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# Cuts in IRS Budget Have Compromised Taxpayer Service and Weakened Enforcement

By Chuck Marr and Joel Friedman[1]

House and Senate appropriators have begun considering the Internal Revenue Service (IRS) budget, which is part of the Financial Services and General Government appropriations bill. While much attention will likely focus on certain policy issues, such as the IRS's examination of tax-exempt organizations and its role in implementing the Affordable Care Act, policymakers should not ignore the damaging effects of the significant cuts that have occurred in IRS funding, which remains well below its 2010 level even before adjusting for inflation. The cuts have led the IRS to reduce its workforce, severely scale back employee training, and delay much-needed upgrades to information technology systems. These steps, in turn, have weakened the IRS's ability to enforce the nation's tax laws and serve taxpayers efficiently, as the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration, the Internal Revenue Service Oversight Board, and the Government Accountability Office all have documented.

For 2015, the President's budget would halt the downward trend in IRS funding, proposing an increase of $1.2 billion compared to 2014 and returning the agency to roughly its 2010 funding level in nominal (non-inflation-adjusted) terms, though funding would remain 7 percent below the 2010 level after adjusting for inflation. The House appropriations subcommittee bill, however, moves in the opposite direction, cutting IRS funding by another $340 million. The resulting budget would be 10 percent below the 2010 level in nominal terms, and more than 18 percent below when taking inflation into account. The Senate subcommittee proposal provides a modest increase, adding roughly $240 million in nominal terms compared to 2014, barely enough to keep up with inflation.

The IRS plays a crucial role in our system of government — helping taxpayers comply with the tax code and ensuring that the nation's tax laws are enforced fairly and credibly — and policymakers should give it the funds needed to do those jobs effectively. And from a fiscal perspective, starving the IRS makes no sense, as the return on the investment is high. Each additional $1 spent on IRS enforcement yields $6 of additional revenue from collecting taxes owed under current law, according to the Treasury Department. Cuts in IRS enforcement funding are increasing the budget deficit.

In many ways, the IRS exemplifies the problems caused by the low overall funding levels for non-defense discretionary programs resulting from the tight funding caps and sequestration cuts

[1] Nathaniel Frentz provided valuable research assistance.

mandated by the 2011 Budget Control Act (BCA). A range of vital federal services has suffered as funding has declined. The IRS faces cost pressures common to most programs, such as a growing workload and the effects of inflation. But it also faces unique demands, such as the growing problem of identity theft and the tax compliance issues associated with offshore accounts. Demands will only grow in coming years, as the IRS implements the Affordable Care Act and the Foreign Account Tax Compliance Act, which is designed to avert illegal tax evasion that occurs through the use of offshore accounts.

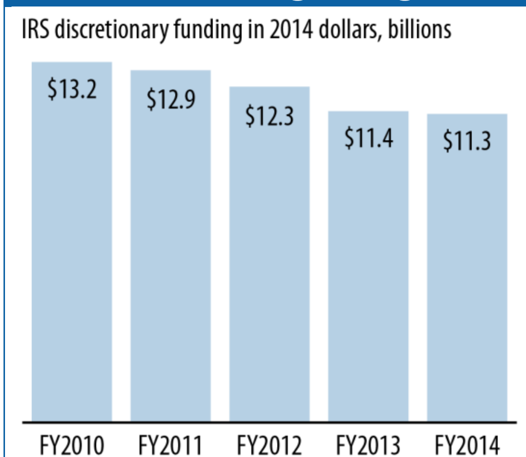
For fiscal year 2015, policymakers must cut total non-defense discretionary funding below the current year's level in order to stay within the BCA cap for this category of the budget.[2] By fiscal year 2016, spending on non-defense discretionary programs will fall to its lowest level as share of the economy (gross domestic product or GDP) on record, with data going back to 1962. It will continue to fall further as a share of GDP in years after that. Within this constrained funding environment, policymakers have few good choices — increases for one important program typically require cuts in another. Policymakers should reach a budget agreement that provides more adequate overall discretionary funding levels starting no later than fiscal year 2016, much as they did last December for fiscal years 2014 and 2015, to avoid undesirable cuts in key services on which many Americans depend and allow important investments in the nation's future.

## IRS Funding Has Fallen Sharply Since 2010

Like many discretionary programs (those funded through annual appropriations), the IRS has faced significant budget cuts since 2010. The 2011 Budget Control Act capped annual discretionary funding for 2012-2021, and sequestration imposed additional reductions starting in 2013. The Bipartisan Budget Act of 2013, negotiated by Senate Budget Committee Chair Patty Murray and House Budget Committee Chair Paul Ryan, restored some but not all of the sequestration cuts for 2014 and 2015. The full sequestration cuts remain in place in 2016 and subsequent years.

Figure 1

**IRS Funding Falling**




Sources: CBPP calculation of Congressional Budget Office, Office of Management and Budget, and Bureau of Labor Statistics data

The IRS's $11.3 billion budget for 2014 is $840 million, or 7 percent, below the level appropriated in 2010 — the last year before Congress began cutting discretionary programs. When the effects of inflation are taken into account, 2014 funding is 14 percent below the 2010 level (see Figure 1).

The IRS experienced its sharpest annual decrease in funding in 2013, largely because of sequestration. While the Murray-Ryan agreement increased overall non-defense discretionary funding for 2014 by about 5 percent (in nominal terms) above the 2013 post-sequestration level, appropriators subjected the IRS to less favorable treatment, increasing the IRS budget in 2014 by only 1 percent, not enough even to keep up with inflation.

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[2] Richard Kogan and Joel Friedman, "House Appropriations Targets Represent Poor Allocation of Insufficient Resources," Center on Budget and Policy Priorities, May 21, 2014, http://www.cbpp.org/cms/?fa=view&id=4147.

These funding reductions have significantly hampered the IRS's ability to carry out its mission. Writing at the end of 2012, even before the sequestration cuts hit, National Taxpayer Advocate Nina Olson concluded that "[t]he IRS is significantly and chronically underfunded to serve America's taxpayers and collect the amount of tax due under law…. The continued underfunding of the IRS poses one of the greatest long-term risks to tax administration today."[3]

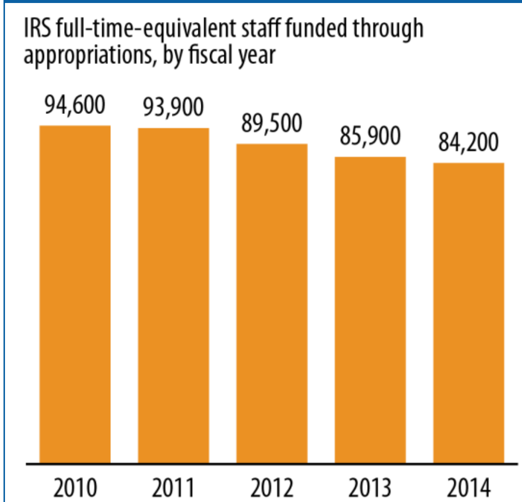
## Cuts in Workforce and Training

Three-quarters of the IRS budget goes to personnel, 86 percent of whom are directly involved in enforcing tax laws or providing taxpayer services.[4] Accordingly, in the face of low funding, the IRS has reduced its workforce substantially; the IRS has about 10,400 (11 percent) fewer employees than in 2010 (see Figure 2). Yet at the same time, the IRS's workload has moved in the opposite direction. For instance, the number of individual income tax returns has grown by an average of 1.5 million each year over the past decade.[5]

As a recent report from the IRS Oversight Board, an independent body created by Congress to provide long-term guidance to the IRS, explained:

> The workforce has decreased over the last four years due to a longstanding combination of attrition and a hiring freeze. As the result of the hiring freeze, new employees replace outgoing employees at a rate of one to five. This means a current IRS employee will see five coworkers leave, some of them the most experienced and well trained, before one new employee is eventually hired to cope with a growing workload. This puts enormous stress on new employees arriving at understaffed offices and those who remain as they shoulder the burden of the work left behind until a new employee arrives to help.[6]

Figure 2
**IRS Has Cut Staff by 11 Percent Since 2010**




Source: Government Accountability Office

The funding cuts have also deeply affected the training of the remaining IRS employees; the IRS's training budget was slashed by 87 percent in

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3 National Taxpayer Advocate, "2012 Annual Report to Congress," Volume 1, Taxpayer Advocate Service, December 31, 2012, http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Volume-1.pdf, p. 34. The National Taxpayer Advocate heads the Taxpayer Advocate Service, an independent organization within the IRS that helps taxpayers resolve problems with the IRS.

4 Based on data in the Appendix, Budget of the United States Government, Fiscal Year 2015, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/appendix.pdf.

5 Based on data presented by the National Taxpayer Advocate in "2013 Annual Report to Congress," Volume 1, Taxpayer Advocate Service, December 31, 2013, http://www.taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Volume-1.pdf, p. 23.

6 IRS Oversight Board, "FY2015 IRS Budget Recommendation Special Report," May 2014, http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf, p. 15.

nominal terms between 2010 and 2013, the most recent year available.[7] The training budget for the IRS Large Business and International Division has seen some of the most dramatic cuts despite the growth in overseas business activity by U.S. residents and businesses, the complexity of many tax issues associated with this activity, and a significant incidence of tax avoidance by U.S. firms that operate overseas.[8]

As the National Taxpayer Advocate has concluded: "[f]aced with a declining budget, the IRS training and education programs have been reduced to bare minimums without consideration for the type of training employees need to perform basic job functions, protect taxpayer rights, and prevent harm and undue burden for taxpayers."[9]

## Delays in Upgrading Information Technology

The IRS needs state-of-the-art information technology (IT) to help it perform its core functions of collecting taxes and enforcing the nation's tax laws while countering sophisticated identity thieves and tax evaders and addressing taxpayers' privacy concerns. The IRS lags behind in this area. For example, some IRS computers still run on an operating system that is so outdated Microsoft no longer services it; the IRS had to spend scarce funds to set up custom support.[10]

The Government Accountability Office (GAO) recently reported that budget constraints have contributed to delays in two essential IT projects: Information Reporting and Documentation Matching, designed to match documents such as 1099-K forms with individual tax returns to help track down underreported income; and the Return Review Program, designed to replace the outmoded Electronic Fraud Detection System, the IRS's main system for detecting fraudulent returns.[11] Part of an aggressive IRS effort to prevent identity thieves from obtaining tax refunds fraudulently, the Return Review Program is designed to enable the IRS to "stay ahead of identity thieves because we will be able to act more quickly to incorporate what we learn about fraud schemes into our filters," according to IRS Commissioner John Koskinen.[12]

The Treasury Inspector General for Tax Administration (TIGTA) describes identity theft as a "rapidly growing problem"[13] that is "personally, professionally, and financially devastating" for its

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[7] National Taxpayer Advocate, "2013 Annual Report to Congress," Volume 1, p. 21.

[8] *Ibid.,* p. 42.

[9] *Ibid.,* p. 41.

[10] IRS Oversight Board, p. 15.

[11] Government Accountability Office, Letter to the Honorable Ron Wyden, the Honorable Tom Udall, and the Honorable Charles W. Boustany, Jr., "Absorbing Budget Cuts Has Resulted in Significant Staffing Declines and Uneven Performance," April 21, 2014, http://www.gao.gov/products/GAO-14-534R, p. 24.

[12] Testimony of the Honorable John A. Koskinen, Commissioner of the Internal Revenue Service, hearing before the House Ways and Means Committee, February 5, 2014, p. 14.

[13] Testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration, hearing before the Senate Committee on Appropriations Subcommittee on Financial Services and General Government, April 30, 2014, http://www.treasury.gov/tigta/congress/congress_04302014.pdf, p. 10.

victims.[14] The IRS identified 339,000 cases of identity theft in 2010,[15] and that figure has grown to more than 2.9 million cases in 2013.[16]

The IRS has made addressing identity theft a priority. As the National Taxpayer Advocate explained in her 2013 annual report to Congress, "In FY 2013, the IRS assigned more than 3,000 employees to work on identity theft cases. Because of the harm identity theft victims suffer, that was the right call to make. But for an overworked agency absorbing budget cuts, the reassignment of so many employees has meant other work in crucial taxpayer service and enforcement areas could not be done."[17] The report also notes that despite the IRS's efforts, an integrated case management system is urgently needed to resolve issues for victims in a timely way. Unfortunately, budget constraints have hindered progress in this area; as the National Taxpayer Advocate has reported, "[b]udget cuts mean that victims of identity theft will have to wait longer than six months to get resolution of their cases and receive their refunds."[18]

## Taxpayer Services Have Worsened

While the National Taxpayer Advocate maintains that "[t]he government has a practical and a moral obligation to make compliance as simple and painless as possible," she finds that cuts in IRS funding have "increased the compliance burden for tens of millions of taxpayers seeking assistance from the IRS."[19] TIGTA has sounded a similar warning, telling Congress earlier this year:

> Although the IRS has implemented certain procedures to better assist the American taxpayer, funding reductions pose a significant challenge. . . . These continuing budget constraints make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide.[20]

For example, despite the rise of electronic filing, millions of taxpayers still communicate with the IRS by telephone and mail. But in 2013, the last full year for which data are available, a typical caller waited about 18 minutes for an IRS representative to get on the line, and about 40 percent of calls were *never* answered. This represents a sharp decline from 2010, when the IRS answered three-quarters of calls and had an average wait time of just under 11 minutes.[21]

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[14] *Ibid.,* p. 14.

[15] Treasury Inspector General for Tax Administration, "There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft," July 19, 2012, http://www.treasury.gov/tigta/auditreports/2012reports/201242080fr.pdf.

[16] George, p. 10.

[17] National Taxpayer Advocate, "2013 Annual Report to Congress," Volume 1, p. 25.

[18] National Taxpayer Advocate, "2012 Annual Report to Congress," Volume 1, p. vii.

[19] National Taxpayer Advocate, "2013 Annual Report to Congress," Volume 1, p. 21.

[20] Testimony of the Honorable J. Russell George, Treasury Inspector General for Tax Administration, hearing before the House Committee on Appropriations Subcommittee on Financial Services and General Government, February 26, 2014, http://www.treasury.gov/tigta/congress/congress_02262014.pdf.

[21] Government Accountability Office, p. 13.

Similarly, the IRS conducts important business with taxpayers through the mail, including individual examinations and clarifications on how much tax a filer owes. Cuts in IRS funding have severely restricted its ability to respond in a timely manner. Even while incoming mail has declined (by roughly 25 percent between 2010 and 2013), the share of mail that the IRS fails to respond to within 45 days has nearly doubled, from 28 percent at the end of 2010 to 53 percent at the end of 2013.[22]

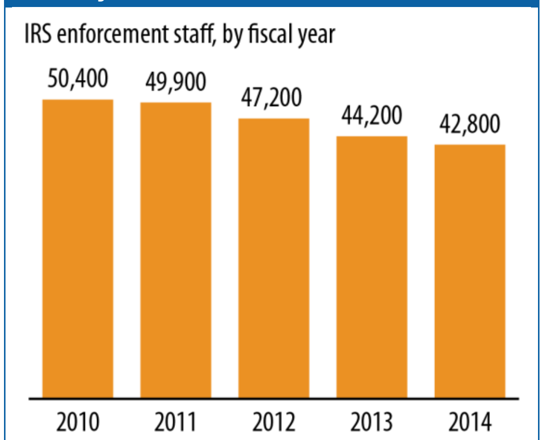
## Enforcement Is Weaker

The number of IRS staff devoted to enforcing tax laws has dropped by 15 percent since 2010.[23] (See Figure 3.) As a result, the IRS is conducting fewer audits overall and fewer audits of high-income taxpayers and businesses. The annual audit rate for individual taxpayers is now below 1 percent, the lowest since 2006, and revenue collected through IRS enforcement actions has fallen by more than $4 billion over the past four years. [24]

As TIGTA put it, "The IRS is facing many new challenges while operating with fewer resources and employees. Several indicators showed the effect of this, including a decrease in enforcement revenue."[25] The IRS Oversight Board warns that the lagged effects of recent underfunding will likely shrink revenues from enforcement further in the next few years, even if no additional IRS funding cuts take place.

Meanwhile, the scope and complexity of the global financial system — and thus the need for robust IRS enforcement — continue to expand. Estimates suggest that the international tax gap (that is, the amount of unpaid U.S. taxes each year on cross-border transactions) is between $40 billion and $133 billion.[26]

Figure 3
IRS Has Cut Enforcement Staff by 15 Percent Since 2010



Source: Government Accountability Office

Weakening IRS enforcement ultimately hurts the entire budget. Indeed, a dollar spent on enforcement yields a significant return in terms of increasing the collection of revenue that is due under current law. The Treasury estimates that, from current levels, every additional dollar invested in IRS tax enforcement activities yields $6 in increased

[22] IRS Oversight Board, p. 13.

[23] GAO, p. 26.

[24] Koskinen, p. 6.

[25] Treasury Inspector General for Tax Administration, press release, September 17, 2013, http://www.treasury.gov/tigta/press/press_tigta-2013-32.htm.

[26] George, Senate testimony, p. 24.

revenue.[27] Every $1 invested in the broader IRS budget (rather than just enforcement) produces $4 in revenue.[28]

Enforcement has suffered in part because Congress failed to include in the Budget Control Act (BCA) a special cap adjustment for funding IRS enforcement. In the past, Congress has enacted adjustments in the discretionary funding caps that allow specified amounts of additional funding to be provided — without counting against the caps — for certain federal activities that have been shown to save more than they cost by reducing overpayments and fraud in various government programs and noncompliance with the tax laws. In crafting the discretionary funding that the BCA set, Congress did provide "program integrity" cap adjustments that enable lawmakers to provide funds above the BCA caps for Continuing Disability Reviews in Social Security Disability Insurance (SSDI) and Supplemental Security Income (SSI), financial redeterminations in SSI, and activities to combat Medicare and Medicaid fraud and overpayments.[29] But Congress refused the Administration's request to provide a comparable adjustment for IRS enforcement, despite a "tax gap" estimated at over $385 billion a year[30] and evidence that various IRS enforcement efforts save many times what they cost.

When statutory caps limiting discretionary programs were first established in 1990, Congress provided a cap adjustment for five years for an IRS "compliance initiative" to improve the training of staff responsible for collecting delinquent taxes and staff who examine and audit tax returns. The discretionary funding caps set in the 1990s eventually expired, but when President George W. Bush requested their reinstatement in 2005 and subsequent years, he specifically called for creating a cap adjustment for IRS tax enforcement.

In its version of the BCA in 2011, the Senate included such an adjustment to bolster IRS tax compliance and enforcement efforts; the provision would have saved $30 billion over the decade, according to the Congressional Budget Office and Joint Committee on Taxation.[31] But the House rejected the provision and refused to allow its inclusion in the BCA, limiting cap adjustments to overpayments in spending programs while ignoring tax fraud and noncompliance. President Obama's budgets since the BCA's enactment have proposed to re-establish cap adjustments for IRS enforcement.

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27 "The Budget of the United States Government, Fiscal Year 2015, The Department of the Treasury," http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/treasury.pdf, p. 126.

28 Written testimony of John A. Koskinen, Commissioner of the Internal Revenue Service, before the Senate Appropriations Committee Subcommittee on Financial Services and General Government, April 30, 2014, http://www.appropriations.senate.gov/sites/default/files/hearings/IRS%20Koskinen%20Statement.pdf, p. 11.

29 While Congress has funded program integrity activities for Social Security and SSI, it has yet to fund them for Medicare.

30 The tax gap is the difference between what is owed in federal taxes and what is paid each year. The most recent estimate is that $385 billion was owed for tax year 2006, but never paid. See: Internal Revenue Service, "Tax Gap for Tax Year 2006, Overview," January 6, 2012, http://www.irs.ustreas.gov/pub/newsroom/overview_tax_gap_2006.pdf.

31 Douglas W. Elmendorf, Director, Congressional Budget Office, Letter to the Honorable Harry Reid, "Analysis of the Impact on the Deficit of the Budget Control Act of 2011 as Revised in the Senate," July 29, 2011, http://www.cbo.gov/publication/41624.

## IRS Responsibilities Growing

Restoring IRS funding to a more adequate level is important to enable the agency both to reverse the decline in taxpayer service outlined above and to handle its new and expanding responsibilities that range from combating identity theft to its responsibilities under the Affordable Care Act. TIGTA notes that health reform "contains an extensive array of tax law changes that, absent added funding, will present budgetary challenges for the IRS in coming years."[32] Most important, the IRS is charged with administering the premium tax credits — the subsidies that millions of near-poor and middle-income taxpayers are receiving to help them afford coverage in the health insurance marketplaces — as well assistance with health insurance deductibles and co-payments for taxpayers with modest incomes.

Another major new set of responsibilities for the IRS concerns the Foreign Account Tax Compliance Act (FATCA). Enacted in 2010, FATCA seeks to reduce illegal tax evasion by requiring filers and financial institutions to report more information to the IRS about assets held in offshore accounts. More than 77,000 financial institutions in 70 countries have already registered under FATCA.[33] The IRS needs added personnel and IT resources to collect and analyze the large amounts of information that FATCA will generate and to conduct enforcement activities where warranted.[34]

## More Adequate Funding Needed

Funding is an increasingly serious problem for the IRS, although not the agency's only challenge; many analysts believe that the IRS needs to more effectively manage its operations. But funding is a key constraint and cannot be ignored as a crucial factor in diminishing the IRS's effectiveness.

The President's budget would begin to address these challenges by reversing the several-year decline in IRS funding. Its proposed $12.5 billion funding level for 2015 is a 10.5 percent increase over the current level.[35] This would restore the funding lost since 2010 in nominal — though not inflation-adjusted — dollars. The increase includes $480 million for enforcement that would be provided through a "program integrity" adjustment (and thus would not count against the BCA caps). The majority of the proposed increase is directed to operations support, which includes IT improvements, which are crucial to improving both taxpayer service and tax enforcement. The additional funds would also bolster depleted personnel levels, increasing them by 8 percent and restoring about two-thirds of the staff reductions since 2010.

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[32] Testimony of Alan R. Duncan, Assistant Inspector General for Audit, Treasury Inspector General for Tax Administration, joint hearing before the Committee on Oversight and Government Reform, Subcommittee on Energy Policy, Health Care And Entitlements and the Committee on Homeland Security, Subcommittee on Cybersecurity, Infrastructure Protection, and Security Technologies, U.S. House of Representatives, July 17, 2013, p. 1.

[33] Robert W. Wood, "IRS Nets Offshore Data From 77,000 Banks, 70 Countries In FATCA Push," *Forbes,* June 3, 2014, http://www.forbes.com/sites/robertwood/2014/06/03/irs-nets-offshore-data-from-77000-banks-70-countries-in-fatca-push/.

[34] Internal Revenue Service fiscal year 2015 budget request, http://www.treasury.gov/about/budget-performance/CJ15/10.%20-%2015.%20IRS%20CJ.pdf.

[35] This amount is the Administration's request that is consistent with the discretionary caps for 2015 and 2016 and does not include the additional $165 million request for taxpayer services that is part of the "Opportunity, Growth, and Security Initiative."

In sharp contrast, the House appropriations subcommittee bill would cut IRS funding by $340 million below the 2014 level in nominal terms, worsening the IRS's funding squeeze. This would take the IRS budget, which rose by 1 percent in 2014 in nominal terms, back *below its 2013 post-sequestration level*. The Senate subcommittee bill avoids this nominal cut and adds $240 million in 2015 compared to 2014. Still, both bills would leave the IRS with a funding level far below its 2010 level and below the 2012 level, before the sequestration cuts.

Collecting taxes is one of government's most essential functions, yet budget cuts in recent years have made it harder for the IRS to enforce tax laws, and the ACA and FATCA have added to the agency's responsibilities. Policymakers should give the IRS sufficient resources to carry out its mission. In particular, policymakers who profess to be concerned or even alarmed about the nation's current or future fiscal course should provide the IRS with the funding it needs to administer the nation's tax laws and collect taxes due under the laws of the land.