5500 Not-So-EZ, The

C. Eugene Steuerle

Document date: August 07, 2000
Released online: August 07, 2000

I must confess, sometimes the IRS drives me crazy. Sure, Congress creates most of the mess with which the agency is forced to deal. But a lot of tax problems can be eased by the agency if it would use a little imagination and take a bit of initiative. One continues to wonder whether the "new IRS" is going to win out over the "old IRS." For example, the new IRS will do one thing better, then turn around the next minute and offer the excuse that it can't do other things right because it has been too busy fixing the first thing.

My latest case in point is the Schedule 5500 EZ, a form used by so-called "one-participant retirement plans." The taxpayers involved are self-employed, with no employees or leased employees. Many of them are also employed elsewhere and make some self-employment income on the side—a mechanic fixing the cars of some neighbors or an academic who writes a few papers for a fee.

This year, for the first time, the Schedule 5500 EZ, which is made available through the IRS, had to be filed with the Pension Welfare Benefits Administration (PWBA) at the Labor Department. The taxpayer is thus put in the position of having to deal with two government agencies.

Presumably, the hope is that this changeover in the place of filing will enhance the use of the data reported on the form, but I am skeptical. Neither the employee benefit part of the IRS nor the PWBA is financed very well. My guess is that hundreds of thousands of people should file the form but do not, and many more filers fill it out incorrectly. One reason the IRS and the Labor Department do not spend bundles on enforcement is that little revenue would be generated.

To make matters worse, the IRS has been notoriously bad at sending the forms to individuals. I constantly fail to get the forms sent to me even though I file year after year. I'm guessing that part of the problem is that there is a computer program that ignores the instruction that individuals must file if combined assets total over $100,000 in all employer plans. Thus, the computer ignores returns with less than $100,000 in total assets, and a person filing for two plans with $60,000 each won't get blank returns the next year. Whatever the problem, it hasn't been fixed in years.

This year, to make matters worse, the IRS and the Labor Department decided to go backward in technology. To begin with, electronic filing isn't available for Form 5500 EZ. In fact, you aren't even allowed to download copies of the return from the IRS Web site. The forms are available only through the mail. So, the time I had set aside to work on the return had to be postponed to fit with the IRS's schedule for mailing. Of course, the IRS first mailed me the wrong form (Form 5500 rather than 5500 EZ), but that's another story.

Why the mail requirement? It seems that the IRS and the Labor Department have adopted a form with color coding for boxes that presumably will make the data more accurate when read by a scanner. That is a step forward? It precludes both electronic filing and the simplification that could be provided by Intuit and other private- sector groups that could facilitate the needlessly complex filling out of returns, and reduce the errors that the IRS and Labor see every year.

The new form requires many more pages—nothing like killing a few more trees. Worst of all, the color boxes are so light that even with my magnifying glasses it was very difficult to fill out the return so that the numbers were put in the right boxes. I couldn't fill out the return on my personal computer, so potentially typed numbers turned into hand-written ones.

I'm guessing that the number of scanned errors will be quite large. Then, the IRS and the Labor Department will once again have the impossible choice of either sending out hundreds of thousands of letters asking for corrections—some of those corrections may be required because of their own scanning problems—or simply continuing the practice of ignoring the many errors that show up on the filed forms. Of course, the biggest problem of enforcement will still be the thousands who do not file at all.

Then there are the instructions; calling them obtuse is understatement. Here are a few examples:

- Suppose, like many self-employed people, I put money in the plan after the close of the calendar year but before April 15 of the following year. The instructions say to include "cash contributions" received by the plan during the year, but the line on the schedule itself indicates that one should include "cash contributions received by the plan for this plan year." Do they mean "for" or "during?"

  Another instruction says to include contributions "owed to the plan at the end of the year." Do I need a lawyer to interpret "owed" for deposits made during the next year? And is "owed" under a money purchase plan different from "owed" under a profit sharing plan? Or are next-year contributions "owed" under one and not the other since one type allows greater flexibility as to how much can be deposited?

- In the part of the instructions describing who has to file the form, it states that you may not have to file if "you have a one-participant plan that had total plan assets of $100,000 or less...OR [y]ou have two or more one-participant plans that together had plan assets of $100,000 or less. . . . " Do they really mean "OR?" If I have two plans, each with $60,000, don't I meet the first condition even if I don't meet the second?

- For years I was told that one should include in plan assets (as well as plan contributions) the deposits made the following calendar year for the previous plan year. But this year I called Vanguard, the mutual fund group with whom I deal, and their tax expert said, "No, don't include those assets." But then is that consistent with including in deposits what is "owed?" Would it be so hard to indicate exactly what is required?

- Then there's the Schedule P, Form 5500, that my mutual fund group, Vanguard, indicates "may be filed to satisfy the requirements under section 6033(a) for an annual information return from every section 401(a) organization exempt from tax under section 501(a)." It further states that "filing this return will start running the statute of limitations under section 6501(a) for any trust described in section 401(a) that is exempt from tax under section 501 (a)." So I dutifully file this exact same information every year for every plan held by my wife and myself. The form doesn't even change information each year, so I'm sure the authorities at the IRS and the Labor Department take these forms and spend hours poring over them and copying them. NOT!

I could go on. I'm sure somewhere out there is a pension lawyer who's going to tell me that all of this is really understandable. And that may very well be true. But I have worked for more than two decades in the field of taxation, at one time I served as the highest economic tax official in the Executive Branch, and I have published a number of articles and books on pensions and social security. OK, you can legitimately dispute whether any of that means very much, but if I'm lost, what about typical filers? My guess is that if they file at all, they really don't care.

The real rub is that, for the most part, the form is unnecessary. The filing requirement itself is somewhat of an anomaly. For a lot of individual retirement account and simplified employer IRA plans, such as IRA-SEPs, no filing along the lines of the 5500 EZ is required. The IRS and Labor do have a very legitimate concern: the tendency of some small business persons to try to garner inappropriate tax advantages for themselves while ignoring the rights of employees under various discrimination rules. For most singleparticipant plans, however, this is not an issue because there are no employees. Here is what the IRS could do. It could call in representatives from the investment company industry and from the tax filing industry like Intuit, and figure out how to vastly simplify this unnecessary tax filing burden. Maybe for some taxpayers there's already enough information being filed on the 1040, on which aggregate contributions are already reported. Maybe the mutual fund industry could file on behalf of taxpayers in most cases. Maybe the tax filing industry could suggest to the IRS a simple option for how the taxpayer could report. Or the IRS could think about ways of offering some true pension simplification to Congress, even if only one step at a time.

Make no mistake about it, this filing burden can be reduced. Saving a few million hours of individuals' time may not be a gigantic gain, but it is just the type of change taxpayers should expect from the new IRS. So why they would move in a direction that makes it harder for taxpayers to use computers or file electronically is really beyond me. Yes, I know that the IRS must deal with the PWBA. Nonetheless, this a classic case in which only initiative at the top can lead a dedicated, but understaffed, bureaucracy where it needs to go.

Other Publications by the Authors

- C. Eugene Steuerle