No surprises as Finance Committee Democrats, Republicans spar over FY 2025 IRS funding proposals

Senate taxwriters were, as expected, divided largely along party lines as they discussed details of the Biden's administration's plans to fund the Internal Revenue Service for fiscal year 2025 with IRS Commissioner Daniel Werfel during an April 16 Finance Committee hearing.

Administration's proposal

The White House plan proposes to maintain the IRS's regular operating budget—that is, funding provided under the annual appropriations process—for fiscal year 2025 at $12.3 billion, a level consistent with its fiscal year 2023 and 2024 allocations, as agreed to by President Biden and then-House Speaker Kevin McCarthy, R-Calif., in the Fiscal Responsibility Act of 2023 (P.L. 118-5) in June of last year and affirmed this past January in a handshake deal on government funding between current Speaker Mike Johnson, R-La., and Senate Majority Leader Charles Schumer, D-N.Y.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

The budget plan also calls for extending the special mandatory funding allocation for the IRS enacted under the Inflation Reduction Act of 2022 (P.L. 117-169) to strengthen the agency's enforcement and compliance operations, modernize its information technology systems, and improve its taxpayer service functions.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

As enacted, the Inflation Reduction Act provided $80 billion in mandatory funding for the IRS through 2032; however, $20 billion of that amount was subsequently reallocated to other budget priorities in keeping with what the president and congressional leaders have agreed to as part of their recent spending accords. The administration's budget plan proposes to backfill that reduction by making the mandatory funding stream available through 2034—that is, for the additional years covered by the 10-year budget window in the fiscal year 2025 blueprint. In total, the agency would receive $104.3 billion in mandatory funding through 2034, with about half of that dedicated to enforcement, and lesser amounts dedicated to technology and operations support, taxpayer services, and business systems modernization. (For details on all of the tax proposals in the president's FY 2025 budget blueprint, see *Tax News & Views*, Vol. 25, No. 11, Mar. 12, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240312_1.html

Democrats laud new compliance efforts

Democrats at this week's Finance Committee hearing contended that the IRS thus far has effectively managed its new mandatory funding infusion by hiring specialized examiners and overhauling its information technology systems so that it can unwind complex tax returns filed by multinational corporations, large partnerships, and high-wealth individuals and identify potential tax-avoidance or tax-abuse transactions among these segments of the tax base, all as part of its ongoing effort to narrow the "tax gap"—the difference between the amount of tax owed to the government and the amount actually paid and collected on a timely basis.

In his opening statement at the hearing, Finance Committee Chairman Ron Wyden, D-Ore., touted the IRS's recent announcement of new enforcement initiatives focused on nonfiling among high-wealth individuals and improper deductions involving personal use of business aircraft, and suggested that the agency launch a separate initiative to examine improper deductions for personal use of business-owned yachts. He also warned of the moral hazards that would arise if the agency is not adequately funded.
URL: https://www.irs.gov/newsroom/irs-launches-new-effort-aimed-at-high-income-non-filers-125000-cases-focused-on-high-earners-including-millionaires-who-failed-to-file-tax-returns-with-financial-activity-topping-100-billion
URL: https://www.irs.gov/newsroom/irs-begins-audits-of-corporate-jet-usage-part-of-larger-effort-to-ensure-high-income-groups-dont-fly-under-the-radar-on-tax-responsibilities

"If Congress continues to cut the IRS's funding—or if the Inflation Reduction Act funding expires and Congress doesn't add more—we know what is going to happen. Wealthy tax cheats will have an easier time getting away with breaking the law. And it'll be misery and higher costs for typical American taxpayers who are just trying to do their civic duty when tax filing season comes around every spring," he said.

Democratic taxwriter Mark Warner of Virginia commented that if noncompliant taxpayers simply paid what they owe, Congress would be under less pressure to find new revenue offsets to pay for tax relief proposals and new spending programs. He asked Commissioner Werfel to elaborate on how the IRS is using the Inflation Reduction Act funds to chip away at the tax gap.

Werfel replied that, in addition to the enforcement programs mentioned by Chairman Wyden, the IRS has deployed the new enforcement funding to launch compliance initiatives to address wealthy filers who haven't paid their recognized tax debts, potential corporate abuses of transfer pricing rules, and potential tax avoidance among large partnerships.
URL: https://www.irs.gov/newsroom/irs-ramps-up-new-initiatives-using-inflation-reduction-act-funding-to-ensure-complex-partnerships-large-corporations-pay-taxes-owed-continues-to-close-millionaire-tax-debt-cases

According to Werfel, IRS compliance efforts launched with the Inflation Reduction Act funding infusion and sustained with the additional $104 billion that the administration has requested in its budget blueprint could generate a total of nearly $700 billion in revenue over 10 years.

Republicans wary of 'just-spend-more' approach

Finance Committee Republicans countered that the IRS actually has little to show for its $80 billion funding windfall from the Inflation Reduction Act, particularly in the area of taxpayer service.

Service metrics: Commissioner Werfel told the panel in his opening statement that the agency has deployed a chunk of the new funds to hire additional ground-level employees to answer the phones, staff walk-in service centers, and process returns and taxpayer correspondence. It also has enhanced its telephone technology with features such as call-back options and automated chatbots to reduce call waiting times, and enhanced the irs.gov site to make it easier for taxpayers to submit documents and interact with the agency online, he added. The results of that investment, he said, are borne out in statistics from the just-concluded filing season, which indicate that as of April 6 the IRS received over 101 million individual returns and issued nearly 67 million refunds totaling $201 billion. Phone service statistics showed a call answer rate of 88 percent (up from 15 percent in 2022) and an average wait time of 3 minutes, he added.

Finance Committee ranking member Mike Crapo, R-Idaho, acknowledged that the IRS has made “modest progress” in the area of service but suggested that its overall achievements to date have been less than impressive.

“For $80 billion, one would expect transformational customer service changes and fully modern front- and back-end IT,” he said in his opening statement. “Instead, it seems taxpayers have paid for mail to actually be opened and a decline in phone wait times.”

The fact that the White House is now requesting additional mandatory funding, Crapo said, “underscores that the initial windfall was not a cure, the IRS has not transformed, and the president believes the only way to realize that vision is to just spend more.”

Crapo asked Werfel to explain just how much additional mandatory funding the administration intends to request before it can achieve its vision of a transformed IRS.

Werfel replied that the administration’s latest budget request is based in part on the fact that the IRS has had to rely on the Inflation Reduction Act funding to help subsidize its regular operating budget, which has remained largely unchanged since 2010 even though the tax system has become more challenging since then because of a significant increase in the number of filers, the advent of the gig economy, and increasing complexity in the tax laws.

“What we’re asking for in the new funding,” he said, is to “create a new baseline so as the tax system continues to grow, we have the right set-up to run the train schedules that are created by the tax code.”

The budget request also is intended to address the fact that the Inflation Reduction Act funding allocations across the IRS’s various program areas runs out on a staggered basis over the legislation’s 10-year budget window, Werfel added—noting, for example, that additional funds for taxpayer services are scheduled to lapse in 2026 and funds for technology modernization expire in 2028 and 2029. The new funding, he said, would address these “cliffs” and allow the IRS to maintain the improvements it made in the earlier years of the Inflation Reduction Act’s budget window.

Responding to Crapo and other Republicans who pointed to continuing weaknesses in the IRS’s taxpayer services operations and chided the agency for taking what Crapo called “a victory lap” based on the most recent tax filing season results, Werfel acknowledged that the agency still has “more work to do” to improve its interactions with taxpayers.

“Things are trending better,” Werfel said in response to a question from North Carolina Republican Sen. Thom Tillis, “but that doesn’t mean we’re done.”

Audit red lines: Republicans also criticized what they contend is an imbalance between the Inflation Reduction Act's funding allocations for enforcement (roughly $45 billion over 10 years, as enacted) and taxpayer services ($3 billion over 10 years) and expressed concern that small businesses and middle-class taxpayers would be ensnared in new IRS compliance initiatives.

Republican taxwriter John Barrasso of Wyoming asked Werfel how these taxpayers can be assured that they will be protected from undue audit scrutiny.

Werfel replied that the IRS's focus on auditing large corporate and high-wealth taxpayers reflects his "marching orders" from the Treasury Department.

In a subsequent exchange with Democratic taxwriter Robert Casey of Pennsylvania about the IRS's audit priorities, Werfel, alluding to the concerns Barrasso raised moments earlier, reiterated that Inflation Reduction Act funding must be "exclusively used on enforcement of high-wealth [individuals], complex organizations, large partnerships, and large corporations."

"If you're a mom-and-pop [business or a] middle- or lower-income [individual], there is no wave of audits coming under the Inflation Reduction Act," Werfel said. "The audit rate you had the day before the Inflation Reduction Act [became law], which was historically low, is the same audit rate you had the day after, the same audit rate you have today, and the same audit rate you'll have into the future."

IRS releases FY 2023 data book

In a related development, the IRS on April 18 released its latest annual data book with detailed statistics on returns filed and taxes collected, enforcement activity, taxpayer assistance, the IRS budget and workforce, and other selected topics for FY 2023.
URL: https://www.irs.gov/pub/irs-pdf/p55b.pdf

Among its highlights, the new data book reveals that in 2023, the IRS:

- Collected nearly $4.7 trillion in gross taxes, processed almost 271.5 million tax returns and other forms, and issued about $659.1 billion in tax refunds;
- Closed 582,944 tax return audits, resulting in $31.9 billion in recommended additional tax; and
- Assisted nearly 60.3 million taxpayers who called or visited an IRS office.

The data book also notes that the irs.gov website received more than 880.9 million visits and taxpayers downloaded about 538.1 million files.

In an April 18 news release, the IRS noted that the statistics in the data book reflect the impact of the Inflation Reduction Act funding on the agency's operations. Because of the additional customer service staff hired with Inflation Reduction Act funds, for example, the IRS was able to answer nearly 27.3 million phone calls in FY 2023—a 25 percent increase from FY 2022. The IRS also used Inflation Reduction Act funds to open or reopen more than 50 Taxpayer Assistance Centers in FY 2023 that were closed during the pandemic, resulting in more than 1.6 million in-person customer contacts for the agency at 363 centers across the nation in FY 2023—up 18 percent from FY 2022.

On the compliance side, the release also noted that while the IRS used its new funding infusion to ramp up its enforcement and collections efforts focusing on high-wealth individuals who either did not file returns or underreported their tax liability, there was no increase in audits of tax returns for taxpayers making under $400,000 per year in FY 2023.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP