRS plans to spend about 50 percent of its field time during fiscal years 1980 and 1981 on examinations (compared to the 34 percent planned for fiscal year 1979), the number of planned examinations will be lower. This is based on an anticipated staff year budget reduction and the assumption that a comprehensive examination will be made of a sample of about 25,000 plans during the 2-year period of fiscal years 1980 and 1981. The examinations will be comprehensive because all aspects of ERISA and the Internal Revenue Code requirements will be examined for each plan even though information available to IRS indicates compliance. The comprehensive examinations are being made to

- measure the size and nature of noncompliance with ERISA,
- provide an objective basis for examination program planning and optimum selection of plans for examination, and
- provide an optimum base for revising pension plan reporting requirements.

During fiscal year 1982 IRS plans to use the comprehensive examination results to develop a system for objectively selecting those pension plans for examination which have the highest potential for noncompliance. IRS plans to implement its objective selection system starting with fiscal year 1983.

The planned further reduction in the number of examinations and the reduction in staff time spent on examinations during fiscal years 1982 and 1983 is based on the assumption that the compliance measurement results will show that compliance with ERISA can be assured through determinations and examinations with a reduction of about 14 percent in the fiscal year 1981 staff year level of enforcement effort.

IRS PLANS TO ASSURE DETERMINATION QUALITY

Determinations are to help assure that plans meet ERISA's statutory and related regulatory requirements and that they qualify for favorable tax treatment. This goal should be accomplished with the most effective utilization of IRS, plan sponsor, and plan administrator resources. Recognizing this, IRS plans to upgrade its national office quality review function.

We limited the scope of our examination because of IRS' upgrading plans. Our work, however, supports the need to upgrade the quality review function. We found that weaknesses exist in the determination process which may (1) cause pension plans to be approved and operated which do not meet ERISA requirements and (2) impose an administrative burden on plan administrators by requiring unnecessary amendments to pension plans. There is confusion about what is a plan defect and when amendments should be required before plan approval.

IRS district office employee plan specialists are responsible for evaluating determination requests from plan administrators and for obtaining amendments to plans not meeting ERISA requirements. IRS sends a determination letter to the plan administrator after the determination review is completed.

Each IRS key district office has a technical review staff. The staff is to review a sample of applications processed by employee plan specialists to identify weaknesses in determination processing and to determine the need for staff training or other corrective actions. It is IRS' policy to assign, on a rotating basis, only highly qualified specialists to the technical review function.

Defining plan defects

According to IRS national and regional office officials, two types of plan defects are identified through the determination process--"fatal" (major) and "nonfatal" (minor). The officials stated that fatal and nonfatal are not specifically defined but that definitions are implied in various manuals and policy documents.

An IRS national office official stated that IRS is primarily concerned with detecting, and having corrected, major plan defects. He defined major defects as those that cause a plan to not meet ERISA and Internal Revenue Code requirements as interpreted by regulations and other published guidelines. The official pointed out that major plan defects are often clear, but that situations do arise where ambiguous plan language or the nature of ERISA provisions require employee plan specialists to use judgment and discretion in deciding if a plan defect is likely to result in noncompliance with ERISA and Internal Revenue Code requirements. All major plan defects are required to be corrected before IRS approves the plan.

Minor defects are those that are not likely to result in ERISA noncompliance; these include ambiguous language. Minor defects are not required to be corrected before plan approval unless the plan also has a major defect or numerous minor defects.

Confusion about plan defects

The IRS San Francisco District Office received 852 applications for determinations during September 1977. We reviewed 51 of these applications. Sixty plans were covered by the 51 applications because some of the applications were for more than one plan. We asked a San Francisco District Office specialist who served on the technical review staff to identify and classify as major and minor those defects in the 60 plans that had been required to be corrected for plan approval.

The specialist stated that 22 (37 percent) of the 60 plans had defects. Of the 22 plans, the specialist said that 1 plan had only major defects, 13 plans had both major and minor defects, and 8 plans had only minor defects.

We asked a second specialist who also had served on the technical review staff to review the eight plans in which the first specialist had identified only minor defects and to classify the defects identified by the first specialist as major or minor. The second specialist told us that six of the eight plans had major defects which should have been corrected before plan approval and two had only minor defects which should not have required correction before plan approval. The second specialist also said that five of the defects in three plans identified as minor by the first specialist were not defects at all.

The number and classification of defects in each of the eight plans by both specialists are summarized in the following table.

<u>Plan number</u>	Defects classified as minor by first specialist	Defects as classified by second specialist			
		<u>Not a defect</u>	<u>Minor</u>	<u>Major</u>	<u>Total</u>
1	5	-	4	1	5
2	4	2	2	-	4
3	4	1	2	1	4
4	3	-	2	1	3
5	3	2	-	1	3
6	3	-	1	2	3
7	2	-	2	-	2
8	<u>2</u>	-	-	2	<u>2</u>
Total	<u>26</u>	<u>5</u>	<u>13</u>	<u>8</u>	<u>26</u>

The above indicates that confusion exists in the IRS San Francisco District Office about when a plan has a defect which should be corrected before approval. This confusion may cause (1) plans to be approved which do not meet ERISA requirements and (2) a burden on plan administrators to unnecessarily amend plans.

National office quality review

According to IRS, before ERISA the national office had a technical review program for evaluating the quality of determinations. This was a review at the national office of a sample of closed determination cases. After ERISA's enactment, the review of closed cases at the national office was stopped because the national office needed resources to resolve the technical issues raised by the complex ERISA provisions and to provide employers and IRS district office personnel with guidance on ERISA requirements.

As an interim measure, IRS delegated the review of closed cases to the regional offices and started a national office onsite review at selected district offices of pending cases that had completed determination processing and were awaiting the issuance of a determination letter. Although IRS has tried to make onsite reviews of pending determination cases in selected district offices of each region once a year, this has not always been accomplished since ERISA's enactment. IRS stated that onsite reviews were not made at two of the seven IRS regional offices during fiscal year 1978 because of travel money restrictions. Thus, IRS' national office quality review efforts since ERISA's enactment have been limited.

IRS plans to start the national office review of closed cases again during calendar year 1979 and, at the same time, continue the onsite review. According to IRS, a review of closed cases of each key district office in all regions will be made once a year and involve an annual review of about 1,200 closed determinations. This is less than 1 percent of the estimated determination cases to be closed during calendar year 1979. A national office onsite review of pending cases will follow the national office review of each region's closed cases. The number of key district offices covered during the onsite review will depend on the results of the review of closed cases and staff time available.

IRS plans to use about 4.5 staff years (1 percent of the determination field staff years) to accomplish the national office technical review goals during fiscal year 1979.

An IRS official stated that regional and district offices will be told about determination problems (such as those we noted) and corrective action that is needed. The technical review program and determination problems will be monitored to determine the review program's effectiveness. Depending on the monitoring results, the review program will be redirected, expanded, or reduced. The IRS official pointed out that expanding the review program to accomplish technical review program goals will depend on the availability of staff resources.

CONCLUSION

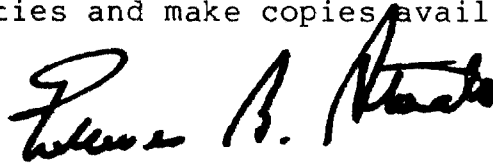
During the 4 years since the enactment of ERISA, IRS has spent most of its field enforcement effort on determining whether plan provisions comply with ERISA requirements. Little effort has been spent on determining whether plans operate in accordance with ERISA requirements.

IRS has processed over 400,000 determination applications. IRS recognizes, and our review supports, the need to assure the quality of determinations. Weaknesses in the determination process may (1) result in pension plans being approved and operated which do not meet ERISA requirements and (2) impose an administrative burden on plan administrators due to IRS requiring unnecessary amendments to pension plans.

IRS officials recognize the need to improve their ERISA enforcement efforts; they stated that IRS has plans to (1) increase the number of examinations, (2) develop criteria to measure overall compliance with ERISA and develop an objective approach for selecting plans for examination, and (3) upgrade efforts to assure the quality of determinations. Their actions should improve the enforcement of ERISA standards.

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As arranged with your office, we will send copies of this report to interested parties and make copies available to others on request.

A handwritten signature in black ink, appearing to read "Eugene A. Stearns". The signature is written in a cursive style with a large initial 'E'.

Comptroller General
of the United States

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