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The Internal Revenue Service's Strategic Operating Plan to Spend \$79 Billion in Inflation Reduction Act Funding

The Inflation Reduction Act (IRA, P.L. 117-169) provided the Internal Revenue Service (IRS) with \$78.9 billion in mandatory funding that is available for obligation through FY2031. Of this amount, the act specified that \$45.6 billion (58%) would go to tax law enforcement, \$25.3 billion (32%) to operations support, \$4.8 billion (6%) to the IRS's business systems modernization (BSM) program, and \$3.2 billion (4%) to taxpayer services.

Shortly after the IRA's enactment, the Department of the Treasury promised to deliver to Congress by mid-February 2023 a report detailing how the IRS intended to use the IRA funding. The report, delivered April 6, 2023, sets forth five key objectives for using the funds and a variety of initiatives and projects for accomplishing them.

This In Focus looks at the IRS's strategic operating plan's (SOP's) objectives and how the IRS intends to achieve them. It also discusses potential obstacles to realizing the objectives.

Objective 1: Provide Taxpayers with the Prefiling Services They Want and Need

The IRA provided \$3.2 billion for IRS taxpayer services such as filing and account services, prefilling assistance, and education. This funding is intended to allow the IRS to make substantial improvements in how it interacts with taxpayers who have questions about their tax obligations. The IRS answered between 18% and 19% of taxpayer calls during the 2020 and 2021 filing seasons, down from 59% in 2019.

Under the SOP, the IRS intends to expand digital options that would let taxpayers and tax professionals receive support in their preferred medium—digitally, by phone, or in person. Taxpayers would also have more options to prove their identities, allowing them to access more services without needing to reconfirm. More tax forms could be filed digitally. As part of the IRA, the IRS is also exploring the feasibility of creating a direct-file tax preparation service.

According to the SOP, the IRS plans to put all of a taxpayer's interactions and tax history in a centralized information system, which would enable staff to respond to taxpayers' questions more knowledgeably. To improve ease of use for taxpayers, transcripts and taxpayer account data would be written in plainer language and available in languages besides English. Planned improvements in information systems would also enable taxpayers to track the status of their returns, refunds, audits, and other interactions with the IRS in real time; to make more

payments digitally; and to expand online account services for businesses and tax professionals.

In addition, the IRS plans to offer legal guidance to taxpayers on more questions, including clarifying ambiguities in the tax code that can cause taxpayer error and encouraging those who are eligible for tax credits and deductions to claim them.

There are some signs that the IRS is making progress in its IRA-funded efforts to improve taxpayer services. The agency claimed it answered 87% of taxpayer calls during the 2023 filing season, thanks to the hiring of 5,000 customer service representatives using IRA funds.

Further success could depend, in part, on whether the IRS can hire, train, and retain qualified individuals and integrate certain planned improvements in its business information systems with new taxpayer service options in a timely fashion.

Objective 2: Quickly Resolve Taxpayer Issues

According to the SOP, the IRS plans to use some of the IRA funds for taxpayer services to make its efforts to resolve taxpayer issues timelier. Recent backlogs in responding to taxpayer correspondence have increased the pressure on the IRS to streamline its case resolution processes.

The IRS had 2 million pieces of correspondence awaiting a response at the end of the 2019 tax-filing season. For reasons mainly related to the COVID-19 pandemic, the backlog grew to 5.9 million pieces at the end of the 2021 season. The IRS had reduced the backlog to 4.5 million pieces as of November 2022. According to a 2021 Taxpayer Experience Survey conducted by the IRS, nearly 60% of respondents reported that they had an issue that required IRS assistance to resolve but had trouble reaching anyone at the agency.

With the IRA funding, the agency hopes to expand prefilling assistance programs. This could include identifying issues with taxpayers' filings—such as missing forms, math errors, or missing income reported by third parties—and notifying taxpayers or preparers about how to resolve the issues. Doing so could prevent many taxpayers from having to file an amended tax return.

The SOP also specifies that the IRS intends to make greater use of data analytics to help the agency better tailor its taxpayer services. Areas in which the IRS says it intends to apply more advanced analytics include recognizing and

remediating taxpayer errors, detecting nonfilers and underpayers so the agency can expand outreach to them, and identifying taxpayers well suited to installment payment plans or other debt resolution programs.

Objective 3: Expand Efforts to Improve Tax Compliance by Certain Groups

Congress dedicated the majority of the funds for the IRS in the Inflation Reduction Act—\$45.6 billion—to bolstering enforcement of the tax code. This was a response to recent declines in the agency's enforcement budget. Appropriations for tax enforcement fell by 26% in inflation-adjusted dollars from FY2010 through FY2022, leading to significant declines in audit rates for taxpayers thought to account for a major share of an estimated \$500 billion federal tax gap, which is the difference between federal taxes owed and federal taxes paid in full and on time.

The SOP notes that the IRS intends to use these funds to expand enforcement for large corporations, partnerships, and filers with high incomes or large wealth, and for other "areas where audit coverage has declined" in recent years. Such areas include employment taxes, excise taxes, and estate taxes. IRS Commissioner Daniel Werfel has told Congress that the IRS would hold the audit rate for taxpayers with incomes below \$400,000 to 2018 levels "for at least several years." The agency also plans to pursue what it calls "appropriate enforcement" for emerging tax issues, such as complex international taxation and digital assets including cryptocurrency. To achieve these goals, the IRS intends to hire additional staff, centralize its compliance programs, and use more data analytics to target its enforcement efforts more cost effectively.

Objective 4: Deliver Cutting-Edge Technology to Operate More Effectively

The IRA provides \$4.8 billion in mandatory funding for the IRS's BSM program. This objective is arguably central to the entire plan. As explained in the SOP, modernized information technology (IT) systems will serve as the foundation for the planned improvements in taxpayer services and enforcement results.

Upgrading its information systems is hardly a new goal for the IRS. Since the late 1960s, the agency has launched a number of programs intended to improve its information systems to enable the IRS to more effectively and efficiently help taxpayers understand and meet their tax obligations, and to increase tax compliance among major contributors to the federal tax gap. Most of these programs were marred by cost overruns and extended delays in delivering intended system enhancements.

The IRS's current IT modernization program stems from a business plan it released in April 2019. The plan identified projects to be carried out through FY2024 aimed at improving taxpayer services, bolstering enforcement, making agency operations more efficient, and enhancing cybersecurity and data protection. The program does not address the replacement of the IRS's legacy information systems, which mostly operate with programming

languages from the 1960s. In a 2023 report, the Government Accountability Office found that such systems generally pose security risks, impede the achievement of an agency's mission, can be difficult to maintain owing to a shortage of workers with the requisite knowledge, and are increasingly costly to operate and maintain.

The SOP calls for a variety of initiatives to accomplish the IT modernization objective by FY2028. These include updating programming language for the individual and business master files, replacing legacy databases, implementing a standard case management platform, and migrating more data to a modern cloud architecture.

Objective 5: Hiring, Training, and Retaining a Talented and Diverse Workforce

This SOP objective addresses a critical ongoing need for the IRS: adequate staffing with the knowledge and skills to allow the agency to carry out its mission effectively and efficiently.

Underlying the objective are several worrisome recent trends in IRS employment and anticipated attrition in the IRS workforce in the next few years. Between FY2010 and FY2022, the IRS's workforce decreased by almost 10,000 employees (a decline of 10%); employees involved in examinations and collections fell by almost 16,000 (a 33% drop). According to the IRS's FY2024 budget request, 63% of current IRS employees are eligible to retire between FY2023 and FY2028; the agency expects to lose more than 8,000 employees a year in both FY2023 and FY2024.

The SOP does not specify a hiring goal through FY2031. Instead, it sets forth ways in which the IRS might meet its anticipated workforce requirements in the next few years. The plan calls for offering higher pay for individuals with knowledge and skills in great demand; recruiting from diverse and underrepresented talent pools; and streamlining a time-consuming hiring process that can dissuade candidates from joining the IRS. Accomplishing the SOP's other objectives could require the IRS to hire tax accountants, attorneys, software engineers, and other experienced, skilled professionals.

Recent IRS hiring efforts suggest that hiring and retaining enough individuals with the requisite skills and knowledge may be difficult. The IRS has long struggled to compete with the private sector for talented individuals, especially tax auditors and certain IT specialists. One reason has been limits on the pay the IRS can offer job candidates. To skirt that barrier, the agency is seeking streamlined critical pay authority in its FY2024 budget request to allow the IRS to offer higher salaries to persons with critical skills that are in short supply.

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