How Might the Internal Revenue Service Use $78.9 Billion in Mandatory Funding?

November 17, 2022

The law commonly referred to as the Inflation Reduction Act (IRA, P.L. 117-169) provides the Internal Revenue Service (IRS) a total of $79.6 billion in mandatory funds, most of which are available for obligation until September 30, 2031. These funds are in addition to the IRS's annual appropriations during that period. This marks the first time that Congress has approved multiyear funding for the service. The IRA specified that $78.9 billion should be distributed among the IRS's four appropriation's accounts, as follows:

- $45.6 billion to expand enforcement activities;
- $25.3 billion to acquire and operate information technologies (ITs) to support critical functions;
- $4.8 billion to accelerate the modernization of IRS's business systems; and
- $3.2 billion to improve taxpayer services.

The remaining $700 million is for activities broadly related to the IRS's use of the mandatory funds:

- $15 million (until September 30, 2023) for an IRS task force to develop an estimate of the cost of options for implementing a free direct filing option through a secure IRS web portal for all taxpayers, with input from taxpayers and experts;
- $403 million (until September 30, 2031) for the Treasury Inspector General for Tax Administration;
- $104.5 million (until September 30, 2031) for the Treasury Department's Office of Tax Policy;
- $153 million (until September 30, 2031) for the U.S. Tax Court; and
- $50 million for other Treasury Department offices involved in implementing IRA's provisions.

The IRA funding for the IRS has the potential to substantially boost its annual budget through FY2031, depending on when the money is obligated. In FY2022, for instance, the IRS received $12.6 billion in

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IN12050

appropriations. If 10% of the mandatory IRA funding had been available for obligation that year, the IRS budget would have been 63% larger.

Rationale for Mandatory Funding for the IRS

The IRA funding for the IRS effectively implements key elements of an IRS funding proposal set forth in a May 2021 report by the Treasury Department on ways to improve taxpayer compliance. Among other things, the report called for providing the IRS with sufficient resources to substantially reduce the federal tax gap, which is the difference between the total amount of federal taxes owed and the total amount of those taxes paid on time. According to the IRS's latest estimate of the gross gap, it averaged $496 billion between FY2014 and FY2016.

The rationale for Treasury's funding proposal was partly grounded in several trends since the mid-2010s that have stirred broad concern that the IRS was not doing what it needed to fairly and efficiently administer the federal tax code. Largely because of a hiring freeze from FY2011 to FY2018 and a wave of retirements, the IRS's full-time-equivalent workforce decreased by 17% between FY2010 and FY2021, including a 30.5% drop in IRS examination and collection employees. During the same period, the IRS's budget, measured in 2010 dollars, fell by 11%. These decreases contributed to declines in enforcement and taxpayer services. The audit rate for persons with $1 million or more in income dropped from 8.1% in FY2011 to 0.8% in FY2019, and 18.5% of taxpayer calls to speak with a customer service representative were successful in FY2021. Additionally, IRS's backlog of unprocessed individual tax returns reached historically high levels during the 2021 and 2022 filing seasons.

Debate over How the IRS Should Spend the $78.9 Billion in Mandatory Funding

In mid-August 2022, Treasury Secretary Janet Yellen directed the IRS to produce a plan by mid-February 2023 for spending the $78.9 billion in mandatory funding; she specified that the plan should focus on preventing large unprocessed tax return backlogs, hiring new employees, improving taxpayer service, and technology modernization.

Secretary Yellen's message highlights a key question: how should the IRS spend the mandatory funds? As the rationale for such a large investment in the IRS suggests, there are several possible urgent uses. A key challenge facing IRS senior managers is how to distribute the funds among those uses. Perhaps the most important decision is how to apportion the money among taxpayer service improvements, information technology implementation, and enforcement enhancements. Secretary Yellen's directive suggests that she assigns a higher priority to using the mandatory funds to improve IRS's taxpayer services and information systems than to greatly increasing enforcement. Some proponents of the mandatory funding disagree because they think that shrinking the federal tax gap should be the IRS's top priority.

The IRS can invest substantial amounts of money at the same time in taxpayer assistance, technology improvement, and enforcement. Senator Ron Wyden articulated such a view in a letter dated October 4, 2022, to Secretary Yellen and then-IRS Commissioner Charles Rettig. Senator Wyden stated that he expected the money to be invested in (1) allowing the IRS to process returns and letters of correspondence and respond to taxpayer phone calls for assistance with no long delays; (2) upgrading its information technology to complete audits faster and better detect tax evasion; and (3) increasing the IRS's resources for auditing the returns of high-income individuals and partnerships at higher rates than the audit rate for claimants of the earned income tax credit; cracking down on offshore tax evasion; reducing the federal tax gap; and rebuilding the investigative capacity of IRS's Criminal Investigation Division, whose workforce declined by about 25% from FY2010 to FY2021.

Not all lawmakers support the mandatory funding provided by the IRA. Critics have expressed concern about what they see as the implications of the substantial boost in enforcement spending specified in the act. In their view, the increase could enable the IRS to hire tens of thousands of examination and collection agents who would be tasked with collecting unpaid taxes owed by middle-income taxpayers, including a large number of small business owners, using strong-armed tactics if necessary. Critics contend that such actions would be done without a mechanism in place that subjects them to adequate accountability and transparency. Both Secretary Yellen and the IRS Commissioner have publicly pledged not to use the mandatory funding to increase the audit rate for taxpayers with less than $400,000 in income, as of IRA's date of enactment.

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