IRS well positioned to implement child tax credit changes in bipartisan tax relief package, Werfel tells House taxwriters

Internal Revenue Service Commissioner Danny Werfel assured House Ways and Means Committee members at a February 15 hearing that his agency will be able to quickly adjust its computer systems and implement changes to the child tax credit included in the Tax Relief for American Families and Workers Act (H.R. 7024), the bipartisan tax relief package currently moving through Congress, despite the fact that those changes, if enacted, would take effect well after the start of the tax year 2023 filing season.
URL: https://www.congress.gov/118/bills/hr7024/BILLS-118hr7024eh.pdf

Tax Relief for American Families and Workers Act

The $78 billion tax package, which was negotiated between Ways and Means Committee Chairman Jason Smith, R-Mo., and Senate Finance Committee Chairman Ron Wyden, D-Ore., would, among other things, temporarily revisit three business-unfriendly tax provisions that were enacted in the Tax Cuts and Jobs Act of 2017 (P.L. 115-97) but did not take effect until several years after that measure became law, enhance the child tax credit and the low-income housing tax credit, and impose new strictures on the pandemic-era employee retention tax credit program. It cleared the House taxwriting panel by a bipartisan vote of 40-3 on January 19 and was approved by the full House by a vote of 357-70 on January 31.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

The measure has been stuck in the Senate, however, where Republicans have complained about several elements of the expanded child tax credit—including a provision allowing the IRS to adjust refunds for those taxpayers who would be due an additional benefit under the modified credit but filed their taxes before the legislation was enacted. Giving the IRS that authority, critics contend, would create an opportunity for the Biden administration to curry favor with voters by sending out additional refund payments just before this November's presidential election. Chairman Smith has disputed this claim (and others leveled by Senate Republicans) and used his time during the hearing to quiz Werfel about IRS's capacity to administer the new provisions if they become law.
URL: https://waysandmeans.house.gov/correcting-the-record-tax-relief-for-american-families-and-workers-act-protects-taxpayers-and-prevents-attempts-to-politicize-americans-tax-refunds/

Responding to several pointed questions from Smith, Werfel told the committee that the IRS would be able to implement the child tax credit changes in the legislation within 6 to 12 weeks after enactment, depending on the exact language included in the final measure. He added that he is "committed to work[ing] diligently to make sure we're closer to the 6-week end of that range than the 12-week."

Implementing these provisions, Werfel said, would pose far fewer challenges to the IRS than it faced in implementing various pandemic-era relief programs that required the agency to issue stimulus checks to millions of individuals and create a system that allowed taxpayers to receive a temporarily beefed-up child tax credit in the form of monthly advanceable cash payments.

Indeed, "[t]he work that [the IRS] did to implement [those programs] allowed us to build additional capacity to make us even more ready for this challenge," he added.

Werfel confirmed for Chairman Smith that only about 10 percent of households would be eligible for additional benefits under the expanded child tax credit provisions and that any refund adjustments would be modest. Taxpayers who file their returns early and who become eligible for additional benefits once the legislation is enacted would not be required to file amended returns to claim those benefits, Werfel said. He also urged taxpayers to file their returns as soon as they're ready to do so and advised against delaying filing in anticipation of action by Congress. (See separate coverage in this issue for additional details on the current status of the Tax Relief for American Families and Workers Act.)

1099-K reporting thresholds

Also at the hearing, Werfel pushed back against criticisms from Republican taxwriter Carol Miller of West Virginia that the agency exceeded its authority when it issued administrative guidance in two successive years that postponed the enforcement of the more stringent information reporting requirements for third-party payment processors that were enacted in 2021. (The IRS's actions regarding the reporting thresholds have been a sore point for Ways and Means Committee Republicans generally and were a major impetus for convening the February 15 hearing. For prior coverage, see *Tax News & Views*, Vol. 25, No. 6, Feb. 9, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240209_5.html

The American Rescue Plan Act of 2021 (P.L. 117-2) reduced the dollar-threshold triggering the Form 1099-K reporting requirement from $20,000 under prior law to $600 and eliminated the prior-law 200-transaction threshold, effective for reporting for returns filed for calendar years after 2021. Although these more stringent thresholds have come in for bipartisan criticism in Congress, legislative efforts since then to delay, relax, or repeal them have been unsuccessful.
URL: https://www.congress.gov/117/plaws/publ2/PLAW-117publ2.pdf

The IRS stepped in with administrative relief at the end of 2022 with the release of Notice 2023-10, which delayed enforcement of the new rules until after 2023. A second round of relief—Notice 2023-74, issued last November—provides that the IRS will treat calendar year 2023 as an additional transition period with respect to enforcing the American Rescue Plan provision. In a statement, the agency attributed this latest delay to "feedback from taxpayers, tax professionals, and payment processors" and its desire "to reduce taxpayer confusion." The statement also noted that the IRS will phase-in the implementation of the American Rescue Plan provision by setting the dollar-threshold triggering the reporting requirement at $5,000 (instead of $600) for tax year 2024.
URL: https://www.irs.gov/pub/irs-drop/n-2023-10.pdf
URL: https://www.irs.gov/pub/irs-drop/n-23-74.pdf
URL: https://www.irs.gov/newsroom/irs-announces-delay-in-form-1099-k-reporting-threshold-for-third-party-platform-payments-in-2023-plans-for-a-threshold-of-5000-for-2024-to-phase-in-implementation

By what authority?: At the hearing, Miller commented that these delays are part of "a long stream of illegal and questionably legal actions taken by the IRS and the Department of Treasury either willfully ignor[ing], chang[ing], or misinterpret[ing] the laws that have been passed by Congress" and asked why the IRS did not simply administer the reporting provision as enacted.

Werfel replied that he believes the IRS commissioner "has the authority to implement laws in a manner that ensures taxpayer rights," and, as a result, implementation can sometimes be "delayed or ramped up over time in order to make sure that we are achieving that balance." Decisions to slow-walk the $600 reporting threshold, he said, were based on the recommendations from "stakeholders across the tax industry [and] commercial industry."

"From every direction we were hearing calls that there was risk" in implementing this provision, he said.

Timeline for implementation: When Miller asked if the IRS ever intends to implement the provision, Werfel stated that the agency is "on a path to get it done" and "intend[s] to begin implementation next year." The agency's focus, he said, is on doing it in a way that best protects taxpayer interests.

"We don't want taxpayers overpaying their taxes, we don't want them to be confused, we don't want them to be bombarded with forms and paper they shouldn't be receiving," he explained. "If we go forward with implementation without being able to adequately protect against that risk, then I'm not meeting my legal responsibility as commissioner to help taxpayers and help protect their rights."

The $5,000 question: Werfel also said in response to a question from Miller that the IRS's decision to set the threshold to trigger the reporting requirement at $5,000 for tax year 2024 was based on the "strong recommendation" of stakeholder groups representing taxpayers and third-party payment platforms. There was "consensus," he explained, that the $5,000 threshold "would ensure the most revenue would be impacted" while also protecting the greatest number of taxpayers from unnecessary paperwork.

When Miller asked Werfel to explain what authority allowed the IRS to set an interim reporting threshold that was not provided for in the statute, he replied that the agency has "the authority under the code to administer laws consistent with taxpayer rights." (He did not cite a specific code section for that authority, however.)

The agency's goal, Werfel said, is to administer new tax laws "on Day One," but he noted—without elaborating—that there are "a variety of examples throughout history where the IRS . . . has either delayed implementation or ramped up implementation."

Is it legal?: In response to Miller's contention that the IRS's actions in this area are illegal, Werfel replied that "it's not illegal to take a step to protect taxpayer rights."

Inflation Reduction Act funding

Democrats and Republican taxwriters also engaged with Werfel in largely familiar partisan discussions regarding the merits of—or problems arising from—the mandatory revenue stream allocated to the IRS over

10 years under the Inflation Reduction Act of 2022 (P.L. 117-169) to strengthen its enforcements resources, modernize its information technology systems, and overhaul its taxpayer service operations.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

Under the legislation as enacted, the agency was set to receive roughly $80 billion over the 10-year window. 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 deal 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.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

Democrats focus on compliance boost, service enhancements: Democrats on the panel generally focused their questions on how the new funding will promote fairness in the tax system—for example, by ensuring that taxpayers across the income spectrum pay all the tax they legally owe—and improve the quality of service the IRS can offer.

In an exchange with ranking member Richard Neal, D-Mass., for example, Werfel stated that the new funding is allowing the IRS to:

- Improve tax compliance by hiring specialized audit staff and enhancing its information technology capabilities so it can better identify and pursue any large corporate and high-wealth taxpayers who are creating complex tax returns with the goal of shielding their income and avoiding their tax obligations;
- Close “gaps” in taxpayer data security by using sophisticated new technology to implement “robust audit trails” that can track how data is moving across the organization and determine when there is a risk of data falling into the wrong hands; and
- Reopen formerly shuttered walk-in IRS service centers, add staff to IRS call centers, and develop new technology such as callback options all as part of a larger effort to make it easier for taxpayers to interact with the agency.

On the issue of compliance, Democratic taxwriter Lloyd Doggett of Texas asked Werfel to discuss the types of taxpayers the IRS is targeting for its expanded enforcement programs. Werfel replied that, on the individual side of the code, the IRS is pursuing “millionaires and billionaires who are delinquent on owed taxes.” Werfel noted that the agency has created a “high-risk list” of 1,600 wealthy taxpayers who are currently delinquent on their tax obligations, and its efforts to recover those unpaid taxes have thus far have recouped some $500 million for the fisc.

Werfel also stressed in his exchange with Doggett that it is vital for Congress to ensure that the IRS’s annual discretionary budget continues to be funded at healthy levels. Cuts to the base budget, he cautioned, would force the IRS to borrow from the Inflation Reduction Act funding stream just to cover the cost of day-to-day operations.

“If we keep doing that, we won’t modernize. We’ll keep the lights on, but we won’t build the capacities that are so important to help taxpayers,” he said.

Democratic taxwriter Mike Thompson of California asked Werfel to discuss the impact to the federal deficit of cuts to IRS budget. Werfel replied that for every $100 million taken from the IRS, the deficit grows by $600 million over 10 years. He also noted that $100 million in IRS funding can pay for 700 audits of millionaires and billionaires, 200 audits of complex partnerships, 100 audits of large corporations, and 32,000 collection cases involving high-wealth individuals.

Republicans warn of audit overreach: The panel’s Republicans, for their part, cautioned against what they see as an overly aggressive focus on audits and enforcement at the agency stemming from the infusion of new funds.

Some GOP taxwriters, like Lloyd Smucker of Pennsylvania, contended that, based on public comments from administration officials, the apparent mindset at the IRS is to assume that all large corporations and wealthy individuals are by definition “tax cheats.”

Werfel disputed that characterization and, in response to a follow-up question from Smucker, stated that the fact that a taxpayer has filed a complex return does not in and of itself raise a red flag for the IRS.

If a return is “accurate, complete, and legitimate,” the IRS has no issue with it, Werfel said. He noted, though, that because of years of congressionally mandated budget cuts, the IRS has fallen behind in its audits of large corporations, complex partnerships, and ultrawealthy individuals. The lack of a robust and visible enforcement operation opened the door to “aggressive avoidance and even evasion” among certain taxpayers in these groups, he explained.

The IRS, Werfel said, is “looking for spaces where we think evasion is proliferating and trying to hold people accountable for what they owe.”

GOP taxwriter Adrian Smith of Nebraska asked Werfel what steps the IRS is taking to ensure that small businesses and middle-income families are not caught up in the sweep of an expanded compliance regime.

Werfel replied that the IRS is adhering to the Biden administration’s pledge that no Inflation Reduction Act funds will be used to increase audits—relative to “historical levels”—of taxpayers with income below $400,000. He explained that the IRS is using 2018 as the baseline for measuring subsequent increases or decreases in audit rates for taxpayers across various income levels, noting that audit rates that year were “historically low.” Because audit rates stratified by income level are published in the IRS’s annual “Data Book,” Congress will be able to determine whether the agency is adhering to its pledge and hold it accountable if it falls short, he said.

Republican Drew Ferguson of Georgia argued that there is fraud at the lower end of the income spectrum—specifically within the earned income tax credit and the child tax credit programs—and asked whether

Congress should consider cracking down on unscrupulous tax preparers who promote these credits to unsophisticated taxpayers. He contended that this issue is ripe for bipartisan legislation.

Werfel replied that his goal is to protect honest taxpayers who are being victimized and that Congress and the IRS should be on guard against “nefarious tax preparers” who lure unsuspecting individuals with promises of quick tax credits and then “rip them off in some way, shape, or form.”

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