



June 2019

INDIVIDUAL RETIREMENT ACCOUNTS

Formalizing Labor's
and IRS's Collaborative
Efforts Could
Strengthen Oversight of
Prohibited Transactions

GAO Highlights

Highlights of [GAO-19-495](#), a report to the Ranking Member, Committee on Finance, U.S. Senate

Why GAO Did This Study

IRA owners are able to invest in a wide variety of assets, but they are prohibited from engaging in certain transactions involving IRA assets. IRA owners who engage in prohibited transactions may incur increased income tax liability, additional taxes, and the loss of the tax-advantaged status of their accounts. DOL can grant exemptions from the prohibited transaction rules. IRS enforces tax laws relating to IRAs and can assess additional taxes.

GAO was asked to examine (1) DOL's process for granting exemptions for prohibited IRA transactions and outcomes of that process, and (2) the extent to which DOL and IRS collaborate on oversight of prohibited transaction rules for IRAs. GAO reviewed relevant federal laws and regulations; examined agency guidance, exemption process documentation, and application case files; assessed interagency coordination using internal control standards and prior work on interagency collaboration; and interviewed DOL and IRS officials.

What GAO Recommends

GAO is recommending that DOL and IRS establish a formal means—such as a memorandum of understanding or other mechanism—to collaborate on oversight of prohibited IRA transaction exemptions. GAO is also recommending that DOL document policies and procedures for managing the exemptions process. DOL and IRS generally agreed with GAO's recommendations.

View [GAO-19-495](#). 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 jeszeck@gao.gov.

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Formalizing Labor's and IRS's Collaborative Efforts Could Strengthen Oversight of Prohibited Transactions

What GAO Found

The Department of Labor (DOL) has a process to grant administrative exemptions for individual retirement account (IRA) transactions that would otherwise be prohibited by law, such as an IRA buying investment property from the IRA owner. DOL evaluates applications using statutory criteria and follows administrative procedures codified in regulations. Applications for proposed transactions that are substantially similar to certain other transactions previously granted exemptions may follow an expedited process.

Prohibited Transaction Exemption Applications for Individual Retirement Accounts Processed by the Department of Labor (DOL), January 1, 2006 through May 16, 2017

Application status	Individual	EXPRO ^a
Withdrawn	28	28
Granted	20	28
Denied	11	5
Closed administratively or other	4	n/a
Total	63	61

Source: GAO analysis of DOL data. | GAO-19-495

^aEXPRO is the common name for a class exemption that allows DOL to authorize relief from the prohibited transactions rules on an expedited basis, generally a shorter period of time than it takes to review individual applications.

As shown in the figure, GAO found that roughly half (56) of the IRA prohibited transaction exemption applications it reviewed were withdrawn by the applicant before the review process was completed. In reviewing processed applications, GAO found that most of the prohibited transactions for which an exemption was sought involved the sale of IRA assets. With regard to DOL's application review process, GAO found that DOL has not sufficiently documented internal policies and procedures to help ensure effective internal control of its process. Documenting procedures could increase transparency about how applications are handled, reduce the risk of DOL employees carrying out their duties inconsistently, and provide a means to retain organizational knowledge should key personnel leave unexpectedly.

Although DOL and the Internal Revenue Service (IRS) share some information as part of their oversight responsibility for prohibited IRA transactions, no formal mechanism exists to help guide collaboration between the agencies. Of the 124 IRA applications GAO reviewed, only eight reflected DOL contact with IRS. GAO found that DOL has information about requested exemptions to prohibited IRA transaction rules that could be useful to IRS in carrying out its oversight responsibilities. For example, DOL does not share information on denials—information that could be useful as prohibited transaction examples for IRS examiner training and educational outreach to IRA owners. In prior work on interagency collaboration, GAO has found that formal agreements, such as a memorandum of understanding, can help agencies monitor, evaluate, and update interagency collaboration. Formalizing the sharing of information between DOL and IRS regarding IRA prohibited transaction exemptions could help the agencies better support their current coordination efforts and identify additional opportunities for greater collaboration.

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Abbreviations

DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act of 1974
IRA	individual retirement account
IRC	Internal Revenue Code
IRS	Internal Revenue Service
MOU	memorandum of understanding
OED	Office of Exemption Determinations

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June 7, 2019

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate

Dear Senator Wyden:

Individual retirement accounts (IRA) provide key tax advantages to encourage individuals to save for retirement. While contributions to IRAs are subject to annual dollar limits, there are few restrictions on the types of investments allowable in an IRA. Many IRA owners invest in publicly traded assets, such as stocks, bonds, and mutual funds. But as we have previously reported, some IRA owners choose to invest in less conventional or nonpublicly traded assets such as real estate, virtual currency, or private equity.¹ We have also reported that IRA owners who have accumulated unusually large IRA balances likely have invested in unconventional assets like nonpublicly traded shares of stock and partnership interests.²

IRA owners who invest in unconventional assets can assume greater responsibility for managing their accounts and, as a result, can be exposed to heightened risks of noncompliance with complex rules governing tax-favored retirement accounts. For example, although IRA owners are able to invest in a wide variety of types of assets, they are not permitted to engage in certain transactions involving those assets. These transactions are prohibited to prevent misuse of the IRA to benefit the owner in a way other than as a vehicle to save for retirement, such as using an IRA to purchase a personal residence. IRA owners who engage in prohibited transactions may incur increased income tax liability, additional taxes, and the loss of the tax-advantaged status of their account.

¹GAO, *Retirement Security: Improved Guidance Could Help Account Owners Understand the Risks of Investing in Unconventional Assets*, [GAO-17-102](#) (Washington, D.C.: Dec. 8, 2016).

²GAO, *Individual Retirement Accounts: IRS Could Bolster Enforcement on Multi-Million Dollar Accounts, but More Direction from Congress is Needed*, [GAO-15-16](#) (Washington, D.C.: Oct. 20, 2014).

The Department of Labor (DOL) and the Internal Revenue Service (IRS) within the Department of the Treasury each have responsibilities for overseeing prohibited transactions relating to IRAs. DOL has primary responsibility for interpretive guidance and exclusive authority to grant exemptions from the prohibited transaction rules for retirement plans and IRAs. Whereas IRS and DOL share oversight responsibilities for employer-sponsored retirement plans such as 401(k) plans, IRS is responsible for enforcing tax laws relating to IRAs and, among other things, assessing additional taxes for early distributions for IRA owners that engage in prohibited transactions.³

You asked us to examine the challenges associated with enforcing rules governing IRAs invested in unconventional assets. This report examines: (1) the DOL process for granting exemptions for prohibited IRA transactions and outcomes of that process, and (2) the extent to which IRS and DOL collaborate on oversight for prohibited transaction rules for IRAs. This report is part of a larger body of work on retirement security—a key issue we have identified facing the nation.⁴

To describe the process for granting exemptions for prohibited IRA transactions, we examined relevant federal laws and regulations. We reviewed DOL procedures and guidance for granting administrative exemptions for certain prohibited transactions. We interviewed DOL officials from the Employee Benefits Security Administration (EBSA) about their prohibited transaction exemption process and procedures. Specifically, we asked officials within EBSA's Office of Exemption Determinations about IRA exemption application submissions; steps and criteria for the application approval process; and communication with applicants and IRA owners, as well as with IRS, regarding application decisions.

To describe the outcomes of the DOL exemption process, we reviewed DOL's internal Case Tracking System data on 124 IRA applications processed over an 11-year period from January 1, 2006, to

³This report addresses IRAs set up by individuals. Employer-sponsored IRA plans such as Saving Incentive Match Plans for Employees or a Simplified Employee Pension were not included in the scope of this report.

⁴See https://www.gao.gov/key_issues/retirement_security.

May 16, 2017.⁵ To report on the types of exemptions granted, denied, or withdrawn by applicants, we reviewed the system reference guide and DOL's definitions of subject codes used to categorize the IRA transactions. We reviewed the subject codes DOL assigned to each application and summarized the types of transactions and assets for which applicants most often requested an exemption. To assess the reliability of the data, we compared selected key data points to documentation in the supporting case files, which we had requested from DOL for this purpose.⁶ We interviewed DOL officials about the reliability of the data and discussed suspected anomalies we found. Based on our analysis and discussions with DOL officials, we determined that the DOL data were sufficiently reliable for the purposes of our descriptive analysis for the period we reviewed.

To determine the extent to which IRS and DOL collaborate on oversight for prohibited transaction rules for IRAs, we reviewed the 124 applications for documentation of DOL coordination with IRS about the application review or decision. We interviewed DOL officials responsible for the exemption process about their interactions with IRS regarding prohibited IRA transactions. We interviewed IRS officials responsible for enforcement of prohibited transactions rules on IRAs about their use of DOL exemption information. We assessed coordination using the relevant *Standards for Internal Control in the Federal Government* and our prior work on interagency collaboration that identifies key practices and considerations for implementing collaborative mechanisms.⁷

We conducted this performance audit from December 2016 to June 2019 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

⁵The number of applications does not represent the numbers of individuals or IRAs affected. For example, an application may involve multiple IRA account owners applying for an exemption for a transaction where multiple IRA owners will be investing. DOL reported that it processed an additional seven IRA application cases from May 17, 2017, to December 31, 2018; we did not review the additional cases for this report.

⁶We did not conduct an independent legal analysis of the exemptions included in our review.

⁷GAO, *Managing for Results: Key Considerations for Implementing Interagency Collaborative Mechanisms*, [GAO-12-1022](#) (Washington, D.C.: Sept. 27, 2012); and *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies*, [GAO-06-15](#) (Washington, D.C.: Oct. 21, 2005).

findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

IRA owners are not permitted to engage in certain prohibited transactions involving IRA assets. Prohibited transactions generally fall into two categories:

- **Transaction involving disqualified persons.** An IRA is prohibited from engaging in a transaction with disqualified persons, such as members of the IRA owner's family or an IRA fiduciary.⁸
- **Transaction involving self-dealing.** An IRA owner who is a fiduciary is prohibited from engaging in a transaction with the IRA where the IRA owner personally benefits (other than through the receipt of a distribution).⁹

We previously reported that prohibited transactions are more likely to arise when IRA owners make unconventional IRA investments.¹⁰ Unlike conventional IRA investments in publicly traded stocks, bonds, and mutual funds, unconventional investments in real estate, virtual currency, or private equity are more likely to involve the IRA owner, disqualified family members, or other disqualified persons. For example, an IRA invested in rental real estate can leave IRA owners susceptible to a number of prohibited transactions, such as renting to family or paying for repairs with personal funds.

IRA owners may face adverse and potentially severe tax consequences if they are found to have engaged in a prohibited transaction. Specifically, the IRA could lose its tax-favored status. The account would then be treated as distributing all its assets to the IRA owner at the fair market value on the first day of the year in which the prohibited transaction

⁸See 26 U.S.C. § 4975(c)(1)(A)-(D) & (e)(2) and 29 U.S.C. § 1106(a). A fiduciary is anyone who exercises discretionary authority or discretionary control in managing an IRA or exercises any authority or control in managing or disposing of its assets; renders investment advice to an IRA for a fee or has the responsibility to do so; and has any discretionary authority or discretionary responsibility in administering an IRA. See 26 U.S.C. § 4975(e)(3).

⁹See 26 U.S.C. § 4975(c)(1)(E)-(F) & (d)(9) and 29 U.S.C. § 1106(b).

¹⁰[GAO-17-102](#).

occurred.¹¹ The IRA owner may be subject to additional income taxes because of any early distribution from an IRA.¹² The prohibited transaction may also be subject to excise taxes.¹³

The Employee Retirement Income Security Act of 1974 (ERISA), which established IRAs and rules prohibiting certain IRA transactions, assigned IRA oversight roles to both DOL and IRS.¹⁴ To avoid confusion over dual jurisdiction, a 1978 Executive Order further clarified the agencies' roles and responsibilities regarding prohibited transactions.¹⁵ As a result, the authority to interpret the prohibited transaction rules and grant exemptions to those rules was transferred to DOL. The transfer did not affect IRS' ability to enforce the excise tax provisions or the tax consequences for IRA owners who are found to have engaged in a prohibited transaction. However, in enforcing such tax consequences, IRS is bound by the regulations, rulings, opinions, and exemptions issued by DOL.

DOL has the authority to grant administrative exemptions to the prohibited transaction rules on either an individual or a class basis.¹⁶ DOL can grant prospective exemptions for a transaction that an IRA is considering, as well as retroactive exemptions for transactions that have already occurred.

¹¹See 26 U.S.C. § 408(e)(2)(B).

¹²See 26 U.S.C. § 72(t).

¹³If a disqualified person other than the IRA owner or beneficiary engages in a prohibited transaction, that person may be liable for a 15 percent excise tax on the amount involved in the prohibited transaction and a 100 percent additional tax if the transaction is not corrected within the taxable period. See 26 U.S.C. § 4975(a). If the IRA ceases to be an IRA as a result of the prohibited transaction, the IRA owner or beneficiary is not subject to the excise tax. See 26 U.S.C. § 4975(c)(3).

¹⁴See Pub. L. No. 93-406, 88 Stat. 829. ERISA includes provisions related to prohibited IRA transactions in Titles I and II. The Title II provisions are found in the Internal Revenue Code (IRC). Throughout this report, we generally refer to the prohibited transaction rules *writ large* (inclusive of the provisions in both ERISA and the IRC), unless otherwise clear from context.

¹⁵ See Reorganization Plan No. 4 of 1978, available at <https://www.govinfo.gov/content/pkg/USCODE-2010-title5/pdf/USCODE-2010-title5-app-reorganiz-other-dup102.pdf>. Accessed April 2, 2019.

¹⁶Class exemptions provide relief from the prohibited transaction rules to an identified class of entities or individuals who engage in the transaction(s) described in the exemption and who satisfy its conditions.

DOL Has Not Sufficiently Documented Internal Policies and Procedures for Reviewing Prohibited IRA Transaction Exemption Applications

To grant an exemption from prohibited IRA transaction rules, DOL evaluates applications using statutory criteria, and follows administrative procedures codified in regulations. Generally, DOL may not grant an exemption unless it finds the exemption to be:

- administratively feasible,
- in the interest of the plan and its participants and beneficiaries, and
- protective of the rights of plan participants and beneficiaries.¹⁷

Before granting an exemption, DOL generally must publish a notice of proposed exemption in the *Federal Register* inviting interested parties to comment on the proposed exemption.¹⁸

DOL Has a Process to Grant Administrative Exemptions for Otherwise Prohibited IRA Transactions

DOL regulations lay out the process for filing and processing prohibited transaction exemptions applications.¹⁹ Among other things, the regulations explain:

- who may apply,
- what information must be included with an application,²⁰
- when a conference with DOL can be requested,
- when a request for reconsideration of a DOL decision can be made, and
- how DOL and the applicant will notify interested persons if DOL decides a tentative approval is warranted.

DOL also publishes a booklet that provides an explanation of the regulations and applicable laws, and includes additional information for applicants like examples of common types of exemption requests.²¹

¹⁷See 26 U.S.C. § 4975(c)(2)(A)-(C) and 29 U.S.C. § 1108(a)(1)-(3).

¹⁸See 29 C.F.R. § 2570.42.

¹⁹See 29 C.F.R. §§ 2570.30 through 2570.52.

²⁰See 29 C.F.R. § 2570.34. Among other things, applications must include a detailed description of the exemption transaction, the reason the IRA would have for entering into the exemption transaction, and a statement explaining why the transaction meets the criteria in 26 U.S.C. § 4975(c)(2).

IRA owners or their fiduciaries file applications for exemptions with DOL's Office of Exemption Determinations which is part of EBSA. Applicants can research information about past exemptions granted by the agency on EBSA's website.²² As explained in the DOL booklet describing the application requirements, applicants have the burden of demonstrating that they should be granted an exemption.

If DOL tentatively denies an application, applicants have options for requesting that the denial be reconsidered. Within 20 days of the tentative denial, applicants can request a conference with DOL, or notify DOL of their intent to submit additional information.²³ If, after a conference has been convened, DOL issues a final denial of the application, DOL will entertain one request for reconsideration if the applicant presents significant new facts or arguments, which, for good reason, could not have been submitted earlier.²⁴

After DOL publishes a notice of proposed exemption in the *Federal Register* that describes the pending application, the applicant must notify interested persons of the pending exemption.²⁵ Often, the contents of the information sent to all interested persons, the manner in which it is sent, and any associated deadlines will have previously been agreed to by DOL and the applicant. DOL may also hold public hearings during the comment period. For example, if the transaction involves potential fiduciary self-dealing or conflicts of interest, any individual potentially adversely affected by the exemption may submit a request for a public hearing to DOL.²⁶ If granted, DOL publishes information about the exemption in the *Federal Register* and on its website. Figure 1 provides an overview of the exemption application process.

²¹DOL, *Exemption Procedures Under Federal Pension Law*. Available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/publications/exemption-procedures-under-federal-pension-law.pdf>. Accessed April 8, 2019.

²²See <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/exemptions/individual>. Accessed on August 21, 2018.

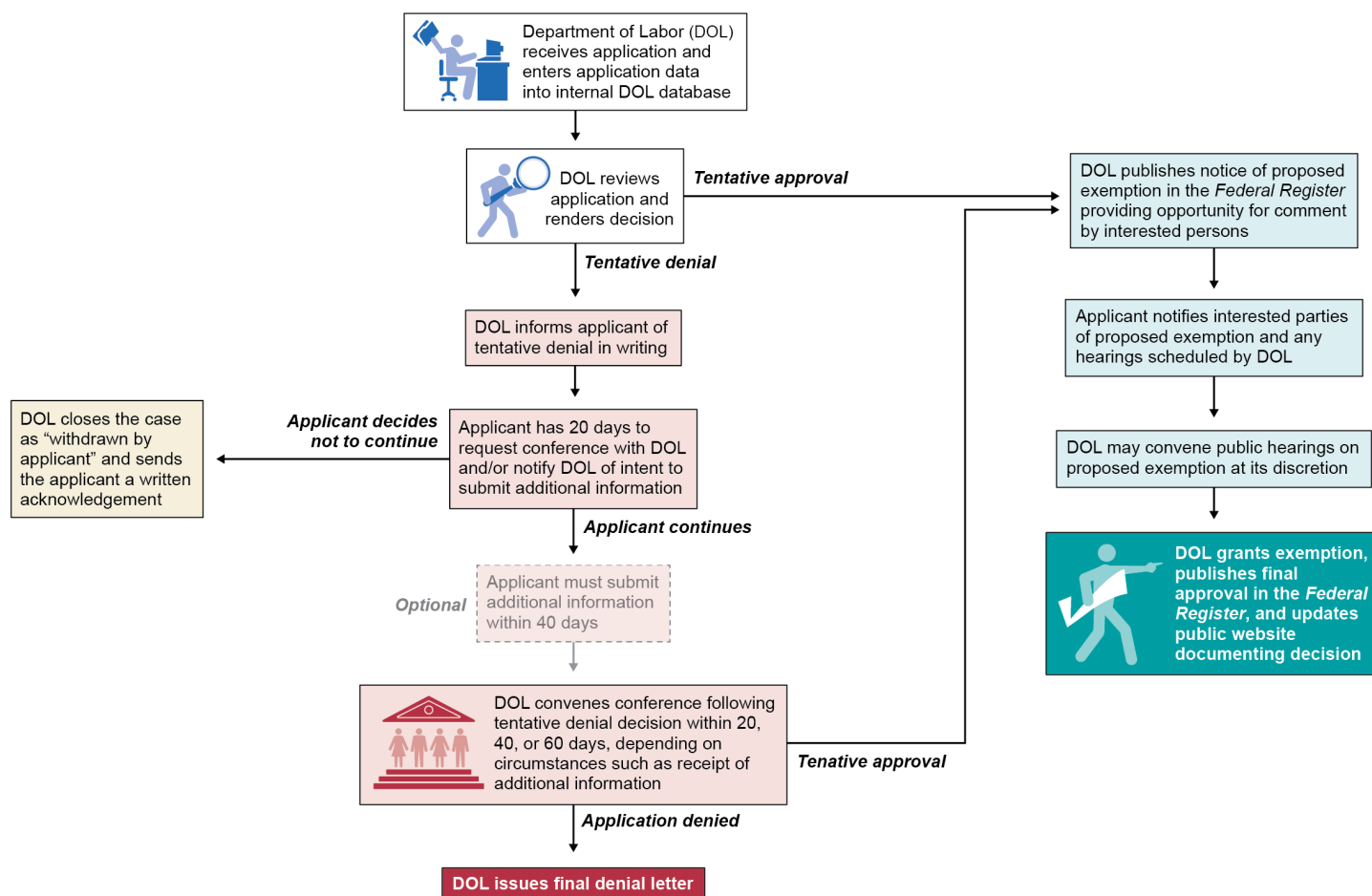
²³See 29 C.F.R. § 2570.38.

²⁴See 29 C.F.R. § 2570.45. The applicant must explain why these new facts or arguments could not have been submitted for the agency's consideration during its initial review.

²⁵See 29 C.F.R. § 2570.43.

²⁶See 29 C.F.R. § 2570.46.

Figure 1: Overview of Department of Labor’s (DOL) Process for Reviewing Prohibited Transaction Exemption Applications



Source: GAO analysis of DOL’s Prohibited Transaction Exemption Procedures; relevant federal laws and regulations, and other related agency documents. | GAO-19-495

Note: The figure provides a general overview of the DOL process for reviewing applications under DOL regulations codified at 29 C.F.R. part 2570. Under certain circumstances, DOL may issue a final denial letter for a proposed exemption it had tentatively approved. An applicant can withdraw an application prior to final denial or approval; DOL closes withdrawn cases as “withdraw by applicant” and sends the applicant a written acknowledgement.

The regulations describe circumstances in which DOL will ordinarily not consider an application.²⁷ For example, DOL generally will not consider an individual application if DOL already has under consideration a class

²⁷ See 29 C.F.R. § 2570.33.

exemption relating to the same type of transaction. DOL will also not consider an application for transactions subject to DOL or IRS investigations. DOL requires applicants to disclose in their applications whether exemption transactions are, or have been, subject to an investigation or enforcement action by DOL or IRS. In addition, if the applicant or any other party in interest becomes the subject of an investigation or enforcement action, the applicant is required to promptly notify DOL.²⁸

If applicants find that their prospective transaction is substantially similar to other transactions for which the agency has previously granted exemptions, they can follow an expedited process by submitting an “EXPRO” application.²⁹ EXPRO applications are required to cite prior exemptions granted by DOL to demonstrate that the proposed IRA transaction is substantially similar to other IRA transactions for which DOL has previously provided an exemption. Specifically, EXPRO applicants must cite as substantially similar, either (1) two individual exemptions granted by DOL within the previous 5 years, or (2) one individual exemption granted within the past 10 years, and one transaction authorized pursuant to the EXPRO class exemption within the past 5 years. The applicant must give notice to all interested persons, and the applicant must resolve all substantive adverse comments provided by interested persons before DOL will grant final approval.

The time to complete the exemption process can range from a few months to more than a year. DOL officials told us that the process generally takes about 1 year for an individual IRA application that is relatively simple or routine. EXPRO applications have been processed in as few as 78 days. According to DOL officials, the process can start before an applicant submits a formal application because applicants can, and do, request informal consultations and conferences with DOL. DOL officials explained that sometimes potential applicants decide not to file an application after an informal conference because applicants realize that their application would likely be denied.

²⁸See 29 C.F.R. § 2570.37(b).

²⁹EXPRO is the common name for a class exemption that was created by DOL in 1996 (PTE 96-62) “that allows DOL to authorize relief from the prohibited transaction rules on an expedited basis.” EXPRO applications are granted an “authorization” under class exemption rules. For purposes of this report, unless otherwise clear from context we generally use the term “exemption” to refer to both individual exemptions and EXPRO “authorizations.”

DOL officials explained that during the review process, they first confirm their understanding and characterization of the proposed exemption through correspondence with the applicants. Then, in response, DOL often sets conditions under which relief from the prohibited transaction rules is contingent, such as on the applicant taking additional actions and remaining in compliance with those conditions. For example, if an applicant wants to sell or purchase an asset in what would be an otherwise prohibited IRA transaction, DOL may stipulate that the applicant first obtain an independent appraisal or valuation assessment to determine a fair-market value of that asset.

After applications are formally submitted, many IRA applicants withdraw during DOL’s review process. Over an 11-year period, we found that of the 124 IRA applications, applicants withdrew roughly half (56) before the review process was completed (see table 1). Of the remaining 68 applications that continued with the review process, DOL granted 48, denied 16, and closed four application cases for administrative or other reasons.³⁰ DOL officials did not dispute the results of our analysis, but they said that it would be misleading to conclude that DOL is more likely to grant than deny applications. Rather, they said that their practice of encouraging applicants to consult with DOL in advance leads some potential applicants to decide not to pursue an exemption.

Table 1: Prohibited Transaction Exemptions Applications for Individual Retirement Accounts Processed by the Department of Labor (DOL), January 1, 2006 through May 16, 2017

Application outcome	Individual	EXPRO ^a
Withdrawn	28	28
Granted	20	28
Denied	11	5
Closed administratively or other	4	n/a
Total	63	61

Source: GAO analysis of DOL data. | GAO-19-495

^aEXPRO is the common name for a class exemption that allows DOL to authorize relief from the prohibited transactions rules on an expedited basis, generally a shorter period of time than it takes to review individual applications.

³⁰Applications closed for administrative reasons can include those that do not accurately identify the plan under review, among other reasons.

In our review of processed applications, we found that most of the applications involved the sale of IRA assets. We found that 88 of the 124 applications were for transactions involving the sale of IRA assets. Most of these were sales of securities or real property (see appendix I for additional information). The next most common type of transaction was for the purchase of assets (21 applications), and most of those also involved securities or real property. The remaining applications involved other transactions, including leases, loans, and extensions of credit.

DOL Lacks Documented Policies and Procedures to Manage Its Reviews and Data

DOL has not sufficiently documented internal policies and procedures to manage and help ensure effective internal controls of its prohibited transactions exemption process. While DOL regulations and guidance detail the requirements for applicants, DOL generally lacks internal documentation of the steps and actions DOL officials are to follow when processing applications, and the roles and responsibilities of agency officials.

DOL officials told us that they use a case tracking system to record and track applications. When an application is received by DOL, the division chief of EBSA's Office of Exemption Determinations (OED) reviews the application and assigns it to an OED supervisor. Either the division chief or the supervisor enters preliminary information from the application into the system, and classifies the transaction by applying one or multiple subject matter codes. The supervisor then reviews the information in the applicant's case file and assigns the case to an OED analyst. DOL officials told us that any interim data, such as the publication date for a proposed exemption, is entered by the supervisor in the system. If an application is withdrawn by an applicant, denied, or granted, the supervisor records this information in the system, including the dates of these actions. When a case is closed, the analyst completes a close-out index form and submits it to the supervisor for review, and the supervisor enters a closing code in the system. DOL officials told us that they can use the system to generate management reports, such as on the number of applications filed and the amount of time to process cases.

Neither the process described above, nor the different roles and responsibilities of the OED division chief, supervisors, and analysts in that process, were documented in the internal documents that DOL provided. A system reference guide included instructions to system users for how to input and modify case records, generate reports, and add or modify users. The reference guide also included screen prints indicating which fields are required by the system to process a case. However, the

reference guide did not contain information about responsibilities and duties for these data entry activities, and how those duties are assigned. The documentation provided is unclear regarding who within OED is ultimately responsible for making final decisions on applications.

According to *Standards for Internal Control in the Federal Government*, documentation of an agency's policies and procedures is a necessary part of an effective internal control system.³¹ Such documentation can appear, for example, in management directives or operating manuals, and it should be readily available for examination. Policies and procedures can also help document internal control responsibilities within the agency.

DOL officials told us that OED is a small and compact organization, and as such, its policies and procedures can easily be communicated "person to person" and through onsite training. DOL officials also said that the process for entering data is not difficult, and there are few opportunities for error because nearly all data on applications is prepopulated.

The principles of internal control, however, apply to both large and small organizations. The level and nature of documentation may vary based on the size of the organization and the complexity of the processes the organization performs, but documentation is still necessary. By documenting policies and procedures, management will be better positioned to monitor whether the organization's activities are aligned with those policies and procedures, and assess whether the organization is achieving its objectives. Documenting procedures also would provide greater transparency about how applications are handled, and can reduce the risk of employees carrying out their duties inconsistently. For a small organization like OED, documentation of policies and procedures provides a means to retain organizational knowledge, and can help ensure continuity of and consistency in operations if key personnel leave the organization unexpectedly.

³¹See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

DOL and IRS Currently Share Some Information on Exemption Applications, but More Formalized Collaboration Could Improve Their Oversight Efforts

Some information sharing takes place between DOL and IRS on applications for IRA prohibited transaction exemptions, but no formal mechanism exists to help guide collaboration between the two agencies. As previously discussed, DOL and IRS share oversight responsibility for prohibited IRA transactions. Based on our review of applications and DOL data as well as interviews with agency officials, we found that interactions between DOL and IRS regarding applications for prohibited transaction exemptions are infrequent and limited in scope. Of the 124 applications we reviewed, only eight were coded in OED's Case Tracking System as having "external contact with IRS," and DOL officials confirmed that this accurately reflects the level of interagency coordination.³² DOL officials stated that they sometimes contact IRS about exemption applications, and IRS officials confirmed to us that they periodically receive communications from DOL. IRS officials also told us that they occasionally contact DOL.

Both agencies described to us how their current interaction occurs. DOL officials told us that they coordinate with IRS in the following ways:

- If, during the application review process, OED staff identify applications that may warrant further review or investigation for tax violations, they refer the case to EBSA's Office of Enforcement, which may then coordinate or refer the case to IRS.
- DOL officials said that OED staff review the IRS "Dirty Dozen" list of potentially abusive tax scams and schemes.³³

IRS officials said that when possible prohibited transactions arise during an examination that might require DOL input, IRS examiners reach out to DOL to ensure that IRS understands DOL decisions on those transactions.³⁴

DOL officials said that, in their view, most requested prohibited IRA transaction exemptions do not require extensive interaction with IRS. They questioned the potential usefulness of information about denied or

³²DOL's reference guide describes using the "external contact with IRS" code in situations where OED staff consulted with IRS representatives.

³³The list is published annually by IRS and identifies any emerging tax schemes and scams for IRS and the public, <https://www.irs.gov/newsroom/dirty-dozen>.

³⁴[GAO-15-16](#).

withdrawn applications that might be shared with IRS, but said that IRS could certainly obtain this information if IRS requested it.

IRS officials, however, told us that more information from DOL about prohibited IRA transactions and requested exemptions could be useful in carrying out IRS's oversight responsibilities. For example, DOL does not share information on denied or withdrawn applications with IRS, information that IRS officials told us would be helpful to them. We found that denial information could be useful to IRS as illustrative examples of prohibited transactions for examiner training and educational outreach to IRA owners.³⁵ Information about the types of transactions in withdrawn applications could also help IRS identify emerging issues or trends in potential prohibited transactions marketed to IRA owners.

Although some limited collaboration between DOL and IRS exists, the agencies have not applied to their oversight of prohibited transactions some key practices we have identified in prior reviews of interagency collaboration.³⁶ Specifically, developing a mechanism to formalize the sharing of information between DOL and IRS could help support current collaboration activities, and could be useful in helping the agencies identify opportunities for greater collaboration going forward. Furthermore, documentation is a necessary part of an effective internal control system.³⁷ Documenting the procedures for interagency collaboration would improve internal control over the agencies' activities. A formal agreement, such as a memorandum of understanding (MOU) or other mechanism, can further help agencies monitor, evaluate, and update interagency collaboration.

For example, DOL and IRS have previously formalized their collaboration regarding oversight of a different type of retirement savings vehicle—employer-sponsored retirement plans. DOL and IRS have oversight responsibilities for employer-sponsored retirement plans, such as pensions, and in 2003, DOL and IRS completed an MOU to implement collaboration between the two agencies with regards to investigations of

³⁵In [GAO-15-16](#), we recommended that IRS identify options to provide outreach targeting taxpayers with nonpublic IRA assets and their custodians. IRS has taken some action to provide general outreach but had no plans as of February 2019 to target outreach to taxpayers with nonmarketable IRA assets at greater risk of noncompliance.

³⁶[GAO-12-1022](#).

³⁷[GAO-14-704G](#).

and litigation involving employer-sponsored retirement plans.³⁸ The employer retirement plan MOU and the implementing guidance contain some features of interagency collaboration mechanisms that we have identified in prior work. For example:

- The responsibilities of each agency are documented, and responsible agency components and officials are identified.
- The agencies use collaboration tools (checklists) for determining whether issues presented in an examination or investigation by one agency should be referred to the other.
- A system and process exists to track referrals, and the agencies reconcile their data about referrals (including pending referrals) quarterly.

The employer retirement plan MOU also established a process to periodically monitor its effectiveness, and the MOU was last updated in 2013. Developing a similar mechanism to formalize the sharing of information between DOL and IRS regarding IRA prohibited transaction exemptions could help the agencies better support their current coordination efforts and identify additional opportunities for greater collaboration.

Conclusions

IRAs are a key vehicle for individuals to save for retirement. IRA owners' decisions to invest in unconventional assets can expand their role and responsibilities substantially. The consequences for account owners who make a mistake can be severe.

When IRA owners request an exemption from rules on prohibited transactions, DOL evaluates applications using statutory criteria, and follows administrative procedures codified in regulations. However, DOL has not sufficiently documented internal policies and procedures for how to manage its process for granting exemptions. Such documentation is a necessary part of an agency's effective internal control system.

DOL and IRS share oversight responsibility of prohibited IRA transactions. While the two agencies do share some information, they do

³⁸EBSA Enforcement Manual, Chapter 12, Memorandum Of Understanding, *Internal Revenue Service/Department of Labor Coordination Agreement*, June 3, 2003. Available at: <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement/oe-manual/chapter-12>. Accessed December 11, 2018.

not have a formal mechanism to guide and monitor their collaboration. By formalizing interagency collaboration, such as through an MOU or other mechanism, DOL and IRS could help reinforce their current information sharing and potentially identify new opportunities to improve their oversight efforts through greater collaboration. Documenting procedures for DOL and IRS collaboration on prohibited IRA transactions would also help introduce better internal control over these activities.

Recommendations for Executive Action

We are making a total of three recommendations, including two to DOL and one to IRS.

The Secretary of Labor should document internal policies and procedures for managing the IRA prohibited transaction exemption process. (Recommendation 1)

The Secretary of Labor, in consultation with the Commissioner of Internal Revenue, should establish a formal means, such as a memorandum of understanding or other mechanism, to support and guide DOL's and IRS's collaborative efforts to oversee IRA prohibited transaction exemptions. (Recommendation 2)

The Commissioner of Internal Revenue, in consultation with the Secretary of Labor, should establish a formal means, such as a memorandum of understanding or other mechanism, to support and guide DOL's and IRS's collaborative efforts to oversee IRA prohibited transaction exemptions. (Recommendation 3)

Agency Comments

We provided a draft of this report to the Secretary of Labor, the Commissioner of Internal Revenue, and the Secretary of the Treasury for review and comment.

In its comments, reproduced in appendix II, DOL generally agreed with our two recommendations directed to it. For recommendation 1, DOL plans to create an internal procedure manual formalizing OED's administrative case processing procedures to help in passing along institutional knowledge. For recommendation 2, DOL agreed to periodically discuss all IRA exemption cases with IRS and did not elaborate on the formal means for this information sharing. DOL also provided technical comments which we incorporated as appropriate.

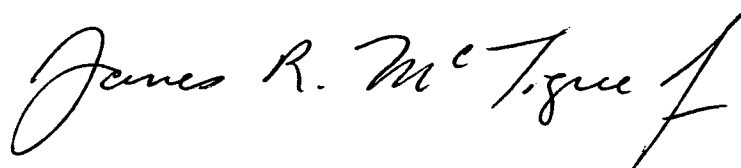
In its comments, reproduced in appendix III, IRS generally agreed with our recommendation directed to it. For recommendation 3, IRS said it is committed to discussing an appropriate mechanism, including periodic meetings, to formalize collaboration on IRA prohibited transaction exemptions. IRS plans to consider expanding its formal collaboration with DOL as part of the next periodic update of the existing employer plan MOU. IRS also provided technical comments which we incorporated as appropriate.

The Department of the Treasury provided technical comments which we incorporated as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees, the Secretary of Labor, the Secretary of the Treasury, and the Commissioner of Internal Revenue. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact James R. McTigue, Jr. at (202) 512-9110 or Charles A. Jeszeck at (202) 512-7215. You may also reach us by email at mctiguej@gao.gov or jeszeckc@gao.gov. GAO staff making key contributions to this report are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink that reads "James R. McTigue, Jr." with a stylized flourish at the end.

James R. McTigue, Jr.
Director, Tax Issues
Strategic Issues

A handwritten signature in black ink that reads "Charles Jeszeck" in a cursive style.

Charles A. Jeszeck
Director, Education, Workforce,
and Income Security

Appendix I: Applications for Individual Retirement Account Exempted Transactions by Type

Table 2: Transaction Types from Individual Retirement Account Prohibited Transaction Exemption Applications Processed by the Department of Labor, January 1, 2006 through May 16, 2017

Transaction type	Individual	EXPRO ^a
Sale of...		
securities	17	25
real property	9	17
partnership or limited liability company interest	8	10
other assets	1	1
Subtotal	35	53
Purchase of...		
securities	5	4
real property	3	2
partnership or limited liability company interest	5	0
other assets	2	0
Subtotal	15	6
Loan (secured by)...		
real property	3	0
personal property	1	0
other assets	2	0
Subtotal	6	0
Lease of...		
real property	0	1
personal property or other assets	2	0
Subtotal	2	1
Extension of credit by plan	4	1
Other transaction(s)	1	0
Total	63	61

Source: GAO analysis of DOL data. | GAO-19-495

Note: We reviewed transaction subject matter codes the Department of Labor (DOL) assigned to each application processed during the review period. We grouped some transactions under codes with clearer descriptions that DOL more commonly uses. In some cases, we consolidated several similar transaction subject codes under one of the more common subject matter codes identified. We did not conduct an independent legal analysis of the exemptions included in our review.

^aEXPRO is the common name for a class exemption that allows DOL to authorize relief from the prohibited transactions rules on an expedited basis, generally a shorter period of time than it takes to review individual applications.

Appendix II: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210



Charles A. Jeszeck
Director, Education, Workforce, and Income Security
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Jeszeck:

Thank you for the opportunity to review the Government Accountability Office (GAO) draft report entitled "Individual Retirement Accounts: Formalizing Labor's and IRS's Collaborative Efforts Could Strengthen Oversight of Prohibited Transactions" (GAO-19-495). The draft report concerns the Department of Labor's (Department) process for granting exemptions from prohibited transactions involving Individual Retirement Accounts (IRAs). The draft report contains two recommendations for the Department of Labor (Department). Specifically, the draft report recommends that the Secretary of Labor: (1) should document internal policies and procedures for managing the IRA prohibited transaction process; and (2) in consultation with the Commissioner of the Internal Revenue, should establish a formal means, such as a memorandum of understanding or other mechanism, to support and guide DOL's and IRS's collaborative efforts to oversee IRA prohibited transaction exemptions.

The Department's Office of Exemption Determinations (OED) in the Employee Benefits Security Administration (EBSA) was delegated the responsibility for processing requests for individual and class exemptions from the prohibited transaction provision of the Employee Retirement and Income Security Act of 1974, as amended (ERISA). Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. 1 (1996), transferred the authority of the Secretary of the Treasury to issue exemptions from prohibit transaction under the Internal Revenue Code of 1986 (Code) to the Secretary of Labor. In all instances involving the grant of exemptive relief, OED is required to make findings, as set forth under ERISA section 408(a) that the exemption is: (1) administratively feasible; (2) in the interests of the plan its participants and beneficiaries; and (3) protective of the rights of participants and beneficiaries of such plan.

In regards to the first recommendation, the process and procedures applicable to applying for, reviewing, granting, or denying an exemption request are set forth in 29 CFR part 2570, subpart B (76 FR 66637, 66644, October 27, 2011). OED follows these written codified procedures when processing applications for exemptions involving IRAs or ERISA covered plans, and grants exemption only after making the required statutory findings. As noted in your report, OED is a small office within EBSA (currently twelve full time employees). OED's management is directly involved in the operational processes of the office and in constant direct contact with the personnel. The Department believes that given the size of the office, its adherence to codified exemption procedures, its consistently observed obligations to make statutory findings, and the intimate involvement of its management in the exemption

determinations, there are already extensive and adequate internal controls. Nevertheless, we agree that formalizing OED's internal administrative case processing procedures could be helpful in passing on institutional knowledge. To that end, OED will create an internal procedural manual.

With respect to the second recommendation, as previously mentioned, the Department has the authority to issue IRA exemptions from the Code's prohibited transactions while the IRS maintains its enforcement authority over IRAs. The exemption process is, by law, an open and public process. Exemption files are open to public disclosure and exemptions that are granted are first proposed in the Federal Register, which provides any person or organization opportunity to comment on the proposed exemption. When EBSA processes an exemption application involving an IRA, OED routinely contacts the IRS to collaborate when it needs the benefit of the IRS's expert knowledge. These collaborations are documented in the exemption file and can involve the sharing of information via phone conversation, emails, and meetings. While we believe this procedure is effective for the processing of exemptions applications involving IRAs, EBSA agrees to periodically discuss all of the files in its inventory of IRA cases with the IRS.

Thank you again for the opportunity to review your draft report and recommendations. Please do not hesitate to contact us if you have questions concerning this response or if we can be of further assistance.

Sincerely,



Preston Rutledge
Assistant Secretary

Appendix III: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

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

May 31, 2019

Mr. James R. McTigue, Jr.
Director, Tax Issues, Strategic Issues

Mr. Charles A. Jeszeck
Director, Education, Workforce and Income Security
United States Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Messrs. McTigue and Jeszeck:

Thank you for the opportunity to review the draft report of the Government Accountability Office entitled "Individual Retirement Accounts: *Formalizing Labor's and IRS's Collaborative Efforts Could Strengthen Oversight of Prohibited Transactions.*" (GAO-19-495) (Job Code 103139).

The draft report contains three recommendations but only one for the Internal Revenue Service (IRS). Specifically, it recommends that IRS and the Department of Labor (DOL) establish a formal means to support and guide DOL and IRS collaborative efforts to oversee Individual Retirement Account (IRA) prohibited transaction exemptions.

As the draft report states, the applicable rule expressly assigns authority over "exemptions under section 4975 of the Code" to DOL. See Reorganization Plan No. 4 of 1978 § 102, 5 U.S.C. App. 1. On exemption applications, the draft report found that "denial information could be useful to IRS as illustrative examples of prohibited transactions." To the extent that DOL determines that disclosure of useful information is permissible, IRS would be willing to receive it.

As the draft report acknowledges, IRS and DOL already have a memorandum of understanding (MOU) as to certain retirement plan enforcement matters. In this light, we will consider expanding our formal collaboration with DOL. The next periodic update of the MOU would be the appropriate time frame for this discussion.

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We appreciate Congress' and GAO's interest in this important topic. If you have questions, please contact me, or a member of your staff may contact Rob Choi, Director, Employee Plans, at 718-834-5028.

Sincerely,


STEVEN M. MARTIN

for Kirsten B. Wielobob,
Deputy Commissioner for
Services and Enforcement

Enclosure

Enclosure

Recommendation 3:

The Commissioner of Internal Revenue, in consultation with the Secretary of Labor, should establish a formal means, such as a memorandum of understanding or other mechanism, to support and guide DOL's and IRS's collaborative efforts to oversee IRA prohibited transaction exemptions.

Comment:

The IRS agrees and is committed to discussing with DOL any appropriate mechanism, including periodic meetings, to formalize collaboration on exemptions from prohibited transaction treatment in IRAs, and will do so upon the next periodic update of the existing MOU.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contacts

James R. McTigue, Jr., Director, Tax Issues, Strategic Issues, (202) 512-9110 or mctiguej@gao.gov

Charles A. Jeszeck, Director, Education, Workforce, and Income Security Issues, (202) 512-7215 or jeszeckc@gao.gov

Staff Acknowledgments

In addition to the contacts named above, MaryLynn Sargent and David Lehrer (Assistant Directors), Ted Burik, Susan Chin, Steven Flint, Emily Gruenwald, Mark Kehoe, Jungjin Park, and David Reed made key contributions to this report. James Bennett, Amy Bowser, Jacqueline Chapin, Edward J. Nannenhorn, Andrew J. Stephens, Walter Vance, and Adam Wendel also provided support.

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