

Werfel fills in some blanks on IRS's Inflation Reduction Act spending plan

IRS Commissioner Daniel Werfel this week gave Senate taxwriters a few new details on how the agency intends to spend the roughly \$80 billion in mandatory funding it will receive over 10 years under the Inflation Reduction Act (P.L. 117-169) that were missing from the agency's recently released strategic operating plan, and he promised that additional information would be available to Congress and the public in the near term.

[URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf](https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf)

[URL: https://www.irs.gov/pub/irs-pdf/p3744.pdf](https://www.irs.gov/pub/irs-pdf/p3744.pdf)

The strategic operating plan—particularly, initiatives related to expanding the IRS's enforcement capacity—was the focus of much of the discussion at an April 19 Senate Finance Committee hearing on the just-concluded 2023 tax filing season and the Biden administration's fiscal year 2024 budget request for the IRS.

The hearing marked Werfel's first appearance before the Finance Committee as commissioner. His nomination to take the top spot at the IRS was approved by the panel and confirmed by the full Senate last month, and he was sworn in as commissioner on April 4.

Enforcement expansion

The Inflation Reduction Act allocated \$45.6 billion of the total IRS mandatory spending package to enforcement and the strategic operating plan explains that the agency's initiatives in this area will focus on addressing the tax gap—the difference between the amount of money legally owed to the government and the amount actually paid and collected on a timely basis. Specifically, the agency intends to increase the ranks of revenue agents with the specialized training needed to audit those segments of the tax base that it believes present the greatest risk of noncompliance: corporations, large partnerships, and high-net-worth individuals. (See separate coverage in this issue for a more detailed discussion of the tax gap and the IRS's enforcement initiatives outlined in the spending plan.)

Finance Committee Chairman Ron Wyden, D-Ore., commented in his opening statement at the panel's hearing that the spending plan, which the IRS released on April 6, is focused on “the key issues the new mandatory funding is intended to address.”

“The IRS can't measure the law breaking that's going on if it doesn't have the resources to identify it in the first place. Here's the bottom line on this issue. You cannot get at the tax gap without focusing on wealthy tax cheats and highly complex businesses like large partnerships,” he said.

Responding to a question from Wyden, Werfel reiterated that the IRS intends to focus its stepped-up audit activity on high-dollar noncompliance issues in areas where the agency has been “under-resourced” in the past. The IRS's goal in expanding its enforcement team, he explained, is to gain an understanding of “patterns of behavior across complex organizations” so that it can better determine the nature of the tax gap and clamp down on abuses of the tax code.

New details on \$400,000 bright line for audits: But Finance Committee ranking member Mike Crapo, R-Idaho, countered that what the IRS released “is noticeably light” on specifics and lacks provisions that would “hold the IRS, Treasury Department, or anyone else accountable for any missteps.” (Across the Capitol, House Ways and Means Committee Chairman Jason Smith, R-Mo., expressed similar misgivings about the plan in a statement released on April 6.)

URL: <https://waysandmeans.house.gov/chairman-smith-blasts-hollow-irs-plan-that-fails-to-provide-details-on-how-their-80-billion-raise-will-be-spent/>

One particular source of concern for Crapo and other Finance Committee Republicans was the plan’s lack of specificity over how the IRS intends to ramp up its enforcement program without increasing audits of small businesses and less affluent individuals. The plan cites a directive from Treasury Secretary Janet Yellen that the agency may not use Inflation Reduction Act funds to increase audits of taxpayers with income of less than \$400,000 “relative to historic levels,” but does not elaborate on how it intends to shield these taxpayers from additional audit scrutiny.

GOP taxwriter James Lankford of Oklahoma pressed Werfel on how the IRS intends to define “historic levels” for audit rates to comply with Treasury’s directive. Werfel replied that the IRS will use as its benchmark the “historically low” audit rates for tax year 2018—the most recent year that falls outside the statute of limitations for undertaking new audits.

That should serve as “the marker for at least several years, and then we’ll revisit it,” Werfel said.

Finance Committee member Marsha Blackburn, R-Tenn., asked Werfel to clarify the standard the IRS will use to calculate income for purposes of Treasury’s \$400,000 threshold.

Werfel explained that the \$400,000 cutoff will be based on “total positive income.”

Addressing the treatment of small businesses specifically, Werfel stated in an exchange with Finance Committee Democrat Ben Cardin of Maryland that the IRS intends to reach out to these taxpayers through expanded service initiatives in an effort to help them better understand the tax code and make it easier for them to be compliant.

Enforcement v. service: Some Republicans on the panel contended that the mandatory funding allocations in the Inflation Reduction Act are disproportionately skewed to enforcement efforts at the expense of improving taxpayer service. (The plan allocates \$3.2 billion to taxpayer services over the 10-year budget window.)

Werfel acknowledged that the IRS needs to make significant improvements in both program areas, but he cautioned in an exchange with Sen. John Thune, R-S.D., that reallocating money from enforcement to taxpayer services would hamper the IRS’s efforts to address noncompliance among corporations, large partnerships, and ultrawealthy individuals and narrow the tax gap.

“Every dollar we move off our efforts to build the capacity to unpack those returns means I think we’re leaving money on the table for the American people in terms of our ability to close the gap in terms of what’s paid versus what’s owed,” he said.

Werfel noted in response to a similar question from Sen. John Barasso, R-Wyo., that the IRS currently has just 2,600 staff responsible for overseeing returns of more than 390,000 high-wealth taxpayers. Moving money out of enforcement and into taxpayer services would dilute the IRS’s already-limited capacity to address compliance issues in that growing segment of the tax base, he said.

Details on expenditures, hiring plans on the way, Werfel says

Ranking member Crapo also criticized the IRS for not providing cost estimates for the initiatives outlined in the strategic operating plan; moreover, congressional Republicans generally have taken the agency to task for including a relatively limited amount of data on the number of new employees that it intends to hire across all of its operating areas over the 10-year budget window.

Werfel told the panel that he would provide “extensive detail on planned expenditures over a 10-year period and on hiring over a three-year period” during a closed-door briefing with the committee scheduled for April 20. Details on “expected hiring across the full 10-year window” should be available “within the next three to six weeks,” he added.

FY 2024 budget request

President Biden’s fiscal year 2024 budget blueprint, which was released last month, proposes to increase the IRS’s regular operating budget—determined as part of the annual congressional appropriations process—to \$14.1 billion for the coming fiscal year, a \$1.8 billion increase over its fiscal year 2023 level. It also would extend the agency’s mandatory funding stream for two additional years beyond what was enacted in the Inflation Reduction Act, proposing allocations of \$14.3 billion in fiscal year 2032 and \$14.8 billion in fiscal year 2033. (For details on the administration’s tax-related budget proposals for the coming fiscal year, see *Tax News & Views*, Vol. 24, No. 9, Mar. 10, 2023.)

URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230310_1.html

Werfel told Senate taxwriters that the administration’s discretionary spending request for the IRS would allow it to continue providing the base level of services it currently offers, noting that the agency’s day-to-day operations have been hampered by a decade of congressionally mandated budget cuts plus the operational disruptions caused by the COVID-19 pandemic. He also cautioned against diverting mandatory Inflation Reduction Act funds to pay for basic agency functions—an issue also highlighted in the strategic operating plan. The new mandatory funding, he said, is intended to enable the IRS to enhance its service offerings, enforcement programs, and technical capabilities above and beyond current levels.

1099-K filing thresholds

Sen. Sherrod Brown, D-Ohio, asked Werfel if he would support efforts to relax the more stringent Form 1099-K reporting thresholds imposed on third-party settlement organizations under the American Rescue Plan in 2021. That legislation reduced the dollar threshold for the reporting requirement from \$20,000 to \$600 and eliminated the 200-transaction threshold, with the changes effective for calendar years after 2021; however, the Treasury Department announced late last year in Notice 2023-10 that it would delay enforcement of the new rules until after 2023. (Many lawmakers had hoped to repeal or delay the new reporting requirements during last year's post-election lame duck legislative session but were unable to reach a deal on a package that included this or other tax law changes that had bipartisan support.)

URL: <https://www.irs.gov/pub/irs-drop/n-2023-10.pdf>

Werfel replied that increasing the reporting threshold would cut the volume of filings submitted to the IRS and reduce complexity for the agency, but he noted that judgments on the merits of any legislative proposals on that issue were the province of the Treasury Department.

Filing backlogs

Taxwriters from both sides of the aisle asked Werfel about the IRS's progress in addressing a backlog of unprocessed paper-filed returns, employee retention tax credit (ERTC) claims, and amended return filings.

Werfel replied that with the filing season now concluded, the IRS can redeploy staff to accelerate work on these issues. He told Sen. Maggie Hassan, D-N.H., that the agency has been scaling up its ability to scan paper returns and that scanning will play an even more prominent role in the next filing season.

He noted in response to a question from Sen. Mark Warner, D-Va., that resolving ERTC claims can be time-consuming because they involve "extremely complicated" processing issues and present a high potential for fraud. The agency's post-filing-season goal is to complete 40,000 ERTC claims a week (up from 20,000 a week during the filing season), with claims processed in the order they were received, he said.

Chief counsel vacancy

Finance Committee member Michael Bennet, D-Colo., commented that the confusion early in the filing season regarding the IRS's position on whether inflation-related rebate payments and certain other direct payments made by states to their residents in 2022 constituted refund payments that were includable in income might have been avoided if a Senate-confirmed chief counsel had been in place to guide the agency's decision-making. (The commissioner and the chief counsel are the only two positions at the IRS that require Senate confirmation.)

The chief counsel position has been vacant since President Biden took office and the White House has not yet put forward a nominee. William Paul, the current principal deputy chief counsel, has been serving as acting chief counsel in the interim.

Werfel commented that it is “absolutely critical” that the position be filled, noting that many of the issues facing the IRS involve “complex legal elements” and that operating without a confirmed general counsel in place has been “an impediment” for the agency.

Finance Committee Chairman Wyden agreed on the importance of filling the vacancy.

“We need a nominee,” he said.

Werfel to face House taxwriters on April 27

Werfel is likely to field additional questions on the IRS’s strategic operating plan and its proposed budget for the coming fiscal year when he appears at an April 27 House Ways and Means Committee hearing focusing on “accountability and transparency at the Internal Revenue Service.”

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

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