IRS plans to 'front-load' new enforcement hiring in FY 2024 with Inflation Reduction Act funds

As Congress waits for the Internal Revenue Service to release a detailed plan for spending the roughly $80 billion in new mandatory funding it will receive over the coming 10 years under the Inflation Reduction Act (P.L. 117-169), the agency revealed this week that it intends to use a chunk of that money in fiscal year 2024 to "front-load" the hiring of experienced tax professionals focused on audits of large businesses and ultrawealthy individuals to advance its efforts to narrow the "tax gap"—the difference between the amount of tax legally owed to the government and the amount that is timely paid and collected.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

Meanwhile, the Treasury Inspector General for Tax Administration (TIGTA), the federal watchdog agency that oversees the IRS, offered recommendations for how the IRS can improve its processes for estimating and reporting the amount of revenue lost to the fisc from taxpayer noncompliance.

Enforcement hiring plans

In a report to Congress justifying the administration's budget request for the IRS for fiscal year 2024, the agency states that it plans to spend a total of $5.8 billion in Inflation Reduction Act funds across all of its program areas in the coming fiscal year, with some $1.4 billion of that amount earmarked for enforcement.
URL: https://home.treasury.gov/system/files/266/IRS-FY-2024-CJ.pdf

Specialized agents, complex returns: Topping the IRS's list of enforcement priorities is addressing "compliance issues that contribute to the tax gap" by hiring tax accountants, attorneys, and other specialized staff to focus on audits of complex partnership structures, high-net worth individuals and entities, large corporations, and taxpayers engaging in cross-border tax transactions.

Returns filed by these segments of the tax base, the report explains, often require significant investments of time by highly trained compliance and enforcement professionals. The report notes, for example, that audits of high-net worth individuals can take 250 hours or more to complete, compared to roughly five hours for less affluent individuals. Corporate audits, moreover, "average hundreds of hours over two-to-four years" and "often involve more than a dozen issues that each require separate teams of tax accountants and lawyers to resolve."

The report also notes that by ramping up its expansion of the enforcement team in the near term, rather than filling the ranks gradually over the 10-year budget window, the IRS can ensure that the new hires are trained by current enforcement specialists who are expected to retire within next few years.

"[T]he IRS does not want to lose decades of institutional knowledge through continued waves of retirements without departing experts first training the next generation of experts," the report states.

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The $400,000 bright line: Addressing a frequently cited concern among congressional Republicans that an expanded IRS enforcement program will lead to increased audits of small businesses and middle-class individuals, the report notes that the long-term spending plan for the Inflation Reduction Act funding—which Treasury officials have maintained will be completed "in the coming weeks"—will comply with a directive from Secretary Janet Yellen issued last August "to not increase audit coverage of households and small businesses making less than $400,000 a year relative to historic norms."

GOP taxwriters and appropriators in both chambers grilled Secretary Yellen about this directive in recent hearings on the administration's fiscal year 2024 budget blueprint and some were skeptical that the IRS ultimately would comply. (For prior coverage, see *Tax News & Views*, Vol. 24, No. 9, Mar. 10, 2023; *Tax News & Views*, Vol. 24, No. 10, Mar. 17, 2023; and *Tax News & Views*, Vol. 24, No. 11, Mar. 24, 2023.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230310_1.html
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230317_1.html
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230324_1.html

For its part, the Treasury Inspector General for Tax Administration notes in its own budget justification report that it "will play a key role in ensuring that the IRS does not increase audits" of taxpayers with income falling below the $400,000 threshold and will work to "ensure that IRS resources are focused on audits of high-wealth individuals and businesses who are noncompliant with the tax laws."
URL: https://home.treasury.gov/system/files/266/12.-TIGTA-FY-2024-CJ.pdf

TIGTA to IRS: Mind the gap

The IRS's most recent official estimate of the federal tax gap, covering tax years 2014 through 2016, puts the gross annual amount of foregone revenue at $496 billion and the net amount, which reflects late payments and collections through enforcement actions, at $428 billion. Additional projections included with the official estimate suggest that the tax gap could climb to $540 billion for tax years 2017-2019.
URL: https://www.irs.gov/pub/irs-pdf/p1415.pdf

But TIGTA notes in a March 23 audit report addressing the IRS's practices in developing, reviewing, and publishing its tax gap estimates that the actual amount of tax revenue falling through the cracks may exceed the published estimates because certain sources of noncompliance are not reflected in the reported numbers.
URL: https://www.tigta.gov/sites/default/files/reports/2023-03/202310016fr.pdf

What's missing?: The TIGTA report focuses on the IRS's success in estimating revenue shortfalls from two components of the tax gap:

- Nonfiling, defined as taxes not paid on time because the required returns are filed late or not filed at all, and
- Underreporting, defined as taxes not paid on time because a taxpayer has understated its tax liability on a timely filed return.

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(TIGTA notes that the IRS can directly calculate the third component of the tax gap—underpayment, defined as tax liability that is reported on a timely filed return but is not paid on time—and does not have to rely on estimating techniques.)

According to TIGTA, the *nonfiling* component of the tax gap as currently reported does not include estimates of corporate income taxes, excise taxes, income taxes of estates and trusts, or the unrelated business income tax from Form 990-T, *Exempt Organization Business Income Tax Return*. In addition, the estimate for employment tax nonfiling only includes the self-employment tax.

The *underreporting* component of the tax gap, TIGTA says, does not currently include estimates of excise taxes or the income taxes of estates and trusts. On the corporate side of the code, the estimate of underreported taxes captures information from Form 1120, *US Corporation Income Tax Return*, and Form 1120-A, *US Corporation Short-Form Income Tax Return*, but does not reflect data from certain other returns, such as Form 1120-F, *US Income Tax Return of a Foreign Corporation*.

Also not captured in the underreporting component of the tax gap is information regarding:

- Unrelated business income tax from the Form 990-T;
- Individual income tax filers who are considered "international" based on their filing address or attached forms and schedules, such as Form 2555, *Foreign Earned Income*, and Form 1116, *Foreign Tax Credit*, among others; and
- Employment taxes of household and agricultural employers.

What can be improved: TIGTA notes that the IRS could improve the tax gap reporting process by putting in place a formal strategy to "identify, prioritize, and develop estimates for areas of noncompliance that are not currently captured" in its published tax gap reports. It also recommends that the IRS explain the limitations of its published tax gap estimates by including details of the known areas of noncompliance that have not been addressed or not fully captured, along with details of "other emerging areas of noncompliance"—such as issues related to flowthrough entities, foreign or illegal activities, and digital assets—that may not be fully accounted for in determining the nation's revenue shortfall. (With respect to digital assets, former IRS Commissioner Charles Rettig indicated last year that virtual currency transactions alone could be responsible for a tax gap well in excess of current estimates. For prior coverage, see *Tax News & Views*, Vol. 23, No. 14, Apr. 8, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220408_1.html

Beyond these recommendations, TIGTA calls on the IRS to develop consolidated, written policies and procedures for producing and reviewing tax gap estimates—actions that the report states will ensure consistency and quality of tax gap estimates and improve oversight.

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