BRADFORD TAX INSTITUTE

December 2022

$80 Billion to the IRS: What It Means for You

For the business owner and tax practitioner, the most important part of the Inflation Reduction Act of 2022 was not the tax credit for flashy new electric cars.

It was something much more basic: a long-term budget commitment to help the struggling, failing IRS.

The Inflation Reduction Act invests an additional $80 billion in the IRS over the next 10 years. This is the biggest budget increase the IRS has ever received. To put this in perspective, it is almost six times the IRS's annual $13.8 billion budget.

Some politicians have raised the specter of 87,000 new gun-toting revenue agents scouring the land, looking for tax evaders. This is patently ridiculous.

But the new funding will impact all taxpayers. The average taxpayer should benefit because the IRS will be able to upgrade its operations and improve its woeful levels of service.

On the other hand, the well-above-average taxpayer should look out: the bulked-up IRS will be gunning for you.

How Will the IRS Use the Additional Money?

The new IRS funding will be appropriated as follows:[1]

- $3,181,500,000 for taxpayer services
- $45,637,400,000 for enforcement
- $25,326,400,000 for operations support
- $4,750,700,000 for business systems modernization

The appropriated funds will remain available until September 30, 2031.

This is a mandatory appropriation. This means that Congress can't reduce the appropriation without passing a new law to do so.

There are no limits on how much the IRS can spend in any given year. The Biden administration plans to have the IRS phase in the new spending by implementing no more than $1.5 billion the first year and gradually building up to $15 billion by year 10.[2] The IRS is going to issue a detailed spending plan within six months.

Note that $35 billion of the new money is not for enforcement. Among other things, the IRS plans to use these funds to update its antiquated IT systems (some of which date back to the 1960s), improve phone service, and speed up the processing of paper tax returns.

Taxpayers should see improvements in IRS services relatively soon. Over the next six months the IRS plans to hire 5,000 additional phone representatives, fully staff every IRS Tax Assistance Center, and improve the processing of paper returns by implementing scanning technology.

How Much Will the IRS Grow?

The IRS budget fell by 18.5 percent over the past decade, leading to a 20 percent decline in the agency's workforce. As of 2021, the IRS had only 78,661 employees. By comparison, it had 90,290 employees in 2012 and 116,673 in 1992. Staff losses have been most significant for revenue officers, who collect taxes (a 50 percent decline to 8,200), and revenue agents, who audit complex returns (a 35 percent decline).

Today, the IRS has fewer auditors than at any time since World War II.[3]

The IRS will be adding new employees, but not anywhere close to the 87,000 number bandied about in the media. Much of the new hiring will just offset attrition. The IRS has an aged workforce and expects a whopping 35,000 employees to retire in the next six years, along with another 17,000 who'll leave before retirement. That's 52,000 employees who'll need to be replaced.[4]

Thus, the IRS needs to hire 8,600 new employees per year just to stay even over the next six years. If all goes well, at the end of 10 years the IRS may grow by 20,000 to 30,000 employees, but it will still be smaller than it was in 1992. But the number of revenue agents could increase to 17,000 by 2031—over twice as many as today.

Will Audits Increase?

In a word: yes. Treasury Secretary Yellen has promised that IRS audit rates will remain at "historical levels" for taxpayers earning less than $400,000 per year.[5] "Historical levels" is an ambiguous term. Does it encompass the audit levels of the past decade or so?

In 2010, audit rates were at 1 percent compared with the current historic lows of about 0.25 percent. Thus, audits for those earning less than $400,000 could increase fourfold, albeit from a very low level.

In any event, audit rates will definitely rise for taxpayers earning more than $400,000 per year. This may take some time. The investment in the IRS is expected to raise some $124 billion over the next 10 years.

Planning for the Restored IRS of the Future

If you earn $400,000 or more, your chances of being audited over the next five or 10 years will likely go up, perhaps substantially.

You should keep complete and accurate records and file timely and complete tax returns. (Of course, this is something you should do anyway.)

Here are a few special areas of concern.

Cryptocurrency

The first page of the draft Form 1040 for 2022 asks the following revised cryptocurrency question: “At any time during 2022, did you (a) receive (as a reward, award, or compensation); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?”

When the IRS places a question about an asset on the first page of Form 1040, you know it’s a high-priority item. You can expect increased IRS audits dealing with cryptocurrency transactions.

If you’re one of the millions of Americans who engage in such transactions, it’s important to keep good records and report any income you earn. For detailed guidance, see IRS Focuses on Cryptocurrency: Are You Ready?

S Corporation Compensation

If you’re an S corporation shareholder-employee, you’re likely saving on employment taxes by characterizing part of your compensation as a corporate cash distribution rather than employee wages or bonus. The smaller your salary, the more Social Security and Medicare tax you save.

You’re supposed to pay yourself a reasonable employee salary. If the IRS concludes part of your distribution is really a disguised salary payment, it can recharacterize it as salary and retroactively impose employment taxes, penalties, and interest.

For over 20 years, the IRS has been officially concerned with S corporations paying their shareholder-employees unreasonably low salaries. In the past, it threatened to increase audits of S corporations. But, doubtless due to budget constraints, it never really happened. In 2018, the audit rates for S corporations were a minuscule 0.65

percent.

This time it could be different. If the beefed-up IRS starts looking for low-hanging audit fruit to pick, S corporation salaries would be a likely choice.

You should have your S corporation pay you an arguably reasonable salary and benefits, and document how you arrived at the amount. For guidance, see Avoid Trouble: Don't Let the IRS Set Your S Corporation Salary.

Syndicated Conservation Easements

One hot-button item for the IRS right now is syndicated conservation easements. Even in its currently reduced state, the IRS has been fighting them tooth and nail. They are listed as one of the IRS's dirty dozen tax scams for 2022.[6]

These are real estate partnerships that acquire land and donate the development rights to a qualified organization. The investors in the partnerships then obtain a charitable deduction for the value of the easement. The promoters of some of these deals have used wildly inflated appraisals to increase their tax benefits.

Some investors have claimed charitable deductions four times the amount of their investment. The IRS says that it examines 100 percent of these deals and plans to continue doing so for the foreseeable future.

Note that there are other ways to benefit from a conservation easement. For example, you could donate, to a qualified organization, development rights to a parcel of land that you own. For guidance, see Use a Conservation Easement Donation to Create a $63,000 199A Deduction.

Offshore Accounts

U.S. citizens and residents are taxable on their worldwide income and are required to report foreign bank accounts to the U.S. Treasury. Concealing assets in offshore accounts is another item on the IRS's list of dirty dozen tax scams.

If you have more than $10,000 in one or more offshore accounts, you must file a Report of Foreign Bank and Financial Account (FBAR) each year. Failure to do so can result in substantial penalties: $100,000 or 50 percent of the total balance of the account per violation.

In recent years, the IRS has gone after both banks and bank account holders who hide assets in offshore accounts. In future years, we can expect the IRS to place even greater emphasis on identifying and tracking such offshore assets.

For guidance, see Does Your Foreign Bank Account Smell Like Offshore Tax Evasion to the IRS?

Business Partnerships

Partnerships and multi-member LLCs taxed as partnerships (which describes most of them) can expect increased scrutiny from the IRS in the future.

Currently, partnerships are hardly ever audited. The partnership audit rate has been about 0.4 percent to 0.5 percent for many years.

The IRS's latest five-year strategic plan calls for an increased focus on business partnerships that make up a disproportionate share of unpaid taxes.

The IRS began this process in late 2021 when it launched the Large Partnership Compliance (LPC) program, using data analytics to select 2019-tax-year large partnership returns for audit. You can expect the IRS to devote more resources to this program in the future.

Takeaways

The Inflation Reduction Act gives the IRS an additional $80 billion to spend over the next 10 years. Some $35 billion will be used to upgrade IRS operations, and $45 billion is earmarked for enforcement.

The IRS may grow by 20,000 to 30,000 employees by 2032, and the number of revenue officers who collect unpaid taxes could more than double.

The IRS promises that audits of taxpayers earning less than $400,000 per year will remain at historical levels. But this could mean they increase by as much 400 percent over their current low levels.

Taxpayers who earn more than $400,000 will be in the IRS's crosshairs in future years. Areas it is likely to focus on include cryptocurrency, S corporation compensation, offshore accounts, syndicated conservation easements, and business partnerships.

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1 Pub. L. No. 117-169 (08/16/2022).
2 U.S. Department of the Treasury, "The American Families Plan Tax Compliance Agenda," p. 16 (2021).
3 Ibid., p. 11.
4 IRS Commissioner Rettig written testimony before the House Ways and Means oversight subcommittee (Mar. 17, 2020), p. 3.
5 Remarks by Secretary of the Treasury Janet L. Yellen (Sept. 15, 2022).
6 IR-2022-125.