



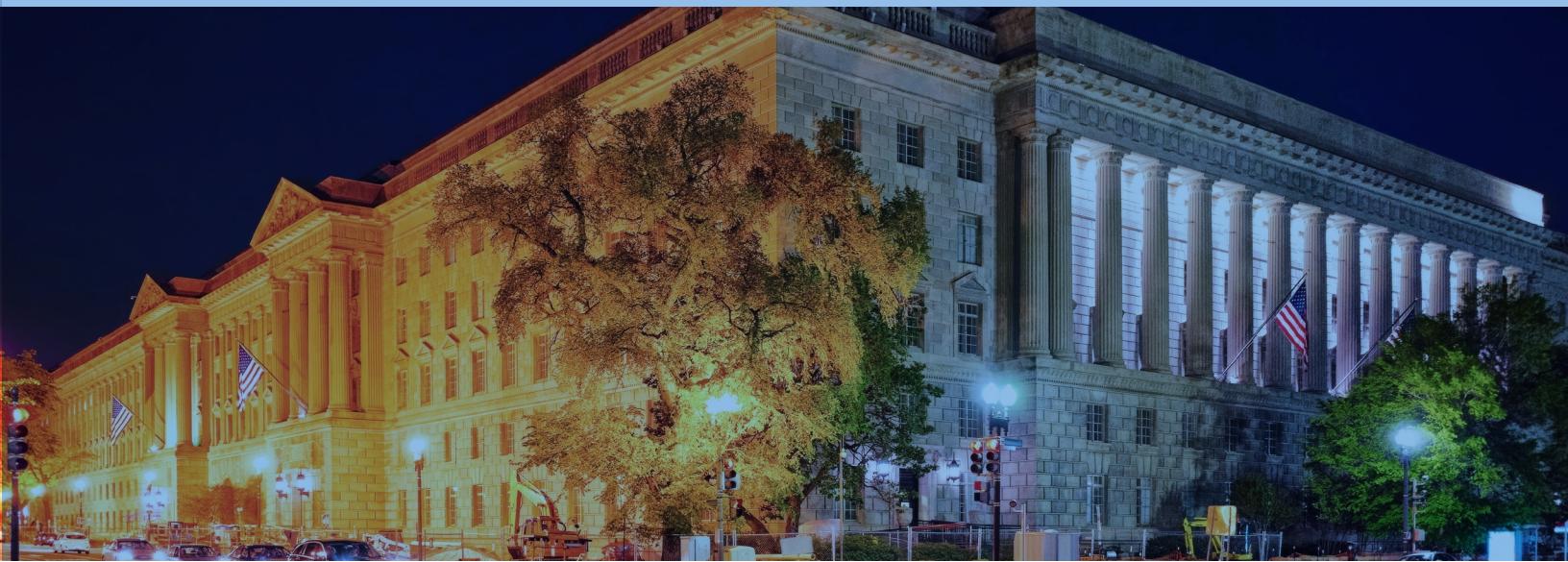
INTERNAL REVENUE SERVICE: INCREASING WORKLOAD UNDER STRAINED BUDGETS

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INTERNAL REVENUE SERVICE:

INCREASING WORKLOAD UNDER STRAINED BUDGETS

KEY TAKEAWAYS:

Internal Revenue Service (IRS) has faced an increased workload with funding that has changed very little over the years. According to some estimates, its budget has fallen by 20 percent in inflation adjusted dollars since 2010, resulting in the elimination of 22 percent of its staff. Covid-19 and the additional workload that came with three stimulus packages have highlighted the IRS's struggles in a number of areas:

- *Revenue Collection, Enforcement and the Tax Gap:* In line with budget cuts, the chances of being audited has decreased, increasing the tax gap (the difference between the tax liability for a given tax year and the amount that is paid) and reducing revenues the agency collects.
- *Taxpayer Services:* The services provided by the IRS, such as answering calls and emails, and other means of taxpayer interaction have been declining. These services are especially important to help taxpayers to navigate the complex tax code and catch mistakes before returns are submitted.
- *Operations Support and Business Systems Modernization:* The IRS's outdated information technology system has been a cause for a concern in light of increasing e-filing, wider data collection and security gaps that make the whole system susceptible to cyberattacks.

In addition to these problems Covid-19 has introduced new issues, such as millions of taxpayers experiencing delays in receiving (or not receiving at all) tax refunds and economic stimulus payments. Given these issues, this paper comes to three key results:

1. The IRS is underfunded and lacks the resources to efficiently and effectively carry out its core functions.
2. Its workload has continuously increased due to increasing populations and changing economic factors (such as new and emerging sources of income and a more global economy).
3. When tasked with significant additional and urgent tasks like the distribution of stimulus payments, the agency has had to change its priorities, in many cases resulting in taxpayer discontent.

Congress should make sure the agency has enough funds to perform its core duties effectively and think carefully before assigning additional tasks to an overworked agency without considering the ramifications for revenue collection and taxpayer service.

Internal Revenue Service: Increasing Workload under Strained Budgets

INTRODUCTION:

Covid-19 has been a big shock to many countries' overall economic systems. It has also highlighted a number of shortcomings both in the public and private sectors. One of the government agencies that has been significantly burdened by an increased workload as a direct result of the pandemic is the Internal Revenue Service (IRS). Due to the economic relief packages passed by Congress, the IRS was tasked with distributing three rounds of stimulus checks¹ in addition to their usual tax administration duties. Both in 2020 and 2021, the tax filing seasons were extended², partly due to the agency starting its filing season later than usual as a result of their new responsibilities and to give tax filers who needed to grapple with changing economic situations additional time to complete their returns.³ These herculean tasks made the prior struggles and needs of the IRS more apparent, drawing the attention of both the Administration and Congress.

In fact, the Biden Administration sees IRS as an integral part of their future plans and has proposed an increase in the IRS' funding to provide additional resources to carry out their current workload more effectively, in addition to widening their reach. Both the "American Jobs Plan" released on March 31, 2021 and the "American Family Plan," released on April 28, 2021 touch on these points. Biden's March 31 plan specifically states that the proposal will "make sure that the Internal Revenue Service has the resources it needs to effectively enforce the tax laws against corporations. This will be paired with a broader enforcement initiative to be announced in the coming weeks that will address tax evasion among corporations and high-income Americans."⁴ According to some reports,

the increased funding will be around \$80 billion over ten years.⁵

In light of all these developments, this short report looks at the ongoing resource constraint problems at the IRS, how they manifest in the current economy and their importance for and impact on the primary duty of the agency, tax collection. It also questions the impact of possible additional expansion in the IRS' duties, such as the need to administer some of the social programs envisioned by the Biden Administration (for example, monthly child benefit payments) or other possible expansions such as creating an IRS-run tax preparation program for certain portions of population.

THE IRS BUDGET AND WORKLOAD OVER THE YEARS

One way to look at how the IRS budget has evolved over the years is to look at the level of funding requested and the amount enacted.

Table 1 compiles data using various Treasury reports for the last 10 years. Up to 2018, IRS budget requests remained fairly flat, followed by a drop in 2018 and a slow increase afterwards. In the majority of years considered, the enacted amounts are less than the amount requested. In 2016, for example, the shortfall was nearly \$1.7 billion.

While **Table 1** gives us a general idea about the Agency's overall budget, **Table 2** provides more detail about how the IRS has faced an increased workload with funding that has changed very little over the years. Since 2000, gross tax collections have increased by 70%, from \$2 trillion to \$3.6 trillion in 2019. Over the same period, operating costs increased by just 43 percent. In other words, the cost of collecting \$100 in revenue decreased from 39 cents to 33 cents between 2000 and 2019. Table 2 also shows that, while

1 Peter G. Peterson Foundation, "What to Know About All Three Rounds of Coronavirus Stimulus Checks," March 15, 2021. <https://www.pgpf.org/blog/2021/03/what-to-know-about-all-three-rounds-of-coronavirus-stimulus-checks>

2 April 15 tax filing deadline was extended to July 15 in 2020 and May 17 in 2021.

3 CNBC, "Calls to Extend the Tax Filing Season Grow as April 15 Deadline Looms," March 16, 2021. <https://www.cnbc.com/2021/03/16/calls-to-extend-the-tax-filing-season-grow-as-april-15-deadline-looms.html>

4 The White House, "Fact Sheet: The American Jobs Plan," March 31, 2021. <https://www.whitehouse.gov/briefing-room/statements-releases/2021/03/31/fact-sheet-the-american-jobs-plan/> and "Fact Sheet: The American Families Plan," April 28, 2021. <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/>

5 The WSJ, "Biden to Seek \$80 Billion to Bolster IRS, Tax Enforcement," April 27, 2021. <https://www.wsj.com/articles/biden-to-seek-80-billion-to-bolster-irs-tax-enforcement-11619539465>

the U.S. population was increasing, the number of full-time equivalent positions in the Agency decreased (from 97,074 to 73,554). While some of this decrease can be attributed to efficiency improvements, in part due to increased automation over the years, as we will discuss in this paper the Agency is understaffed and struggles to meet the demands of its core duties.

A number of recent reports highlight the downward trend in the IRS budget. For example, the Congressional Budget Office (CBO) states that “The IRS’s appropriations have fallen by 20 percent in inflation-adjusted dollars since 2010, resulting in the elimination of 22 percent of its staff. The amount of funding and staff allocated

to enforcement activities has declined by about 30 percent since 2010.”⁶

As shown above, the IRS was strained by budget cuts even before the pandemic. However, during Covid-19, the agency’s workload expanded beyond its usual tax collection activities into distributing three rounds of stimulus checks. As discussed in a recent Washington Post article, with its current budget and staff the Agency has been left “with a significant backlog from the 2019 tax-filing season, plus snags in earlier rounds of stimulus payments. Personnel shortages caused by the pandemic have also caused a major slowdown in agency operations, forcing officials to platoon staff at IRS campuses to open mail and process a backlog of paper returns.”⁷

Table I. Internal Revenue Service Budget Requests and Enacted Amounts, Fiscal Years 2010-2021

Fiscal Year	Budget Request	Enacted Amount	Difference (Request-Enacted)
2021	12,038,503,000		
2020	11,472,389,000	11,510,054,000	(37,665,000)
2019	11,135,000,000	11,187,554,000	(52,554,000)
2018	10,975,000,000	11,430,554,000	(455,554,000)
2017	12,280,095,000	11,235,000,000	1,045,095,000
2016	12,931,071,000	11,235,000,000	1,696,071,000
2015	12,476,527,000	10,945,000,000	1,531,527,000
2014	12,861,033,000	11,290,612,000	1,570,421,000
2013	12,761,213,000	11,887,741,000	873,472,000
2012	13,283,907,000	11,816,696,000	1,467,211,000
2011	12,633,270,000	12,121,830,000	511,440,000
2010	12,126,000,000	12,146,123,000	(20,123,000)

Source: U.S. Department of the Treasury, *Budget in Brief*, Various Years.

Notes:

- (1) Budget request amounts are from year in which request was made.
- (2) Enacted amount as reported in the year following the year in which the request was made. In fiscal years for which no budget was enacted, this amount represents annualized amount under Continuing Resolution.

⁶ CBO, “Trends in the Internal Revenue Service’s Funding and Enforcement,” July 2020. Pg.1 <https://www.cbo.gov/system/files/2020-07/56422-CBO-IRS-enforcement.pdf>

⁷ Washington Post, “Biden Wants the IRS to Drive his Recovery Plan. It can Barely Function as is” February 12, 2021.

Table 2. Collections, Costs, Personnel, and U.S. Population, Fiscal Years 2000–2019

Fiscal year	“Gross collections (thousands of dollars) [1]”	“Operating costs (thousands of dollars) [2]”	“Cost of collecting \$100 (dollars)”	“U.S. population (thousands) [3]”	“Average tax per capita (dollars) [4]”	“Full-time equivalent positions realized [5]”
	(1)	(2)	(3)	(4)	(5)	(6)
2000	2,096,916,925	8,258,423	0.39	283,201	7,404	97,074
2001	2,128,831,182	8,771,510	0.41	286,098	7,441	97,707
2002	2,016,627,269	9,063,471	0.45	288,870	6,981	99,181
2003	1,952,929,045	9,401,407	0.48	291,574	6,698	98,819
2004	2,018,502,103	9,756,344	0.48	294,230	6,860	97,597
2005	2,268,895,122	10,397,837	0.46	296,972	7,640	94,282
2006	2,518,680,230	10,605,845	0.42	299,835	8,400	91,717
2007	2,691,537,557	10,764,736	0.40	302,807	8,889	92,017
2008	2,745,035,410	11,307,223	0.41	305,554	8,984	90,647
2009	2,345,337,177	11,708,604	0.50	308,189	7,610	92,577
2010	2,345,055,978	12,353,344	0.53	[r] 310,391	[r] 7,555	94,711
2011	2,414,952,112	12,358,877	0.51	[r] 312,616	[r] 7,725	94,709
2012	2,524,320,134	12,059,409	0.48	[r] 314,806	[r] 8,019	90,280
2013	2,855,059,420	11,597,560	0.41	[r] 316,953	[r] 9,008	86,974
2014	3,064,301,358	11,591,007	0.38	[r] 319,263	[r] 9,598	84,133
2015	3,302,677,258	11,395,839	0.35	[r] 321,540	[r] 10,271	79,890
2016	3,333,449,083	11,707,422	0.35	[r] 323,784	[r] 10,295	77,924
2017	3,416,714,139	11,526,389	0.34	[r] 325,742	[r] 10,489	76,832
2018	3,465,466,627	11,746,448	0.34	[r] 327,407	[r] 10,585	73,519
2019	3,564,583,961	11,825,241	0.33	[p] 328,981	[p] 10,835	73,554

[r]—Revised.

[p]—Preliminary.

[1] Gross collections are collections before refunds are issued. They also include penalties and interest in addition to taxes. See Table 1 for the difference between gross collections and net collections. Includes gross collections for individual income tax, business income taxes, estate and trust income tax, employment taxes, estate tax, gift tax, and excise taxes. See Table 6 for gross collections data by type of tax.

[2] Operating costs exclude costs reimbursed by other Federal agencies and private entities for services performed for these external parties. Data represent total obligations against appropriated funds. Beginning with Fiscal Year 2005, includes costs for Business Systems Modernization and the Health Insurance Tax Credit Administration.

[3] U.S. population is based on resident population plus armed forces overseas as of October 1 of each year. This information is provided by the U.S. Department of Commerce, Bureau of the Census.

[4] Average tax per capita is based on gross collections (Column 1) and an estimate of U.S. population (Column 4).

[5] Full-time equivalent (FTE) is defined as the total number of regular straight-time hours worked (i.e., not including overtime or holiday hours worked) by employees divided by the number of compensable hours applicable to each fiscal year. Excludes positions funded by reimbursements from other Federal agencies and private entities for services performed for these external parties. In contrast, IRS labor force counts in Table 33 (Internal Revenue Service and Chief Counsel Labor Force, Compared to National Totals for Federal and Civilian Labor Forces, by Gender, Race/Ethnicity, Disability, and Veteran Status) represent the total number of persons, including full-time, part-time, and seasonal workers, employed during the fiscal year.

NOTE: All amounts are in current dollars.

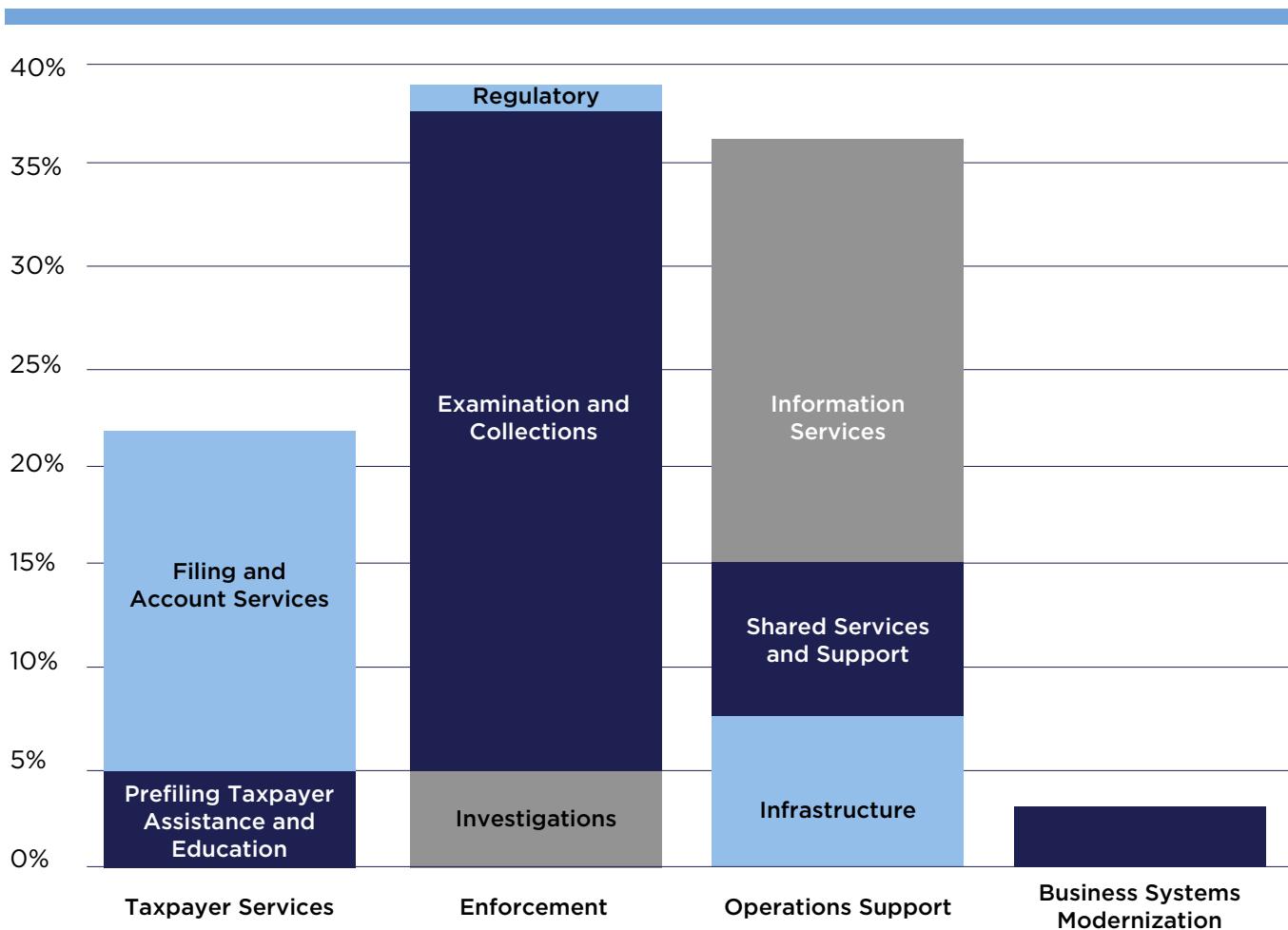
SOURCE: Chief Financial Officer, Corporate Budget and Financial Management.

WHY SHOULD WE CARE ABOUT IRS RESOURCES?

The IRS is tasked with multiple vital duties that are very important for the operation of the government. Its three main functions are tax return processing, taxpayer service, and enforcement. They have additional duties such as drafting regulations, conducting criminal investigations, and overseeing tax-exempt organization and qualified retirement plans.⁸ **Figure 1** shows how the IRS divides its budget between these compo-

nents. The majority of the IRS budget is slated for enforcement (39 percent) which includes examinations and collections, investigations and regulatory activities, followed by operations support (36 percent) which consists of information services, shared services and support, and infrastructure. Taxpayer services such as filing and account services and prefiling taxpayer assistance and education gets 22 percent of the IRS budget. The remaining budget is devoted to business systems modernization.

Figure 1. IRS Costs by Budget Activity, as a percent of Total Budget, FY 2019



Source: Internal Revenue Service, 2019 Data Book, Table 30 “Costs Incurred by Budget Activity, Fiscal Years 2018 and 2019,” June 2020

⁸ Tax Policy Center, “Briefing Book,” <https://www.taxpolicycenter.org/briefing-book/what-does-irs-do-and-how-can-it-be-improved>

As the IRS budget has been shrinking other economic factors such as increasing population, changing income sources, and a more global economy have increased the workload of the agency. All these factors combined and in the last two years clashed with the impacts of the pandemic, spelling trouble for the duties outlined above resulting in underperformance either in terms of coverage or timeline. Some of the duties that have been hit hardest are those that are most important:

- **Revenue Collection, Enforcement, and the Tax Gap:** Revenue collection and enforcement accounts for the largest share of the budget, and for a good reason. The goal of the agency is to collect the revenue due within the legislative framework provided and ensure the appropriate level of revenue is collected by minimizing under-reporting and tax evasion. However, one hundred percent compliance is difficult to achieve due to the complexity of the tax code and the information and infrastructure needed to administer the tax code and follow every taxpayer. This results in a tax gap and the ultimate goal of the agency is to decrease the gap by various methods.

The IRS periodically publishes estimates of the tax gap, along with the reasons behind it, using two related concepts to quantify the tax gap:⁹

- The **gross tax gap** is the difference between the true tax liability for a given tax year and the amount that is paid on time. It is comprised of the non-filing gap, the underreporting gap, and the underpayment (or remittance) gap.
- The **net tax gap** is the portion of the gross tax gap that will never be recovered through enforcement or other late payments.

with the individual income tax was \$314 billion and net tax gap was \$271 billion.¹⁰ When business taxes are factored in, the gross tax gap increases to \$441 billion. The individual income tax accounts for 82 percent of the total \$381 billion net tax gap (which includes the individual income tax, corporate income tax, estate tax, and employment taxes).

A closer look at the numbers reveals that the underreporting gap plays a significant role, accounting for \$245 billion (78 percent) of the \$314 billion gross tax gap on the individual side. The underpayment gap is \$38 billion (12 percent of the gross tax gap) and the non-filing gap is \$31 billion (10 percent of the gross tax gap).

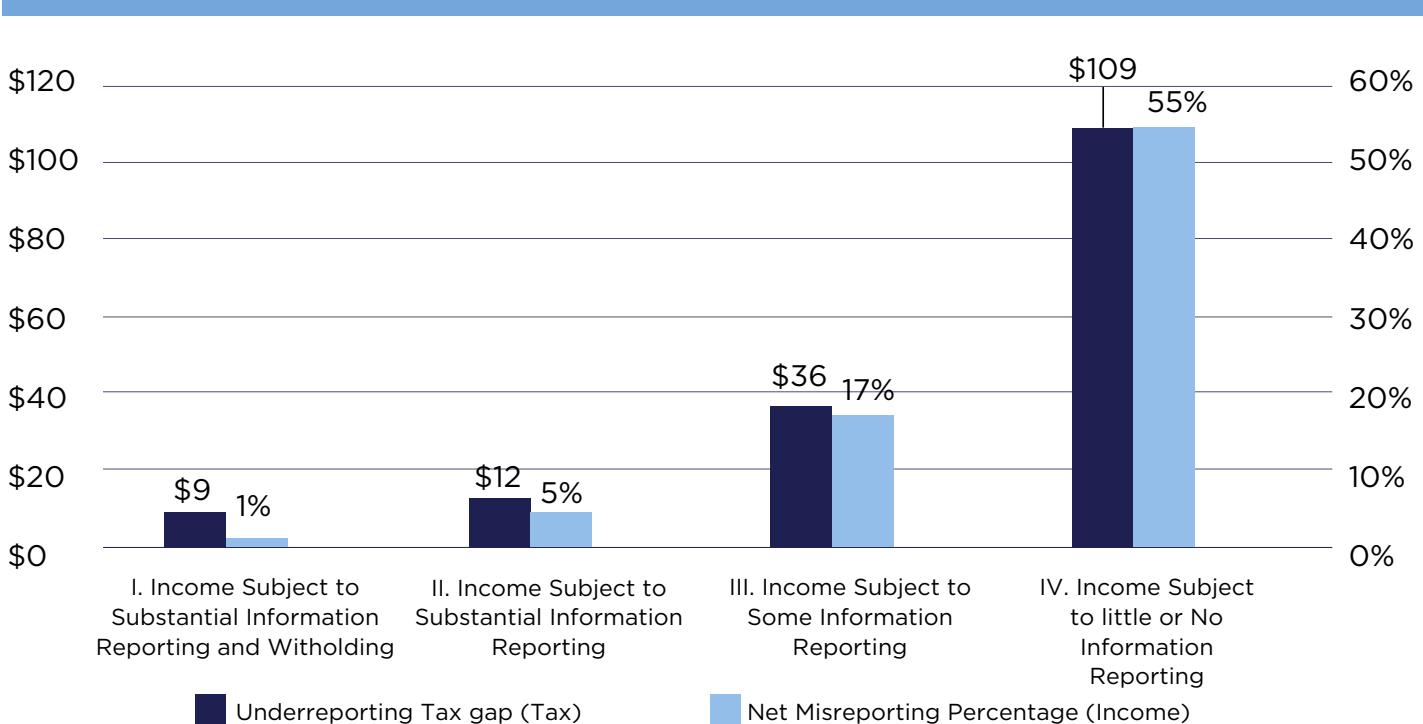
In order to close the tax gap, the underlying causes need closer examination. If the problem is underreporting, there could be an increased demand for accurate and wider third-party reporting requirements. According to **Figure 2**, tax compliance is positively impacted by third-party information reporting. When information is combined with tax withholding (as is the case for wages and salaries) compliance is the highest. The net misreporting percentage is the highest for income subject to little or no information reporting, at 55 percent with a corresponding tax gap of \$109 billion. However, increased reporting requirements can have their own costs on different groups, especially on small businesses who are already burdened by many other legislative and regulatory reporting requirements.

According to the most recent estimates, for tax years 2011-2013, the gross tax gap associated

⁹ IRS Website, Definition “Tax Gap”, Accessed January 2021. <https://www.irs.gov/statistics/irs-the-tax-gap>

¹⁰ IRS, “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013,” September 2019. <https://www.irs.gov/pub/irs-pdf/p1415.pdf>

Figure 2. Effect of Information Reporting on Individual Income Tax Reporting Compliance (Tax Year 2011-2013)



Notes: I. includes wages and salaries, II. includes pensions and annuities, unemployment compensation, dividend income, interest income, taxable social security benefits, III. includes partnership/S.corp income, capital gains, alimony income, and IV. includes nonfarm proprietor income, other income, rents and royalties, farm income, and income from Form 4797.

Source: IRS, “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013,” September 2019. <https://www.irs.gov/pub/irs-pdf/p1415.pdf>

To discourage tax evasion and noncompliance in any form, the best method is enforcement. If the taxpayer perceives the probability of being audited as high, they will be discouraged from noncompliant actions. Unfortunately, budget cuts over the years have reduced the chances of being audited. According to the CBO report, “Since 2010, the IRS has done less to enforce tax laws. Between 2010 and 2018, the share of individual income tax returns it examined fell by 46 percent, and the share of corporate income tax returns it examined fell by 37 percent. The disruptions stemming from the 2020 coronavirus pandemic will further reduce the ability of the

IRS to enforce tax laws.”¹¹ This reduction in the percentage of returns examined coincides with the decline in the IRS budget and increases in workload described above.

In a recent three-hour appearance before the Senate Finance Committee, IRS Commissioner Charles Rettig reiterated the importance of enforcement by estimating the tax gap in coming years. Partly, due to the growth of cryptocurrencies and foreign source income, the estimated tax gap may be much larger than the previously estimated \$441 billion, potentially passing \$1 trillion per year in the coming years.¹²

¹¹ CBO, July 2020.

¹² Fox Business, “IRS chief says \$1T in taxes may go uncollected each year,” April 14, 2021. <https://www.foxbusiness.com/economy/irs-chief-says-1t-in-taxes-may-go-uncollected-each-year>

Another National Bureau of Economic Research (NBER) Paper highlights the importance of the tax evasion especially at the top of the U.S. income distribution, using IRS data from random tax audits, targeted enforcement activities and operational audits.¹³ The data show that random audits underestimate tax evasion at the highest income levels, especially due to the prevalence of offshore accounts and pass-through businesses for this income group. The authors find that, as a result of tax evasion,¹⁴ “unreported income as a fraction of true income rises from 7% in the bottom 50% to more than 20% in the top 1%, of which 6 percentage points correspond to undetected sophisticated evasion.”¹⁴ If the unpaid federal income tax of the top 1 percent were to be collected, the authors estimate that an additional \$175 billion in annual tax revenue could be generated. These figures not only show the importance of an efficient and well-functioning auditing system, but also has implications for current proposals to increase taxes on higher income individuals and the effectiveness of these proposal in the presence of sophisticated evasion strategies and less-than efficient auditing methods at IRS.

The challenges the IRS is facing is apparent to both Congress and the Administration. President Biden’s budget proposal calls for an approximately 10 percent increase for the IRS. However, the Administration is also planning potential tax reforms, especially for business taxes, in addition to social policies that they want to run through the IRS. This would further increase the agency’s workload. The question than boils down to whether a 10 percent increase will be large enough to deal with past budget shortfalls and future increases in workload.¹⁵

A recent CBO estimate of the return on boosting IRS funding found that: Raising IRS funding by \$20 billion over 10 years would increase revenues by \$61 billion, decreasing the cumulative deficit by \$41 billion. If the funding increase is doubled to \$40 billion over the same time period, revenue could go up by \$103 billion.¹⁶ These estimates are uncertain and do not capture the indirect impact of increasing enforcement on taxpayer behavior. In fact, a 2021 macroeconomic analysis of the Administration’s American Families Plan by the Penn Wharton Budget Model projects that through increased funding (\$80 billion over 10 years), IRS will be able to collect an additional \$480 billion in tax revenues.¹⁷

- **Taxpayer Services:** Another important function of the IRS is the services they provide to taxpayers. According to its website, “the IRS assists taxpayers in meeting their Federal tax return filing and payment obligations through its telephone helplines, via the Internet, at IRS Taxpayer Assistance Centers, and through volunteer-provided income tax assistance.”¹⁸ This service is especially important given that the U.S. tax code is very complicated and not intuitive for the general public. Access to agents can help avoid mistakes during the tax preparation and filing process, thereby decreasing the mistakes that need to be corrected at the backend.

According to IRS data, the agency hosted a significant number of calls and queries in fiscal year 2019. For example, the IRS assisted more than 67.3 million taxpayers through correspondence, its enterprise-wide telephone helpline, or at Taxpayer Assistance Centers. But a more recent report by the National Tax Advocate indicates that

¹³ John Guyton, Patrick Langetieg, Daniel Reck, Max Risch and Gabriel Zucman, “Tax Evasion at the top of the Income Distribution: Theory and Evidence,” March 2021, NBER, https://www.nber.org/system/files/working_papers/w28542/w28542.pdf

¹⁴ Ibid, pg 51.

¹⁵ According to both the Wall Street Journal and CNN, the recent Biden proposals would provide an additional \$80 billion over 10 years for “enhanced enforcement.” <https://www.wsj.com/articles/biden-to-seek-80-billion-to-bolster-irs-tax-enforcement-11619539465> and <https://www.cnn.com/2021/04/28/politics/american-families-plan/index.html>

¹⁶ CBO, July 2020.

¹⁷ Penn Wharton Budget Model, “President Biden’s American Families Plan: Budgetary and Macroeconomic Effects,” April 28, 2021. <https://budgetmodel.wharton.upenn.edu/issues/2021/5/5/biden-american-families-plan>

¹⁸ IRS Databook, Services to Taxpayers, <https://www.irs.gov/statistics/service-to-taxpayers>

there was a decline in taxpayer service during 2020. The report states that, as a result of the challenges associated with Covid-19, combined with reduced budget and staff, “In Fiscal Year 2020, the IRS received 100.5 million telephone calls. Employees answered only 24 percent of those calls, with hold times averaging 18 minutes. Put differently, IRS employees did not answer more than 75 million telephone calls from taxpayers seeking help in complying with their tax obligations. (The IRS “answered” 23 million calls by routing them for automated responses, while 39 million taxpayers simply hung up.)”¹⁹

The National Taxpayer Advocate report also points out that decreased taxpayer interaction is not specific to the pandemic. The IRS has reduced other means for taxpayer interaction over the past decade by decreasing the in-person assistance at Taxpayer Assistance Centers and eliminating tax return preparation assistance. In fact, according to a recent report, “Over the past 10 years, the IRS budget has been reduced by roughly 20%, leaving the agency with aging technology and forcing it to cut back on staff and training, according to experts. The added stress of the coronavirus is already causing customer service headaches.”²⁰ All these changes have contributed to increased taxpayer discontent over the years.

- **Operations Support and Business Systems Modernization:** In order to take advantage of quickly evolving technology and avoid delays associated with paper filing, the IRS has been promoting e-filing. As of November 20, 2020, 91 percent of individual income taxes were e-filed, that is quite significant. However, in some ways, increased data transfers have created its own problems that need at-

tention. One issue is the secure storage of that information.

In recent years, cybersecurity has become a major concern globally at the highest levels. All types of businesses and government organizations are under daily attack by hackers targeting financial information. For example, according to a recent presentation, the percentage of small- and medium-sized businesses that experienced a cyberattack increased from 61 percent to 67 percent in 2018.²¹

The IRS is not immune to these attacks and deficiencies in its information system security controls have been highlighted by multiple Government Accountability Office (GAO) reports.²² For example, increased identity theft in the U.S. required the IRS to tighten its taxpayer authentication system to ensure that refund payments are made to legitimate taxpayers. However, a recent GAO study reports that at least \$12.2 billion of identity theft tax refund fraud was attempted in 2016 and that \$1.6 billion was actually paid out to fraudsters.²³

The IRS has been working to address the various information system security gaps that have been identified over the years and has managed to correct some of the issues. But its system is still subject to a significant and growing number of security issues that require attention. According to a 2020 GAO audit of the system, “as of September 30, 2019, IRS had completed corrective actions to address deficiencies associated with 13 of the 127 recommendations we reported in our July 2019 report. As a result, IRS has 132 open recommendations related to deficiencies in information system security controls identified during our audits, including 114 previously

¹⁹ National Taxpayer Advocate, 2020 Annual Report to Congress, “Introductory Remarks by the National Taxpayer Advocate,” January 2021, pg. vi, https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_Introduction.pdf

²⁰ Kelsey Snell, “IRS Budget Cuts, Staffing Challenges Create Coronavirus Payment Headaches,” April 2020, NPR. <https://www.npr.org/2020/04/09/830159777/irs-budget-cuts-and-staffing-challenges-create-coronavirus-payment-headaches>

²¹ Tax Forum 2019, “Data Privacy and Cybersecurity for Tax Professionals,” <https://www.irs.gov/pub/irs-utl/2019ntf-11.pdf>

²² For an extensive discussion, see Eisenach et all, pages 35-37.

²³ GAO, “Strengthening Taxpayer Authentication Efforts Could Help Protect IRS Against Fraudsters,” September 26, 2018. <https://www.gao.gov/assets/700/694737.pdf>

reported recommendations” and 18 new recommendations identified during the GAO’s fiscal year 2019 audit.”²⁴

Not only does the IRS have problems with information system security gaps, but it also has an outdated information technology system. A 2020 GAO Report that looked at the current use of third-party reporting for revenue collection, states that the “IRS’s ability to process and use information returns is limited by its outdated legacy information technology (IT) systems. In 2017, IRS developed a plan to modernize its information return processing systems; however, IRS paused its efforts due to, according to IRS, resource constraints.”²⁵ These reports underline the additional resources the IRS needs to efficiently complete its current workload and how additional responsibilities could impact either the quality of their services with existing resources or increase demands for additional funds.

- ***Emerging IRS Issues: Covid-19 and Increased Workload:***

As mentioned above, due to the economic rescue packages passed by the Congress, the IRS was tasked with the distribution of three rounds of stimulus checks to taxpayers. This herculean task, in some sense, took precedent over the IRS’ other duties, creating problems for some taxpayers as outlined by the National Taxpayer Advocate in its most recent report:²⁶

- Millions of taxpayers experienced lengthy delays in receiving their tax refunds. This was particularly harmful for low-income households, which often rely on tax refunds for a financial boost. This delay stemmed from the IRS’ inability to process 16 million paper tax returns in a timely manner and its fraud detection filters that have generated a high rate of false

positives, leading to refund delays for those returns flagged. In fact, as of March 5, 2021 there were 6.7 million unprocessed individual returns.²⁷ According to more recent data, released by the Taxpayer Advocate, “as of the week ending April 9, 2021, more than eight million individual returns (Form 1040 or 1040-SR) were in suspense status awaiting review and manual processing. For context, during a normal filing season when the ERS unit is fully operational, it does not suspend returns, as it is able to review and process them as they come in.”²⁸ In addition, the IRS is holding:

- 5.3 million individual 2019 and 2020 paper returns;
- 4.7 million individual returns with processing errors or fraud identification issues requiring responses from taxpayers; and
- 11 million business and other returns.

In total the IRS is holding 29 million returns for manual processing.

- Millions of eligible individuals did not receive some or all of the Economic Impact Payments (EIP) for which they were eligible, due to mistakes or changes in their individual situations. Originally, the IRS took the position that it generally would not correct EIP mistakes in 2020. They later changed their position, stating that they would correct some of the mistakes using some sort of the automation. However, some corrections could not be made through automation leaving impacted taxpayers frustrated.

²⁴ GAO, “Improvements Are Needed to Enhance the Internal Revenue Service’s Information System Security Controls,” May 13, 2020, pg 2. <https://www.gao.gov/assets/710/706908.pdf>

²⁵ GAO, “Better Coordination Could Improve IRS’s Use of Third-Party Information Reporting to Help Reduce the Tax Gap,” December 2020. <https://www.gao.gov/assets/720/711228.pdf>

²⁶ National Taxpayer Advocate, 2020.

²⁷ IRS Website, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-march-5-2021>

²⁸ NTA Blog, “2021 Filing Season Bumps in the Road: Part I,” April 22, 2021. https://www.taxpayeradvocate.irs.gov/news/nta-blog-2021-filing-season-bumps-in-the-road-part-1/?cm_ven=ExactTarget&cm_cat=DD+04262021&cm_pla>All+Subscribers&cm_itc=https%3a%2f%2fwww.taxpayeradvocate.irs.gov%2fnews%2fnta-blog-2021-filing-season-bumps-in-the-road-part-1%2f&cm_ainfo=&&utm_source=%20Urban_newsletters&utm_medium=news-DD&&utm_term=TPC

- Millions of taxpayers received late notices bearing dates that had passed and, in many cases, response deadlines that had also passed. And these notices have confused taxpayers and led to anxiety for taxpayers who feared “they had missed critical response or payment deadlines.”
- Public information about the status of IRS operations and processing backlogs was insufficient. Infrequent public communication from the IRS has fueled anxiety regarding tax returns, refunds, balances, and EIPs. As Covid-19 restrictions continue in 2021, the National Taxpayer Advocate urges more frequent and wider dissemination of information regarding the status of various issues, such as delays in processing and the status of agency operation.

WHAT DOES ALL OF THIS MEAN?

The data presented to this point highlights three important points:

1. The IRS is underfunded and lacks the resources to efficiently and effectively carry out its core functions.
2. Its workload has continuously increased due to increasing populations and changing economic factors (such as new and emerging sources of income and a more global economy).
3. When tasked with significant additional and urgent tasks like the distribution of EIPs, the agency has had to change its priorities, in many cases resulting in taxpayer discontent.

These three points also highlight the difficulty of assigning other major projects to the IRS without significantly increasing its budget, first for

existing needs and then for the additional duties. In a critique of IRS’ expanding workload, Erin M. Collins, the current national taxpayer advocate, states “It is morphing the IRS into this dual mission of both tax administration and administering of social programs. The challenge is the IRS was not set up for that purpose and their IT is not structured for that... I am concerned that the IRS systems were not created to do monthly checks...I think if you ask the IRS, they say, ‘We will get it done.’ And they will get it done. But my concern is, at what cost?”²⁹ The previous national taxpayer advocate, Nina Olsen, has also discussed the difficulty of administering social programs through the IRS with its existing systems: “If you’re really looking at things like a monthly child tax credit or a monthly earned income tax credit, you can’t do that through the existing collection pipeline,” Olson said. “What it will mean is that the IRS may not be able to update the information in the system, so it may overpay or underpay.”³⁰

The IRS’ increased workload due to Covid-19 stimulus payments and the problems that resulted also give some insight into how prior calls for an expansion of the IRS’ duties into tax filing might impact the agency. A number of proposals have been put forth over the years, calling for a return-free filing system or pre-filled tax returns for low- and moderate-income taxpayers with relatively simple tax situations. The hallmark of return-free or pre-filled tax return systems is that they require greater involvement by the tax authority in the tax filing process, as well as a comprehensive and timely system of third-party information reporting. These reporting requirements may shift part of the burden of tax compliance to employers, financial institutions, other information providers, and the taxing authority, which must collect, submit, and process the data and in some cases must calculate the correct amount of tax to withhold.

²⁹ *The Washington Post*, February 12, 2021

³⁰ Ibid.

The financial burden of undertaking such a task could be greater than the current additional workload the IRS is handling due to the pandemic. Obviously, the extent of the financial demands of the new system would be proportional to the complexity of the system under consideration and the portion of taxpayers targeted. The fixed and variable costs to the government could include:

- Development of government tax software
- Information technology modernization
- Increased cybersecurity work
- Software updates and maintenance
- Increased staffing costs

While there is no comprehensive study of costs associated with setting up and administering a return-free filing system in the U.S., these costs are likely to be significant based on the tasks that need to be undertaken. As discussed in previous sections, the IRS budget has been reduced con-

siderably over the past decade leaving the agency with aging technology and overworked staff, unable to keep up with an increased workload. This suggests that adding a major new program and the associated additional responsibilities could impact either the quality of their existing services or result in increased demands for additional funds.

CONCLUSION

There is no doubt that the IRS lacks the resources and capabilities to carry out its core functions effectively and that increased workloads are straining these limited resources even further, creating taxpayer discontent. Additional loss of revenue, due to decreased enforcement efforts, is also significant and of great importance in an economic environment where the national debt is continuously increasing. Congress should make sure the agency has enough funds to perform its core duties effectively first and think carefully before assigning additional tasks to an overworked agency without considering the ramifications for revenue collection and taxpayer service.



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