

The New Inflation Reduction Act Includes an Additional \$80 Billion in Funding for the IRS...

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An \$80 Billion question is: What will IRS do with the money?

First and foremost, it is allocated for 10 years meaning that an appropriation increase is \$8 billion per year on average. This will come close to doubling the IRS budget (2021 budget was \$11.5 billion). But a zillion dollar question is 1) how IRS will use the resources allocated to it among its different functions and 2) how efficiently it will pursue its goals. The past is not necessarily a good indication of the future, but a few details might be worth mentioning.

Of \$80 billion more than half - \$45.5 billion – is allocated to enforcement, which means to all levels of audits from the correspondence ones when a taxpayer receives a letter usually requesting additional substantiation to a field audit when an IRS officer shows up at a taxpayer place of business.

Over \$25 billion goes to operations support and an additional \$5 billion to modernization of business systems. Much of this is intended to be spent on "information technology development, enhancement, operations, maintenance, and security." Most experts agree the IRS needs modernization in this area.

\$15 billion of the total is allocated towards developing a free direct e-file system. This is a renewed attempt to offer free of charge filing of individual taxes.

Less than 5% of the total goes to taxpayer service. Although taxpayers should benefit from both numbers 3 and 4 in this list.

How it will affect you, the taxpayer?

Recent audit rates have dropped dramatically and this will likely change. The IRS states these increases in enforcement are "not about increasing audit scrutiny on small businesses or middle-income Americans." They're promising not to increase audit rates for those with incomes under \$400,000. Moreover, IRS claimed that the audit rates of low- and middle-income Americans are not going up 'relative to recent years'.

I do not know what the term 'relative to recent years' means in this context. I am sure that they are referring to the rates that existed before 2010, before congress drastically cut IRS budget. In my interpretation we can see significant increase in the audits of small businesses, especially sole proprietors and specific industries such as construction. It's worth noting that very few average Americans get audited — just 0.1 percent of those making between \$75,000 and \$100,000 in 2019.

The increased enforcement of tax laws is estimated to bring in a net gain of \$124 billion of collections over the next ten years according to the CBO. I am not sure that this will happen. Such respected economists like Larry Summers are optimistic about it and pushed for it. We will see. We all know though the notorious IRS efficiency. Here are a few examples from Wall Street Journal:

- A May 2022 audit found that 26% (\$1.9 billion) of its American opportunity tax credits for education expenses were improper in fiscal 2021, and 27% (\$541 million) of its net premium tax credits (ObamaCare) were improper in fiscal 2019 (the most recent year it estimated). The same May audit said the IRS acknowledged that 13% (\$5.2 billion) of its enhanced child tax credit payments were improper.

- A September 2021 audit found the IRS in 2020 issued 89,338 notices to taxpayers insisting that “balances were owed even though the taxes were not actually due.” Why? Because the feds had extended the filing deadline amid Covid. The IRS apparently didn’t notice.
- This ineptitude extends to programs that supposedly will now raise revenue—those targeting higher earners. In 2010 Congress passed the Foreign Account Tax Compliance Act, which was supposed to identify wealthy Americans using undisclosed foreign accounts. Congress’s Joint Committee on Taxation said this would raise some \$9 billion in revenue by fiscal 2020. Yet an April audit noted that while the IRS has spent \$574 million to implement the law, the agency has drummed up only \$14 million in compliance revenue.

Just think for a second about it!!! A business spends \$574 million to make \$14 million. This is called bankruptcy. Not in the IRS case. [VT]

- A July 2021 audit related the failure of the IRS small business/self-employed division’s strategy, which began in 2010 to examine more returns from “high-income individual taxpayers.” The IRS defines high earners as those with income greater than \$200,000. Yet from fiscal 2015 to the end of fiscal 2017 (when the strategy was shut down), 73% of returns targeted by the strategy fell below \$200,000.

Conclusion:

1. The IRS will definitely increase the number of its audits as it has to report to the US congress that it follows the new law. The goal of the increase is probably set to the numbers that existed before 2010. The amount and the speed of the increase will depend on how fast the IRS will be able to hire and train its new employees.

2. Usually, such training affects the dramatic increase in the audits of sole proprietors as they are much easier targets to audit than partnerships and corporations.
3. We might expect that more experienced auditors, current IRS employees, will be re-assigned to the audits of owners of path-through entities: partnerships, limited liability companies, and small (S) corporations. Those with personal income of more than \$400,000 will be affected the most.
4. I also expect a continuous effort to increase compliance with Foreign Account Tax Compliance Act. It might turn out to be the easiest way to reach the goal collecting more tax dollars.

When I compare those numbers with the trillion-dollar budgets it all seems to me not very significant and more political than practical.