BETTER**IRS**

CONSERVATIVE EFFORTS TO PAD WEALTHY TAX CHEATS' POCKETS

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This week, House conservatives have proposed conditioning $14.3 billion in emergency funds for Israel on cutting IRS enforcement funding, letting wealthy tax cheats keep as much as $331 billion in their pockets and increasing the deficit by more than 23 times the direct spending.

Beyond this latest attempt, House conservatives have spent the better part of this year attacking IRS funding that ensures wealthy Americans pay what they owe. If Congress gives in to wealthy tax cheats and their conservative friends by going back on the promise of the Inflation Reduction Act to finally narrow the tax gap, we could allow tax cheats to keep nearly $1.1 trillion in their pockets.

Background

The Inflation Reduction Act (IRA) provided the Internal Revenue Service (IRS) with $78.9 billion in mandatory funding from FY22 to FY31, including $45.6 billion for tax enforcement and $25.3 billion for taxpayer services and enforcement programs operations. The IRS has proposed spending $47.4 billion over the next 10 years on expanding enforcement, specifically focusing on wealthy taxpayers to narrow the nearly $700 billion annual tax gap.

Spending on IRS enforcement fell by 26 percent from FY10 to FY22, severely limiting our ability to make the wealthy, who regularly evade and avoid their tax obligations, pay their fair share of taxes. These cuts have caused audit rates to plummet by more than 70 percent between 2010 and 2019. The agency has all but abandoned audits on wealthy individuals. In 2010, 9 percent of those making more than $1 million were audited, yet just one percent were audited in 2019.

The IRS has committed to keep audit rates the same for taxpayers making less than $400,000, suggesting that all new audits will be concentrated among the top two percent of earners.[1] Secretary Yellen, in a letter to the IRS Commissioner last year, clarified "contrary to the misinformation from opponents of this legislation, small business or households earning $400,000 per year or less will not see an increase in the chances that they are audited."

[1] In tax year 2020, the floor for the 98th percentile of adjusted gross income was $366,358.

Threats to IRS Enforcement Funding

Since the beginning of the 118th Congress, House conservatives have taken aim at fully rescinding the IRA's IRS funding.

In January, the House passed H.R. 23, The Family and Small Business Taxpayer Protection Act, which would entirely cut the IRA's IRS unspent/unobligated funding, rescinding more than $71 billion. CBO estimates that this would result in a decrease of $186 billion in revenue over the next decade to the reduction in enforcement actions, a considerable underestimate given new research.

The debt limit deal reached between House conservatives and the Biden Administration in June rescinded $1.4 billion of IRS enforcement and operations funding, which the Congressional Budget Office estimates will reduce enforcement actions and cost taxpayers $2.3 billion in lost revenue. Further, the White House and House leadership agreed to rescind an additional $20 billion in IRS funding over the next two years.

House Republicans' FY24 Financial Services and General Government (FSGG) appropriations bill cuts IRS funding by nearly $1.1 billion (9 percent) from last year's funding level. The cuts are almost entirely targeted at the IRS enforcement budget, cutting $1.23 billion from their FY23 level ($5.44 billion) and coming in $1.7 billion lower than the agency's request of $5.9 billion. Further, the bill rescinds $6.1 billion in enforcement funding and $4.1 billion in operations support funding from the IRA appropriations.

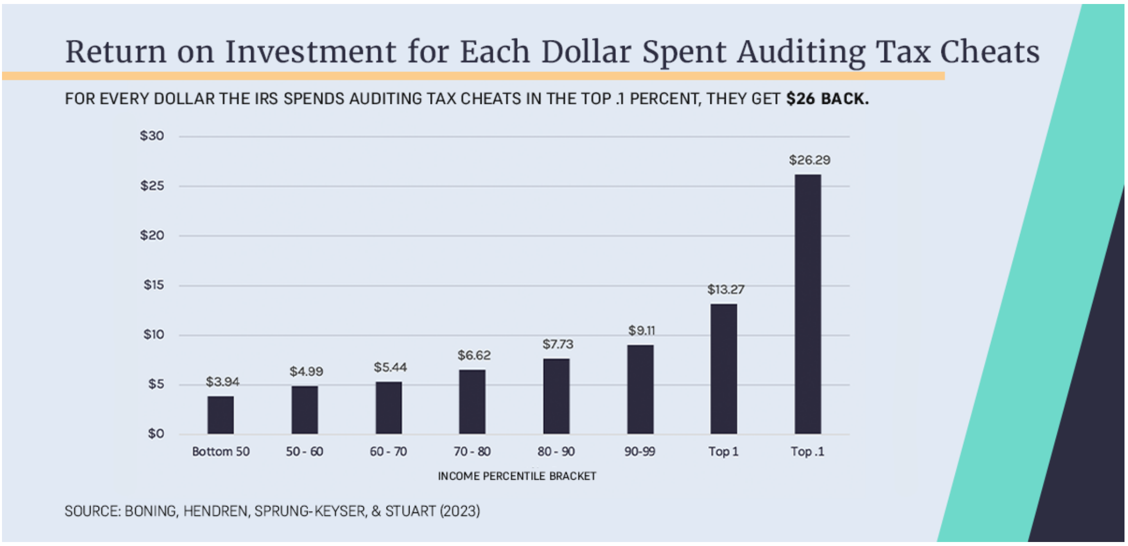
The Senate Appropriations Committee has moved forward a bipartisan FSGG appropriations bill that proposes holding IRS appropriations steady relative to FY23, an effective cut due to inflation levels, and rescinding $10 billion in IRS enforcement funding from the IRA appropriations.

House Republicans have gone further than the appropriations bills that typically determine the IRS funding levels, proposing nearly $57 billion in IRS rescissions in the appropriations bills for Labor, Health and Human Services, and Education (LHHS); Commerce, Justice, and Science (CJS); and Transportation and Housing and Urban Development (THUD).

Most recently, Speaker Mike Johnson unveiled a proposal to "offset" more than $14 billion in funding for Israel by cutting IRS funding. The proposed pay-for would balloon the bill's effect on the deficit.

The Consequences of Rescinding the IRS' Ability to go After Wealthy Tax Cheats

New analysis from Policy Impacts, a research organization based at Harvard University, suggests that if the IRS undertook a major audit expansion, for every dollar spent auditing taxpayers in the top 10 percent, there would be a $9.11 return in revenue (combining the additional collected revenue directly from the audit and indirectly from deterrence effects). For earners in the top one percent (making above approximately $550,000 per year), this return is as much as $13.26. For earners in the top 0.1 percent (making above approximately $2.6 million per year), the return is as much as $26.29. If the IRS maintains the distribution of audits among those in the top 10 percent, the average return for every dollar spent on auditing high-income earners is $22.14.



Extremists in the House have demanded that emergency defense spending for Israel be "offset" with IRS funding rescissions. This would allow wealthy tax cheats to keep as much as $331 billion in their pockets and increase the deficit by 23 times the proposed spending.

If the GOP claws back the entire IRS modernization investment, as proposed by H.R. 23, wealthy tax cheats would keep up to $1.1 trillion in their pockets, robbing as much as $1.05 trillion in net revenue from the federal coffers.

Comparison of Proposed IRS Funding Cuts ($billions)

REPUBLICANS IN CONGRESS COULD LET WEALTHY TAX CHEATS KEEP NEARLY **$1.1 TRILLION** IN THEIR POCKETS.

Proposal	IRS Expanded Enforcement Funding Cut	Estimated Benefit to Wealthy Tax Cheats	
		lower bound	*upper bound*
Israel Supplemental	14.3	302.64	330.95
H.R. 23	71	1,096.99	
FY24 House Appropriations	67	1,004.41	1,092.36
CJS	22.025	318.92	509.73
FSGG	10.166	148.99	235.27
LHHS	9.774	51.3	127.29
THUD	25.035	529.84	579.39
FY24 Senate Appropriations	10	211.64	231.43

NOTES: LOWER BOUND ESTIMATES ASSUME THE IRS APPLIES FUNDING CUTS PORPOTIONALLY TO EXPANDED ENFORCEMENT OF WEALTHY INDIVIDUALS. UPPER BOUND ESTIMATES ASSUME THE IRS MAXIMIZES FUNDING CUTS TO EXPANDED ENFORCEMENT OF WEALTHY INDIVIDUALS. MODEL AND SOURCE DATA AVAILABLE UPON REQUEST.

SOURCE: AUTHOR'S ANALYSIS OF IRS IRA STRATEGIC OPERATING PLAN, IRS DATA BOOK (2022), AND BONING, HENDREN, SPRUNG-KEYSER, & STUART (2023)

Due to the debt ceiling deal, both chambers have marked up appropriations bills proposing approximately $10 billion in cuts to IRS enforcement in FY24. The Senate appropriations bill could allow wealthy tax cheats to keep as much as $231 billion in their pockets. If House Republicans have it their way across all four appropriations bills that rescind $67 billion in IRS funds, they are writing a check to wealthy tax cheats for as much as $1.1 trillion.

Appendix

How does this estimate compare to CBO's revenue estimates for IRS enforcement investments?

CBO estimates that rescinding the unobligated balance of the IRA IRS funding (as proposed in H.R. 23) will reduce revenue by $185 billion. This estimate includes revenue effects from expanded enforcement, as well as other modernization efforts. It is considerably lower than our estimates.

First, CBO's assumptions for returns on investment (ROI) from enforcement are much lower than our assumptions. Recent IRS estimated ROIs suggest that a $1 increase in spending on enforcement yields between $5 and $9 in increased revenue. CBO adjusts this down for two reasons. First, they assume that current IRS limited enforcement spending targets activities that will have the highest ROI, suggesting that if spending increased, returns would decrease. Second, they assume that taxpayers will, in response to expanded enforcement activities, will find new ways to evade taxes.

CBO does not disclose its ROI estimate for this score, but we can presume it is lower than $7.50 (the midpoint between the IRS's range), suggesting that it is, at most, 25 percent of Boning et al.'s average estimated ROI of $22.14 for audits of taxpayers earning more than $400,000 per year. It's likely much lower than this, given their previous estimates of IRS enforcement funding injections have assumed a $6.40 ROI during the first three years and a steep decline thereafter.

CBO's public description of their methodology does not disclose if they take into account differential ROIs based on income distribution, but given that their data source for the ROI range (the IRS budget justification) does not report that, it's unlikely. Further, CBO's estimates did not take into account Secretary Yellen's directive that expanded enforcement efforts be targeted at those earning more than $400,000, because they were computed before that directive was issued.

We do not agree that historically higher numbers of audits of lower income taxpayers are indicative of the IRS targeting limited resources towards activities that yield higher returns, but rather that the IRS's strained resources were so limited that they did not have the resources to pursue widespread complicated audits that yield higher returns. Further, research finds that as IRS enforcement resources were cut over the last decade, returns per audit were relatively stable– if CBO's assumption were correct, you would expect returns to increase as resources dwindle.

Additionally, CBO's pre-adjustment ROI of between $5 and $9 is for *all* appropriations, not just enforcement funding. In FY17, for example, the ROI for all appropriations was $5.10 and the ROI for enforcement spending was $12– considerably closer to Boning et al.'s estimate among the top 10 percent.

CBO's analysis does take into account some deterrence effects of increased enforcement activities. However, they note that their estimates for these effects are highly uncertain and empirical evidence about these effects is inconclusive. Importantly, they note that their understanding of the research is that people with higher income do not generally increase compliance following an audit. However, Boning et al. find that the revenue returns of future compliance induced by an initial audit are at least three times that of the initial audit *and* that these deterrence effects are consistent across the income distribution. This estimate is consistent with Treasury's own deterrence revenue effect estimate of "at least three times" the direct revenue.

Therefore, our estimates are considerably higher than CBO's for two reasons. First, we assume an average ROI of approximately $22, where CBO assumes an average ROI of less than $9. Further, we assume a deterrence effect of three times the initial audit– consistent with Boning et al. and Treasury, which is higher and more precise than CBO's estimated effect.

Finally, CBO's estimates, due to scorekeeping rules, are focused on the effects within the next 10 years. Our analysis is not restricted to a particular time period, and especially due to the lead time for ramping up enforcement efforts and 14 year tail of deterrence effects, much of the estimated revenue in our model is generated beyond the 10-year window.

How does this compare to Sarin and Mazur's recent estimates?

Sarin and Mazur (SM) estimate that IRS IRA funding will raise approximately $560 billion over the next decade assuming a deterrence multiplier of one. Assuming a deterrence multiplier of three, their revenue estimate increases to $1.05 trillion. Of this, assuming a deterrence multiplier of three, approximately $996 billion is from expanded enforcement. SM do not distinguish between expanded enforcement efforts for wealthy taxpayers and other enforcement spending.

SM assume a ROI that grows from $1 in the first year to $5 in years 3 and after (averaging $4.50 over 10 years) in direct revenue effects for enforcement spending, though they note this is potentially an underestimate, especially because enforcement activities focused on high-income taxpayers is likely to yield higher returns. We assume that expanded enforcement of taxpayers earning more than $400,000 yields a return of $22.14. Our estimates do not focus on enforcement spending outside of this particular effort.

SM assume a slightly different allocation of resources. They assume that $46 billion of the IRA funding will be spent on enforcement, and that an additional 20 percent ($9.2 billion) in indirect support costs is required. They assume the other $23 billion is spent on operations support and modernization outside of enforcement efforts. This is slightly different from our assumptions. We use the IRS Strategic Plan IRA allocations to determine that $41.7 billion will be spent on enforcement among high-income taxpayers, plus an additional $5.7 billion in operations support and taxpayer services funding for that expanded enforcement. The rest of the $45.6 billion allocated for enforcement, according to the IRS, will be used for other modernization efforts. Beyond the $47.4 billion for expanded enforcement of high-income taxpayers, we determine that the remaining $32 billion will be spent on improving taxpayer services, modernizing technology, clean energy, and improving workforce retention, skills, and diversity.

SM's deterrence estimates include "self-deterrence" effects (e.g., when taxpayers are audited, they are more compliant after the audit) and "community deterrence" effects (e.g., when taxpayers hear about other taxpayers getting audited, they are more compliant out of fear). Our estimates follow Boning et al. who only consider self-deterrence effects, which estimate to be about 3 times the direct effect. Therefore, SM's estimates assuming a deterrence multiplier of 3 are not different from ours in that respect, though it's possible that the true deterrence effects are larger than Boning et al.'s findings, depending on the magnitude of community effects.

For the non-enforcement spending, SM assume a conservative $2 ROI on service and IT investments and a $15 billion (which they note is the midpoint of an estimated $10 to $20 billion range) in total additional revenue from new information reporting. As a result, they estimate that non-enforcement spending yields approximately $60 billion in revenue. Our estimates focus on just the expanded enforcement funding targeted at high-income taxpayers.

To more directly compare our estimates, if we apply SM's average ROI ($4.50) and deterrence multiplier of three, their estimate of revenue from $47.4 billion spent on expanded enforcement for high-income taxpayers within the first decade would be approximately $853.2 billion. Again, we do not restrict our revenue estimates to the budget window, so there is not a perfect comparison between our models. SM do note that returns persist, and are in fact greater, beyond the first decade.

How do Sarin and Mazurs estimates differ from CBO's?

Sarin and Mazur describe their departure from CBO in detail in the third part of their paper. In short, they believe their estimates are higher because CBO declines to factor in behavioral deterrence effects, understates direct revenue effects, overstates diminishing returns, assumes that investments in service in technology modernization have no direct returns, and fails to fully incorporate the impact of third-party verification. Our analysis departs from CBO in similar ways.