Treasury, IRS ramp up revenue projections from Inflation Reduction Act funding

A report from the Treasury Department and the Internal Revenue Service released on February 7 suggests that the roughly $80 billion in mandatory spending that was allocated to the IRS under the Inflation Reduction Act of 2022 (P.L. 117-169) to strengthen its enforcement program, modernize its information technology, and enhance its taxpayer service operations could increase federal revenues by as much as $561 billion between 2024 and 2034. That amount could swell to as much as $851 billion if the funding stream, which is set to run out in 2031 under the legislation as enacted, is renewed for 2032 and 2033 as proposed in the fiscal year 2024 budget blueprint President Biden sent to Congress last March, the report states.
URL: https://www.irs.gov/pub/irs-pdf/p5901.pdf
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

Broader estimating criteria

According to the report, the Treasury Department had initially projected that the new funding would generate roughly $390 billion in new revenues between 2024 and 2034 based on a "rigorous but extremely conservative" estimating methodology that measured "direct revenue" recouped from noncompliant taxpayers and "protected revenue"—that is, revenue losses that were forestalled because the government caught fraudulent refund claims before refunds are actually paid out. Both of these measurements are tied to increases in IRS enforcement staffing (focused principally on large businesses, complex partnerships, and high-wealth individuals) as a result of the new funding infusion. (The nonpartisan Congressional Budget Office, for its part, estimated in 2022 that the government's heightened enforcement and compliance efforts funded under the Inflation Reduction Act as enacted likely would bring in nearly $204 billion in previously uncollected taxes over the 10-year budget window covering 2022-2031.)
URL: https://www.cbo.gov/system/files/2022-08/hr5376_IR_Act_8-3-22.pdf

But the report contends that a more accurate measure of the return on investment from the new funding must also take into account other changes to agency operations that the IRS is putting into place, such as:

- Enhancements to taxpayer service operations that promote voluntary compliance by making it easier for taxpayers to communicate with the agency, resolve questions, and pay what they owe;
- Expanded third-party information reporting initiatives, which encourage taxpayers file accurately up front and enable the IRS to ensure compliance through electronic information return processing;
- Greater emphasis on issuing "taxpayer-centric" notices intended to "nudge" specific groups of taxpayers into voluntary compliance by reminding them of their filing obligations; and
- Technology improvements such as modernized compliance systems and new tools that allow the IRS to better identify noncompliance and fraud patterns, thus reducing noncompliance and improving revenue protection and recovery.

The report also states that a more stringent and visible enforcement program creates a general deterrent effect on taxpayer behavior that in turn promotes higher levels of voluntary compliance.

Under these expanded estimating methods and assuming the mandatory funding stream is extended for 2032 and 2033, the government would gain $68 billion from direct revenue recapture efforts between 2024 and 2034, $39 billion from the deterrence effect of stepped-up enforcement efforts, $53 billion from adopting behavioral science techniques (such as “nudging”) and $301 billion in efficiency gains from an overhaul of the IRS’s information technology systems, according to the report.

Impact of rescissions

It’s important to note that the projections in the report assume that the IRS receives the entire $80 billion funding stream as originally enacted in the Inflation Reduction Act and that Congress continues to provide sufficient discretionary funding for the agency as part of the annual federal budgeting process.

But President Biden and then-Speaker Kevin McCarthy, R-Calif., reached a handshake agreement during their negotiations over the Fiscal Responsibility Act (P.L. 118-5), the debt limit deal that was signed into law last June, to rescind $10 billion of the Inflation Reduction Act funding in fiscal year 2024 and another $10 billion in fiscal year 2025. And a renegotiated version of that agreement hammered out last month between current House Speaker Mike Johnson, R-La., and Senate Majority Leader Charles Schumer, D-N.Y., calls for rescinding the entire $20 billion in fiscal year 2024. Moreover, Republicans in both chambers are likely to seek further clawbacks of the funding in future negotiations over tax and spending legislation.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

The Treasury Department warned of the potential revenue impact of cutting back the funding allocation in a news release issued in conjunction with the report. According to Treasury, “[a] $20 billion rescission would reduce revenues by over $100 billion.” Although the IRS would still be able to carry out its stepped-up enforcement efforts—primarily targeting large corporations and high-wealth individuals with complex tax returns and opaque sources of income—rescissions “would cause [Inflation Reduction Act] enforcement funding to run out in 2029—about two years earlier than it would have under the [legislation] as enacted—reducing the revenue raised in 2029 and subsequent years.”
URL: https://home.treasury.gov/news/press-releases/jy2079

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP