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Partisan debate over IRS budget persists as Ways and Means Oversight panel looks at 2022 filing season

Questions of whether Congress is adequately funding the Internal Revenue Service left House taxwriters divided along party lines during a March 17 Ways and Means Oversight Subcommittee hearing with IRS Commissioner Charles Rettig on the 2022 tax filing season.

The current filing season, which is now in its eighth week, is unfolding as the Service still struggles to clear a backlog of several million unprocessed returns from tax year 2020—a situation the agency has attributed to pandemic-related shutdowns and staffing shortages, an increased workload as it implemented emergency tax code changes (such as recovery rebate payments and monthly child tax credit payments) enacted to address the economic impact of the pandemic, plus years of congressionally mandated budget cuts.

Inadequate funding?

Several Democrats on the panel agreed that systematic reductions in the Service's operating budget have hampered its ability to carry out its core administrative functions and left it poorly positioned to handle the pandemic-related stresses that hit the agency in 2020 and 2021.

Subcommittee member Judy Chu, D-Calif., who served as acting chair for the hearing, noted that the Service's budget increased by 6 percent budget for the remainder of fiscal year 2022 in the omnibus spending package that President Biden signed into law on March 15. (For additional details on the omnibus and the Service's appropriation, see *Tax News & Views*, Vol. 23, No. 8, Mar. 11, 2022.) But Chu commented that the funding bump is insufficient to meet the agency's long-term needs and touted the Biden administration's proposal to boost the agency's enforcement budget by $80 billion over 10 years in the Build Back Better Act, the roughly $1.75 trillion budget reconciliation package that was approved in the House last November but remains stalled in the Senate.
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220311_1.html

Democratic taxwriter Lloyd Doggett of Texas likewise attributed the Service's predicament to "previous budget decisions [that were] designed deliberately to ensure that the IRS fails [and] that the public would grow dissatisfied . . . with the IRS and eventually replace it with a less progressive system."

Tax gap: Both Chu and Doggett contended that cuts to the IRS's enforcement budget have contributed to what's known informally as the "tax gap"—the difference between the amount of tax legally owed to the government and the amount actually collected in a given year. The most recent official estimate (for 2011-2013) puts the gross annual tax gap at $441 billion and the net annual tax gap at $381 billion. (The net tax gap is the gross amount less any tax eventually collected through enforcement efforts or late payments.) Commissioner Rettig stated last year that the gap may now equal or exceed $1 trillion a year. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 20, Apr. 16, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210416_3.html

In an exchange with Doggett, Rettig stood by his $1 trillion estimate for the tax gap and said the key to reducing it is for the IRS to have "a visible, robust enforcement mechanism." He noted that the Service has lost roughly 17,000 enforcement personnel in recent years and needs to replenish those ranks with "experienced, strategic" new hires.

"We don't have the ability to do what we need to do" to ensure the highest levels of taxpayer compliance, he said.

Audit rates: But Rettig pushed back when Chu, citing a recent report from Syracuse University, asked whether the Service is disproportionately focusing its audit resources on lower-income taxpayers. (According to Chu, the report concluded that lower-income taxpayers are audited at a rate "five times higher than everyone else.")

Rettig replied that the report was "absolutely, 100 percent false" and noted that the IRS data books for 2019 and 2020 show that the audit rate exceeds 7 percent for taxpayers with over $10 million in income, compared to 1.1 percent for taxpayers with income of $25,000 or less.

The IRS is "putting every experienced agent on the most complex tax returns," Rettig said. He added, though, that with only 6,500 experienced front-line revenue agents to examine the 4.2 million partnership returns it received for tax year 2020, the agency may be "outgunned" in its efforts to ensure compliance among taxpayers engaging in highly sophisticated transactions. In a subsequent exchange with Nevada Democratic Rep. Steven Horsford, Rettig noted that the Service faces similar resource constraints in auditing the largest corporations.

Rettig told Chu that audits of lower-income taxpayers generally relate to the earned income tax credit (EITC), adding that the IRS is required by law to audit a percentage of returns claiming the EITC to determine improper payment rates. Errors on those returns typically result from confusion over who counts as a "qualifying child" under the credit and Congress can remedy the situation by simplifying the definition, he said.

Poor resource management?

For their part, Republicans on the panel acknowledged the pandemic-related operational stresses placed on the IRS as well as the increased workload from implementing the emergency COVID tax relief provisions enacted in 2020 and 2021. But they contended that the agency's current dilemma is in large part the result of its failure to manage the funds it received in pre-pandemic years and they appeared skeptical that significant infusions of additional cash would demonstrably improve its ability to administer the tax code and provide effective customer service.

Subcommittee ranking member Tom Rice, R-S.C., said the proposed $80 billion increase for IRS compliance efforts in the Build Back Better legislation was misguided and would turn the Service into "an aggressive enforcement agency that is adverse to taxpayers rather than one that serves the taxpayers."

The long-term goal should be "to fix the customer service problems at the IRS and modernize IRS technology so that the agency can operate effectively in the twenty-first century," he said.

Rice commented that Congress has in the past funded efforts to modernize the Service's information technology but has never seen tangible results. (He noted, for example, that much of the agency's current technology architecture dates back to the 1960s.) The IRS, he said, needs to convince lawmakers that any additional money the agency receives for technology upgrades will increase its efficiency and that it has the capacity to develop a modernization plan, provide Congress with a solid estimate of the likely costs, and actually implement it.

Rettig expressed confidence in the IRS's ability to carry out a modernization plan, pointing to its success in quickly implementing the emergency COVID-related tax initiatives in 2020 and 2021. He added that the Service is willing to work with Congress and with outside consultants in developing and implementing such a plan.

"We welcome oversight," he said. "We take all ideas from all sources."

End to the backlog in sight?

Taxwriters from both parties questioned Rettig about the steps the IRS is taking to reduce the backlog of unprocessed returns from tax year 2020 and when the agency expects the issue to be resolved.

In an exchange with Rep. Chu, Rettig said that "barring unforeseen circumstances," the situation should be under control by the end of this calendar year, roughly dovetailing with the end of his five-year statutory term as IRS commissioner this coming November. As things currently stand, the Service will begin the 2023 filing season "with normal inventories," he said.

In terms of specific actions to address the backlog, Rettig noted that IRS leadership has deployed a surge team of 800 current employees to handle accounts management issues and a separate team of 700 current employees for submissions processing. Moreover, the IRS also recently announced plans to hire 5,000 new employees in three of its service processing centers. (Rettig stated in his written testimony that the Service intends to increase its workforce by a total of 10,000 employees over the coming year.)
URL: https://www.irs.gov/newsroom/irs-hiring-more-than-5000-positions-in-austin-kansas-city-ogden

Ranking member Rice asked why it has taken the Service so long to deliver an action plan.

Rettig replied that the IRS has had a plan since the beginning of the pandemic, but efforts to implement it—specifically, bringing on additional employees to handle returns processing and correspondence—were hindered by the fact that the agency lacked direct-hire authority. Under ordinary government hiring procedures, onboarding new employees typically takes anywhere from six to eight months, he explained.

Rettig noted that Congress gave the IRS direct-hire authority for fiscal year 2022 as part of the just-enacted omnibus spending package. As a result, he said, employees hired under the Service's latest recruitment initiatives can be onboarded in as few as 30 to 45 days.

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Senate taxwriters back tighter rules for donor advised funds, syndicated conservation easements

Members of the Senate Finance Committee urged passage of bipartisan proposals to tighten rules related to donor advised funds and certain syndicated conservation easements during a March 17 hearing to examine charitable giving and trends in the nonprofit sector.

Donor advised funds

Finance Committee member Charles Grassley, R-Iowa, who noted that private foundations currently hold more than $1 trillion in assets and donor advised funds hold some $160 billion, touted the Accelerating Charitable Efforts Act (S. 1981), a bill he introduced with Sen. Angus King, I-Maine, that "is focused on ensuring that tax-deductible contributions to a foundation or a donor advised fund reach their ultimate charitable destination within a reasonable period of time." An identical companion measure (H.R. 6595) has been introduced in the House by Rep. Chellie Pingree, D-Maine, and includes Ways and Means Committee member Tom Reed, R-N.Y., as an original co-sponsor.

Responding to a question from Grassley about the merits of the proposal, one of the witnesses at the hearing, Susannah Morgan of the Oregon Food Bank, commented that "[w]hen I hear of wealthy folks tucking money away in hopes that they will make the future better, my response is 'Make the future better right now for my neighbors who are struggling to put food on the table."

In a subsequent exchange on the issue with Democratic taxwriter Sheldon Whitehouse of Rhode Island, Morgan said that charities generally agree on the need to reform the donor advised fund rules, although she cautioned that any changes should be crafted "carefully" to avoid unintended consequences.

Syndicated conservation easements

Taxwriter Steve Daines, R-Mont., called on Congress to pass the Charitable Conservation Easement Program Integrity Act (S. 2256), a bill he introduced with Finance Committee member Debbie Stabenow, D-Mich., that is intended to curb certain fraudulent arrangements by limiting the tax deduction for qualified conservation contributions made by certain passthrough entities if the amount of the contribution is more than 2.5 times the sum of each owner's relevant basis in the passthrough entity. House Ways and Means Select Revenue Measures Subcommittee Chairman Mike Thompson, D-Calif., has introduced an identical companion bill (H.R. 4164) in that chamber.

"I am very much pro-conservation easements," Daines told his colleagues at the hearing. "It's the abuse of these syndicates that's the issue."

Finance Committee Chairman Ron Wyden, D-Ore., expressed his support for the legislation, telling Daines, "we're on this battle until we get this done."

Other tax issues

Witnesses at the hearing, who represented the nonprofit sector, also told the panel that Congress can promote charitable giving by reviving the now-expired charitable deduction for nonitemizers and expanding incentives that allow certain senior citizens to make tax-preferred charitable contributions directly from their retirement accounts.

The witnesses also generally agreed that Congress can provide direct support to smaller nonprofits by reinstating the employee retention tax credit.

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FY 2023 budget release expected March 28

The White House is expected to release its budget request for fiscal year 2023 on March 28, according to numerous press reports on March 18 citing comments from Office of Management and Budget (OMB) officials.

In conjunction with that release, the Treasury Department is expected to issue its "Green Book," which will provide more granular discussion of the administration's tax and revenue policies, their projected impact on federal receipts, and, possibly, their effective dates. Details in the Green Book are likely to influence subsequent legislation that is marked up in the congressional taxwriting committees and moves through Congress.

The budget for fiscal year 2022, which began last October 1, was finalized just this week when President Biden signed into law a $1.5 trillion omnibus spending package that is largely free of changes to the tax code. (For details, see *Tax News & Views*, Vol. 23, No. 8, Mar. 11, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220311_1.html

Also this week, the Senate voted 61-36 to confirm President Biden's nomination of Shalanda Young to be OMB director. Young had been serving as the agency's acting director prior to her confirmation.

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