IRS launches new Inflation Reduction Act-funded compliance initiatives targeting large business, high-wealth taxpayers

The Internal Revenue Service announced October 20 that it has launched three new compliance programs—all funded with money allocated to the agency under the Inflation Reduction Act of 2022 (P.L. 117-169)—aimed at curbing tax avoidance among corporations and high-wealth individuals. Meanwhile, Republican and Democratic members of two House Oversight subcommittees sparred this week over whether the IRS intends to use the new funding to ensure compliance among upper-echelon taxpayers or to increase its scrutiny of small businesses and the middle class.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

As enacted, the Inflation Reduction Act awarded the IRS roughly $80 billion (over 10 years) in new mandatory funding, on top of its annual discretionary budget, to beef up the agency's enforcement programs, enhance its operations support functions, modernize its information technology systems, and improve taxpayer service. Roughly $20 billion of the original allocation will be clawed back as part of a "handshake" deal reached between President Biden and then-Speaker Kevin McCarthy, R-Calif., when they negotiated the Fiscal Responsibility Act (P.L. 118-5), the debt limit legislation that was signed into law this past June.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

Stepped-up enforcement efforts

In announcing the new enforcement programs, the IRS noted that the Inflation Reduction Act resources will enable it to "[keep] pace with the increasingly complicated set of tools that the wealthiest taxpayers use to hide their income and evade paying their share" in taxes.
URL: https://www.irs.gov/newsroom/irs-launches-new-initiatives-using-inflation-reduction-act-funding-to-ensure-large-corporations-pay-taxes-owed-continues-to-improve-service-and-modernize-technology-with-launch-of-business-tax-account

Transfer pricing practices of large foreign corporations: According to the IRS, this initiative will address US subsidiaries of foreign companies that distribute goods in the US but allegedly avoid paying their full share of tax on the profit they earn from their US activity by reporting losses or inordinately low profit margins through the improper use of transfer pricing. The agency stated that it will be sending compliance alerts to approximately 150 subsidiaries of large foreign corporations to remind them of their US tax obligations and encourage them to self-correct any underreported profits.

IRS Commissioner Daniel Werfel told reporters at a conference on October 25 that the compliance alerts are akin to the "soft letters" the IRS has sent to taxpayers in previous campaigns to promote voluntary compliance on certain issues of interest to the agency.

"The idea around a compliance alert is to let both the taxpayer and the broader taxpayer community know that this is an area of focus for the IRS," he said.

Audits of large, complex corporate tax returns: Also on the horizon, the IRS announced, is an expansion of its Large Corporate Compliance (LCC) program, which is part of the agency's Large Business & International (LB&I) Division and focuses on using data analytics to identify large corporate taxpayers for audit. Taxpayers brought into the LCC program are among the "largest and most complex [entities] with average assets of more than $24 billion and average taxable income of approximately $526 million per year," the IRS noted.

LB&I intends to expand the LCC program in early 2024 as new accountants are brought on board by initiating an additional 60 audits of the largest corporate taxpayers. Selection into the expanded LCC program will be determined based on a combination of artificial intelligence resources and subject matter expertise in areas such as cross-border issues and corporate planning and transactions, the IRS said. (The IRS announced in September that it hopes use Inflation Reduction Act funds to hire 3,700 employees nationwide to tackle compliance issues related to large corporations and complex partnerships.)
URL: https://www.irs.gov/newsroom/irs-looks-to-hire-3700-employees-nationwide-to-help-expand-compliance-for-large-corporations-and-complex-partnerships-experienced-accountants-encouraged-to-apply-for-revenue-agent-positions

Increased compliance focus on high-income, high-wealth individuals: On the individual side of the tax code, the IRS stated that it has heightened its scrutiny of high-income, high-wealth individuals who have either not filed their tax returns or failed to pay recognized tax debt. These efforts are concentrated among taxpayers with more than $1 million in income and more than $250,000 in recognized tax debt, the agency said, adding that "dozens of revenue officers are focusing on these high-end collection cases in the coming fiscal year."

The IRS noted that it has begun contacting about 1,600 new taxpayers in this category that owe "hundreds of millions of dollars" in taxes and has already collected $122 million from 100 of these taxpayers. Prior compliance efforts focusing on this segment of the tax base have garnered $38 million from more than 175 high-income filers, the agency said.

On-going program targeting section 199 deduction fraud: The IRS also touted its success in its continuing efforts to crack down on fraudulent claims for refunds of the now-repealed domestic production activity deduction under section 199. According to the IRS, after the section 199 deduction was repealed in the Tax Cuts and Jobs Act of 2017 (P.L.115-97), the agency received "hundreds of claims collectively seeking more than $6 billion in refunds, with a significant portion of filers claiming the deduction for the first time." A campaign to address noncompliance and review high-risk claims in this area has been "incredibly successful in ensuring revenue is collected," the agency said.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Familiar partisan divide over new funding at House Oversight hearing

Since the Inflation Reduction Act was signed into law, the mandatory funding infusion for the IRS—particularly, the boost for the agency's enforcement efforts—has exacerbated longstanding partisan tensions in Congress over the IRS budget generally.

Democrats contend that the 2022 law gives the IRS the resources it needs to make up for a decade of budget cuts under GOP-controlled Congresses by hiring and deploying specialized audit staff to address noncompliance among those segments of the tax base that engage in the highly complex transactions and frequently have opaque sources of income.

Republicans have countered that the IRS will use the funds to hire an "army" of new revenue agents that will bear down on small businesses and middle-class individuals. One of the first measures that the new House Republican majority moved through the chamber at the start of the 118th Congress in January was the Family and Small Business Taxpayer Protection Act (H.R. 23), which would eliminate some $71 billion of that new funding—specifically, the portions allocated for enforcement activities and operations support—while preserving the remaining $9 billion that is set aside for taxpayer services and business systems modernization. (The legislation has not been taken up in the Democratic-controlled Senate.) Across the Capitol, a proposal from Sen. Rand Paul, R-Ky., to rescind just over $25 billion in Inflation Reduction Act funds allocated to enforcement—which he offered as an amendment to a three-bill appropriations "minibus" making its way to the Senate floor—is set to receive a vote in the coming days. (Under an agreement between Senate Democratic and Republican leaders, Paul's proposed amendment would require 60 votes to be approved.)
URL: https://www.congress.gov/118/bills/hr23/BILLS-118hr23pcs.pdf

That partisan rift was evident when IRS Commissioner Werfel appeared at an October 24 joint hearing held by the House Oversight Subcommittee on Government Operations and the Federal Workforce and the House Oversight Subcommittee on Health Care and Financial Services.

Republicans question enforcement focus: The GOP majority at the hearing asserted that the Inflation Reduction Act funding prioritizes enforcement over taxpayer service at a time when the IRS has been plagued by problems such as lengthy wait times on telephone assistance lines, delays in processing tax returns and refunds, and threats to the security of private taxpayer information. They also questioned the need for increased audit resources and were concerned that the IRS might not confine its increased audit scrutiny to large corporations and highly affluent individuals.

"The IRS needs stronger leadership, not more money and not more audits," said Health Care and Financial Services Subcommittee Chairwoman Lisa McClain, R-Mich.

Government Operations and the Federal Workforce Subcommittee Chairman Pete Sessions, R-Texas, acknowledged that the IRS is under-resourced in certain areas, but he questioned why the agency cannot readily spot tax avoidance and evasion among individuals at the upper end of the income scale.

Werfel replied that tax evasion takes many forms, ranging from overstated deductions to "extremely complicated structures using offshore tax havens." Cuts to the IRS budget in the dozen years leading up to the Inflation Reduction Act, he said, left the IRS ill-equipped to tackle the rapid proliferation of tax-avoidance strategies available to those taxpayers that are in a position "to hire an army of lawyers and an army of accountants." The new mandatory funding, he explained, is allowing the IRS to catch up "by investing in data scientists, engineers, and subject matter experts that are going to help us keep pace and identify with greater specificity and greater accuracy where [the avoidance] issues are and select the right cases for audit and bring those funds that are due back to the American people."

In an exchange with Rep. Virginia Foxx, R-N.C., Werfel explained that under the IRS's three-year staffing plan, the agency expects to hire an estimated 8,000 new revenue agents by the end of 2025. When Foxx asked how the IRS will ensure that those new hires will not be targeting small businesses and middle-class individuals for audits, Werfel replied that IRS audit rates are published annually and are broken down by taxpayer income levels. This transparency means Congress will be able to hold the IRS accountable if statistics show that the agency is inappropriately directing its enforcement resources to audits of less affluent taxpayers, he said.

Democrats decry damage from prior IRS budget cuts: The panel's Democrats, for their part, aligned with Werfel's view that the IRS's current problems on the service, technology, and enforcement fronts stem largely from years of underfunding by Republican-led Congresses and that the new money provided under the Inflation Reduction Act is allowing the agency to play catch-up.

Health Care and Financial Services Subcommittee ranking member Katie Porter, D-Calif., argued in her opening statement at the hearing that "opportunistic politicians" have slashed IRS staff levels by 20 percent since 2010, and that the public has suffered from the resulting decline in the agency's customer service function, the deterioration of its information technology systems, and the reduction in audit rates for large businesses and wealthy taxpayers.

Rep. Jamie Raskin, D-Md., the ranking member of the full Oversight Committee, noted the IRS was operating in an environment of systematic disinvestment in the 10 years before the Inflation Reduction Act became law, and that providing adequate resources to the agency will result in improved services for taxpayers across the board. He specifically asked Werfel about how the agency's new enforcement funds will enable it to crack down on tax avoidance among high-income, asset-rich business entities and individuals.

Werfel replied that the Inflation Reduction Act funding has allowed the IRS to undertake more audits of large corporations and complex partnerships using data analytics to select those taxpayers that pose the greatest risk of noncompliance and to recoup unpaid "back taxes from millionaires and billionaires."

Rep. Gerry Connolly, D-Va., discussed how past reductions in the IRS's enforcement budget have led to the widening tax gap—the difference between the amount of tax owed to the government and the amount paid and collected on a timely basis. Werfel stated in response to a question from Connolly that the latest estimates show the average tax gap is currently $540 billion a year.

Connolly commented that Republicans' willingness to cut funds for audit and enforcement over the past decade resulted in "money left on the table" that could have been applied to deficit reduction—a result he found to be at odds with the GOP's stated concerns about rising deficit levels. (It's worth noting that the nonpartisan Congressional Budget Office has estimated that Sen. Paul's proposal to slice $25 billion from the IRS's newly increased enforcement budget would result in a net increase to the federal deficit of nearly $23.8

billion over 10 years, through the combined effects of a $25.04 billion decrease in outlays and a $48.8 billion decrease in revenues from forgone tax collections.)
URL: https://www.cbo.gov/system/files/2023-10/Whitehouse_letter-SA1226_10-16-2023_1.pdf

“You’d think people who are deficit hawks might want—before we talk about raising taxes—to make sure that everyone who owes tax pays it,” Connolly said.

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