Mobility Matters

Anticipated Increase in IRS Enforcement Activity with Inflation Reduction Act Funding

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In April 2023, the U.S. Internal Revenue Service (IRS) released its Inflation Reduction Act Strategic Operating Plan (the "Plan"). The 150-page Plan describes, at a high level, the IRS's proposed spending of nearly USD 80 billion in mandatory funding it will receive under the Inflation Reduction Act of 2022 ("IRA")[1]. The funds received under the IRA, which will be provided over a ten-year period (through the federal government's fiscal year ending September 30, 2031), are intended to supplement the IRS's annual appropriations from Congress. In June 2023, the debt ceiling deal negotiated between the White House and the Republican majority in the House of Representatives eliminated approximately USD 21 billion of this funding.[2] However, the Plan's basic goals remain unchanged.

This article will examine the Plan's stated objectives, how the IRS intends to achieve those objectives, and what the Plan means for taxpayers.

For globally-mobile employees (who tend to be high-income, high-net wealth individuals), their employers, and their tax service providers, the IRS's plans serve as a reminder (1) to factor in more time around information collection and (2) to exercise extra due diligence when evaluating the accuracy of their returns/return positions.

The Plan sets out five broad objectives the IRS would like to achieve with the funding provided by the IRA:

- **Objective 1:** Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.
- **Objective 2:** Quickly resolve taxpayer issues when they arise.
- **Objective 3:** Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.
- **Objective 4:** Deliver cutting-edge technology, data, and analytics to operate more effectively.
- **Objective 5:** Attract, retain, and empower a highly-skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.

Funding Allocations for the Objectives[3]

Objectives 3 and 4 have been designated by the IRS to receive the most funding. Specifically, the IRS proposes to use USD 47.4 billion (about 60 percent of the IRA funding) to support Objective 3, which is focused on enforcement activities. Objective 4, delivering cutting-edge technology, data, and analytics, is slated to receive USD 12.4 billion, about 16 percent of the total funding. Objectives 1 and 2, primarily centered on improving taxpayer customer service, are set to receive USD 4.3 billion and USD 3.2 billion (5 percent and 4 percent of the total funding), respectively.

Objective 5, focused on enhancing the IRS's ability to attract and retain a qualified and diverse workforce, will receive USD 8.2 billion (or 10 percent) of the IRA funding. Lastly, energy security, a separate goal from the five delineated objectives, is allocated USD 3.9 billion (the remaining 5 percent).

Overview of the Objectives

Objectives 1 & 2

Objective 1 is directed at improving taxpayers' filing experience by creating a more streamlined process for filing returns and engaging with the IRS. The IRS envisions an enhanced digital platform in which it can communicate with taxpayers to achieve this objective. Implementation will entail the IRS building its digital infrastructure and expanding digital, phone, and in-person assistance options. According to the Plan, the IRS will proactively engage taxpayers through their preferred communication channels (e.g., email, phone, and paper correspondence) and will communicate with taxpayers regarding incentives they may be eligible to claim (e.g., certain deductions and credits). Taxpayers will be able to track the status of their filing history, payments, and claims online. In implementing this objective, the IRS strives to decrease the difference between credits and deductions available versus those claimed and reduce inadvertent errors and improper payments.

While Objective 1 is aimed at proactively helping taxpayers comply with the tax laws and claim the correct tax incentives, Objective 2 is centered on improving the resolution process for issues that arise after a taxpayer files a return. Many times, simple mistakes or account errors can lead to a long, drawn-out resolution process. According to the Plan, the IRS will leverage its enhanced technology and communication tools to promptly resolve these types of issues. The IRS plans to implement electronic modes of communication to speed up the resolution process—an improvement from requiring notices and responses to be mailed on paper. The IRS will advance its ability to systemically check electronically filed returns in real time in order to alert taxpayers of potential filing issues. Allowing more opportunities for early self-correction will streamline the resolution process for many issues, ultimately making compliance easier on taxpayers.

Objectives 3 & 4

Of particular note are Objectives 3 and 4, which reflect the IRS's substantive efforts to enforce the tax laws through not only well-established methods but also new methods, with a particular focus on the collection and analysis of data and the use of technology in enforcement efforts.

Based upon the discussion of Objective 3 in the Plan, it is clear the IRS expects the audit rates of large corporations, large partnerships, and high-income and high-wealth individuals to increase (and that the IRS is actively hiring to achieve this result). The IRS also intends to increase audit rates in the employment tax, excise tax, and estate and gift tax areas. In addition to traditional audits, the IRS plans to employ other non-audit compliance treatments to reduce the tax gap (the difference between the taxes owed and the taxes collected). While the IRS does not specifically identify additional treatments or tools it may develop to enforce compliance, the Plan does refer to tools other tax authorities are using to nudge taxpayers to self-correct potential issues with their returns, sometimes referred to as "soft letters."

The IRS's ability to focus its enforcement activities on returns with higher risk of noncompliance will be critical to the IRS's achievement of Objective 3. In that vein, the IRS is creating a centralized planning function that will use data analytics to select and prioritize cases and will assist with the selection of the appropriate treatment for a selected return (e.g., audit or soft letter). For instance, the IRS may embrace predictive analytics to gain a better appreciation for the return issues more suitable for self-correction versus those that require a more direct treatment (e.g., audit) to get resolved. The Congressional Budget Office estimated that federal revenue will increase by USD 180 billion over a ten-year period based only on direct enforcement revenue from increased staffing in the enforcement area.[4]

Enhanced data and technology, including the data analytics that will be leveraged for purposes of Objective 3, are the focus of Objective 4. With the IRA funding devoted to Objective 4, the IRS plans to retire its legacy data systems, bringing its technology infrastructure to current standards. The modernization and centralization of the IRS's systems will allow the IRS to better utilize the data it collects. The IRS intends to create a standard case management platform, giving IRS employees who provide customer service a 360-degree view of a taxpayer's account history across all or nearly all compliance work-flows, thereby enabling employees to resolve taxpayer issues more efficiently. Currently, the IRS stores most data in systems that are not connected or updated in real time, and most taxpayer-facing employees lack access to data sources, in addition to lacking the authority to act on that data in a meaningful way. As noted above, the IRS will focus on building data analytics capabilities, which will drive informed decisions on reducing noncompliance. As the IRS transforms itself to a data-centric organization, it expects the number of data scientists it employs to increase significantly.

Objective 5

Objective 5 outlines the IRS's intended recruitment, hiring, and retention efforts for its workforce, in reflection of the initiatives of Objectives 1 through 4. The goals of this objective are indicative of a large organization moving forward, balancing the needs of employees and the needs of serving taxpayers, while cognizant of the continually-evolving talent market.

Conclusion

The debt ceiling agreement and the uncertainty regarding appropriations this autumn have thrown, and will continue to throw, a wrench into the financing of the Plan's objectives and may lead to a reorientation of existing funds, timelines, and priorities. Since the IRA's enactment, there has already been an increase in the hiring of IRS service center representatives to help improve in-person and over-the-phone taxpayer services.[5] In its most recent wave of posted positions, the IRS is looking to hire 3,700 employees to expand enforcement efforts focused on high-income earners, partnerships, and large corporations.[6] It will take time for the IRS to increase and train staff in enforcement activities.

Globally-mobile employees and their employers are not among the specified areas of focus for the IRS 's enhanced enforcement effort. However, as the Service moves forward with achieving the objectives outlined in the Plan, high-income/high-wealth taxpayers – which describes a number of international executives on assignment and travelling for business – global-mobility departments, and their tax service providers would be well-served to exercise particular caution and due diligence with respect to U.S. tax return compliance.

Although the Plan is high-level, it is clear the IRS has lofty ambitions to transform how it operates and serves taxpayers. Although it will take time (and perhaps more sustained funding) for the IRS to achieve the various milestones it laid out in the Plan, taxpayers should not expect the IRS of the future to resemble the present organization.

Footnotes:

1. Public Law 117-169, the 2022 reconciliation act, also known as the "Inflation Reduction Act."
2. H.R. 3746, the "Fiscal Responsibility Act of 2023." The Fiscal Responsibility Act of 2023 includes an immediate rescission of $1.4 billion of the IRS funding. Further, in a "hand-shake deal," it was also agreed upon that during 2024 and 2025 an additional $10 billion each year would be reallocated away from IRS funding. See Benjamin Guggenheim, "What a $21.4 billion budget cut may mean for the IRS," in *Politico* (online) (May 30, 2023) available at https://www.politico.com/newsletters/weekly-tax/2023/05/30/what-a-21-4-billion-budget-cut-may-mean-for-the-irs-00099171. *Please note you are leaving the KPMG website for an external site (non-governmental, non-KPMG), that KPMG is not affiliated with nor is KPMG endorsing its content. The use of the external site and its content may be subject to the terms of use and/or privacy policies of its owner or operator.*
3. While this article refers to original funding amounts from the IRA and Plan, without consideration of the debt-ceiling deal claw-backs, the main prongs of the Plan, if not the exact dollar figures supporting those prongs, can be assumed to be unchanged from those provided in the IRA.
4. Internal Revenue Service Inflation Reduction Act Strategic Operating Plan: FY2023 – 2031, page 8 at: https://www.irs.gov/pub/irs-pdf/p3744.pdf.
5. Internal Revenue Service, "IRS quickly moves forward with taxpayer service improvements; 4,000 hired to provide more help to people during 2023 tax season on phones," (IR-2022-191, October 27, 2022).
6. Internal Revenue Service, "IRS looking to hire 3,700 employees nationwide to help expand compliance for large corporations and complex partnerships; experienced accountants encouraged to apply for Revenue Agent positions," (IR-2023-172, September 15, 2023).

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