Congress of the United States
Washington, DC 20515

September 27, 2012

The Honorable Dave Camp
Chairman
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Sandy Levin
Ranking Member
Committee on Ways and Means
U.S. House of Representatives
1106 Longworth House Office Building
Washington, D.C. 20515

The Honorable Max Baucus
Chairman
Committee on Finance
U.S. Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
U.S. Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairmen Camp and Baucus and Ranking Members Levin and Hatch:

We are writing to bring to your attention the fact that the Internal Revenue Service is currently studying ways to prevent abuse of tax-preferred individual retirement accounts (IRAs) for tax evasion purposes. We encourage you to consider this particular area of law as Congress considers tax reform legislation or other legislation that would address the fiscal cliff in a balanced way.

Recent media reports indicate that service partners and employees at Bain Capital may have contributed investment funds from company deals to tax-preferred retirement accounts such as IRAs and SEP-IRAs.[1] We are concerned by reports that some shares in these investments, and similar investments at other firms, may have been valued at an other than fair market value, thereby allowing these service partners to engage in tax avoidance by evading the annual contribution limits on IRAs and SEP-IRAs. *The Washington Post* recently reported that Bain Capital employees such as Mitt Romney may have invested in "low-valued" shares through their IRAs and SEP-IRAs. [2] However, Michael J. Graetz, former Deputy Assistant Treasury Secretary for Tax Policy in the Administration of George H.W. Bush, said, "The law deliberately set limits in order to restrict the revenue losses to the Treasury."[3]

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[1] Maremont, Mark. (2012, March 29). "Bain Gave Staff Way to Swell IRAs by Investing in Deals." *Wall Street Journal*. Retrieved July 23, 2012 from http://professional.wsj.com/article/SB10001424052970204062704577223682180407266.html?mg=reno64-wsj.

[2] Hamburger, Tom (2012, September 2). "Mitt Romney exited Bain Capital with rare tax benefits in retirement." *The Washington Post*. Retrieved September 21, 2012 from http://www.washingtonpost.com/politics/mitt-romney-exited-bain-capital-with-rare-tax-benefits-in-retirement/2012/09/02/1bddc8de-ec85-11e1-a80b-9f898562d010_print.html.

[3] Ibid.

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In response to our inquiry on the subject, Assistant Treasury Secretary for Tax Policy Mark J. Mazur recently informed us that the Treasury Department and the IRS "have been taking action to curb abuses" regarding valuation of assets in tax-preferred retirement plans.[4] Assistant Secretary Mazur reports that the IRS has established a working group to "study ways of improving compliance and enforcement in this area."[5]

Evasion of contribution limits on tax-preferred retirement plans is a significant problem that should be addressed as Congress looks to close the nearly $400 billion annual tax gap and, if the IRS comes to the conclusion that additional legislation is needed, we believe that Congress should act accordingly. This type of tax avoidance, at Bain and elsewhere, can increase the deficit and unfairly shift the tax burden onto already struggling middle-class families, and it undermines the fundamental principle of fair tax treatment for all citizens.

Thank you in advance for your consideration of this request.

Sincerely,

George Miller

GEORGE MILLER
Ranking Member
Committee on Education and the Workforce

Chris Van Hollen

CHRIS VAN HOLLEN
Ranking Member
Committee on the Budget

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[4] Mazur, Mark J. Letter to authors. 19 September 2012. (attached)
[5] Ibid.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

SEP 19 2012

The Honorable George Miller
U.S. House of Representatives
Washington, DC 20515

Dear Representative Miller:

Thank you for your letter of August 2, 2012, to Acting Assistant Secretary for Tax Policy Emily McMahon and Assistant Secretary of Labor Phyllis Borzi regarding the potential for taxpayer avoidance of the contribution limits on individual retirement accounts and annuities (IRAs) and simplified employee pension individual retirement arrangements (SEP IRAs). Because the Treasury Department and the Internal Revenue Service (IRS) are responsible for enforcing the contribution limits on IRAs and SEP IRAs, my office is responding on behalf of both the Treasury Department and the Department of Labor. Because I was recently confirmed as the Assistant Secretary for Tax Policy, I am responding to your letter.

Your letter expresses concern arising from media reports suggesting possible avoidance of the contribution limits applicable to IRAs and SEP IRAs through purchases by these accounts of assets for less than fair market value. The Treasury Department and the IRS have been aware of this risk for a number of years and have been taking action to curb abuses in this area.

In late 2003, for example, the Treasury Department and the IRS issued Notice 2004-8 identifying certain transactions involving the undervaluation of IRA assets as "listed transactions" that must be disclosed to the IRS. Specifically, the notice targets schemes involving transactions between a business owned by a taxpayer and a corporation owned by the taxpayer's Roth IRA (the Roth IRA corporation) that have the effect of transferring assets or value from the IRA holder's business to the Roth IRA corporation for less than fair market value.

Under the terms of the notice, the IRS may challenge the tax benefits claimed for the transactions between the IRA holder's business and the Roth IRA corporation by recharacterizing them as a series of transfers from the IRA holder's business to the IRA holder, then from the IRA holder to the IRA, and finally, from the IRA to the Roth IRA corporation. The notice also provides that the IRS may impose applicable taxes on these recharacterized transactions, including excise taxes on any deemed contributions to the IRA in excess of the applicable limits. Further, the notice provides that the IRS may, when appropriate, allocate income from the Roth IRA corporation to the IRA holder (or the IRA holder's business or other entities under the control of the IRA holder), take the position that the transactions give rise to prohibited transactions, and impose other listed-transaction penalties.

The IRS has pursued both the listed transactions identified in Notice 2004-8 and instances in which assets of traditional IRAs and qualified plans have been abusively undervalued. The

Internal Revenue Code, however, currently provides relatively little incentive to shift investment gains into traditional IRAs or SEP IRAs through the use of undervalued assets. While sales or other dispositions of assets within an IRA are not taxable events, any appreciation (or other earnings) on assets distributed from traditional IRAs and SEP IRAs are taxed at ordinary income tax rates when the distribution occurs and are not eligible for favorable capital gains treatment that might apply to the appreciation realized upon the sale or other disposition of assets held directly by the taxpayer. Although value-shifting strategies involving traditional IRAs and SEP IRAs may have offered greater advantages in the early 1990s when the tax treatment of long-term capital gains was closer to that for ordinary income, these advantages appear to be much smaller in recent years.

The IRS generally requires that all IRA assets, including those that are not publicly traded, be valued using a fair market value standard (as opposed to liquidation or other value), and the fair market value of IRA and qualified plan assets must be reported on Form 5498 (IRA Contribution Information) and Form 5500 (Annual Return/Report of Employee Benefit Plan), as applicable. In addition, the IRS requires that this value be supported by audited financial statements, valuations by third-party experts, or contracts or agreements related to an investment, as applicable. The Treasury Department and the IRS are currently working to obtain a reliable estimate of the number of audits that specifically involve IRA asset valuation issues and an estimate of the size of associated tax compliance problems. We would be happy to discuss any additional information that we obtain with members of your staff.

In your letter, you also asked whether we had any policy recommendations for addressing these issues. As noted above, the IRS has pursued these issues diligently and last year convened a working group to study ways of improving compliance and enforcement in this area. The group will consider whether any statutory changes would be helpful to this effort. The group is still in the early stages of its review, however, and is not in a position to make any recommendations at this time. Of course, we will forward any policy recommendations that we develop to your offices for further consideration.

Thank you for your interest in this issue and your willingness to consider our recommendations for legislative action.

Sincerely,

Mark J. Mazur
Assistant Secretary (Tax Policy)

Identical letter sent to:
The Honorable Sander Levin
The Honorable Chris Van Hollen

cc: The Honorable Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor