Inflation Reduction Act Increases IRS Funding by $80 Billion – Does that Mean an Audit is Heading your Way?

The Inflation Reduction Act (IRA), passed by the Senate and the House on August 7 and August 12, respectively, and expected to be signed into law by President Biden on August 16, increases IRS funding over 10 years by a total of nearly $80 billion. Many taxpayers have visions of the IRS using these funds to amass an army of agents eager to unleash audit havoc and may be wondering, "Does this mean I'm going to get audited by the IRS?" Well, we can't answer that question, but we can answer some other questions you may have that hopefully shed a little light on the IRA's supplemental IRS funding.

1. **Is the IRS getting $80 billion to audit more taxpayers?**

   No. The approximate $79.6 million of additional IRS funding appropriated by the IRA is allocated among several functions and purposes as summarized below:

Taxpayer Services	$ 3,181,500,000
Enforcement	$ 45,637,400,000
Operations Support	$ 25,326,400,000
Business Systems Modernization	$ 4,750,700,000
Free Direct E-File Task Force	$ 15,000,000
Treasury Inspector General for Tax Administration	$ 403,000,000
Office of Tax Policy	$ 104,533,803
US Tax Court	$ 153,000,000
Treasury Departmental Offices Oversight	$ 50,000,000
	$ 79,621,533,803

   Taxpayer audits fall under the Enforcement function but are not the only aspect of that function. In addition to enforcement, significant appropriations are also provided for things like IRS facilities and updating the IRS's woefully outdated and notoriously dysfunctional IT (Operations), developing callback and other technology to provide customer service (Business Systems Modernization) and taxpayer education, account and advocacy services (Taxpayer Services).

   All appropriations under the IRA are to supplement (not replace) the amounts that would normally be appropriated for the IRS and will remain available through September 20, 2031.

2. **$45.6 billion for enforcement is nothing to sneeze at. How is the IRS going to use that money?**

   You're right – that is a lot of money. According to the Congressional Research Service, the IRA's enforcement funding represents a 69% funding increase relative to current projections (although there was a 19% decline in such funding from 2010 – 2019). But to [not] answer the question, we don't know exactly how the funds will be spent. The IRS hasn't gotten too specific yet, but the IRA does provide some broad guidelines about how the funds should be used for the tax enforcement activities, including:

- to determine and collect owed taxes;
- to provide legal and litigation support;
- to conduct criminal investigations (including Investigative technology);
- to provide digital asset monitoring and compliance activities;
- to enforce criminal statutes related to violations of internal revenue laws and other financial crimes; and
- to purchase/hire passenger motor vehicles.

There is a lot contemplated besides just hiring agents and increasing audit numbers, but that's clearly part of it. The Congressional Budget Office estimates that the enforcement funding would increase revenues by $204 billion over FY 2022 – 2031. That only happens with more audits and capable agents, and a May 2021 Treasury Report on the Biden administration's American Families Plan (which provided for increased IRS funding in roughly the same total amount as the IRA) calls for hiring additional agents and increasing audit rates for certain categories of taxpayers. What we don't know are how many additional enforcement agents will be hired or the audit rate goals. The May 2021 Treasury report seems to suggest that the additional funding will support the hiring of at least 5,000 new enforcement personnel, but "personnel" is broader than audit agents, and it's not entirely clear that such estimate translates directly to how the IRA enforcement funding will be used. But whatever number of new audit agents are hired, it appears that some of them will be rolling up to their meetings in brand new base-model American-made rides.

3. But what's all this talk of 87,000 new IRS agents I've heard about?

Soon after the IRA was passed by the Senate, social and traditional media were swirling with reports and posts that the IRS was planning to use IRA funding to hire 87,000 new agents who could soon be knocking on your door. This figure appears to come from a table included the May 2021 Treasury report which seems to indicate that the IRS proposed to have filled or created 86,852 full-time equivalent positions over the period 2022 – 2031 with increased funding. We say "seems" because there is simply a row labeled "FTE" in a chart devoid of explanation. But what it does *not* mean is that the IRS is proposing to hire 87,000 audit agents. According to the IRS Data Book, the IRS used 78,661 full-time equivalent positions in 2021 to conduct its work – that's all employees across all positions. What seems virtually certain is that the roughly 87,000 "FTE" figure takes into account all positions and employees across the IRS and may be inclusive of existing positions that are filled as the IRS workforce retires (*e.g.*, the report notes that about half of IRS's technology support employees are eligible to retire).

4. OK, but the IRS does expect to hire more agents and conduct more audits with these funds. Am I going to be in the audit crosshairs?

We don't know exactly what factors the IRS will consider in determining where to deploy its increased audit-related funding, but if you're a high-income individual and you invest or conduct business through multiple pass-through entities and/or across international borders, it appears that your chances of being audited may eventually increase. Treasury Secretary, Janet Yellen, in an August 10 letter to IRS Commissioner, Charles Rettig, directed "that any additional resources – including any new personnel or auditors that are hired – shall not be used to increase the share of small business or households below the $400,000 threshold that are audited relative to historical levels." The letter states that enforcement resources will focus on high-end noncompliance and should target large corporations, high-net-worth individuals and complex pass-throughs. Secretary Yellen's letter reinforces Commissioner Rettig's August 4 letter to the Senate in which he stated that audit rates will not increase for households making under $400,000. The May 2021 Treasury report similarly provided that additional enforcement resources would be directed to examination of large corporations, partnerships and global high-wealth and high-income individuals.

If you tick any or all those boxes, your chances of being audited relative to the last decade may increase, but it won't happen overnight, and an audit based solely on those factors will never be a sure thing. The IRS Commissioner's August 4 letter notes that the IRS currently has fewer front-line experienced examiners in the field than at any time since World War II and the May 2021 Treasury report notes that audits of individual taxpayers with income over $1 million have fallen by over 60% between 2010-2018, with the audit rate decreasing from 8.4% to 3.2%. It will take time to increase audit rates and hire and/or train capable agents. As stated in the May 2021 Treasury report, "IRS agents cannot simply be assigned to global high wealth, partnership, or large and complex business examinations without the requisite skills, training, and experience to analyze returns that are highly complex." It will take some time to gear up, but audit rates for the identified groups are likely to eventually increase.

5. If I do get audited, what can I do to make it painless?

As the youngsters say, *LOL* – an IRS audit will never be painless. However, if you have your tax house in order – which begins long before an audit is initiated – an audit will be less painful. Maintaining accurate records and detailed bookkeeping are critical to smoothing the audit path. Good recordkeeping of course includes saving receipts, invoices and financial records, but it also means making sure that you have written documentation of your business and investment transactions. For example, if you intend to make a business loan to a friendly third-party, ask your favorite business lawyer to draft a promissory note and don't just rely on a hand shake. If you don't get repaid, not only does it improve your enforcement position, but if collection is not feasible, having a signed note vs. a book entry makes it a lot easier to clear an agent's first hurdle if she's examining a bad debt deduction on your return.

Also critical is what is (or isn't) on your tax return. We've already used up too much space to get into a discussion of the standards for tax return positions, but what ends up (or does not make an appearance) on your return should be defendable under those standards. Once you're no longer dealing with only a W-2, tax rules get complicated. If you're entering into a complex transaction, wondering whether the cocktail party tax nugget from your brother-in-law's podiatrist is legit or you have a nagging tax question (Do I really have to require annual interest payments on that promissory note?), getting the advice of a tax attorney or CPA may mean the difference between an audit adjustment or not and/or the imposition of penalties.

It's also important to let your tax advisor know about your assets and transactions that have potential tax implications, and the best person to determine whether there are any potential tax implications probably isn't you. Most people do not knowingly withhold relevant information from their tax advisors, they just may not be aware that it's relevant to their tax return. For instance, if a US person starts dabbling in investments or business ventures outside the US, they may realize that they should talk to somebody about the insanely complicated tax rules for cross-border operations once things get going, but they may not be aware of the slew of potential information reporting requirements for international activities which can apply even before there are any tax income or loss items generated. The penalties for failing to report this information may include significant monetary penalties and keeping the audit statute of limitations open indefinitely on the ***entire*** tax return (not just with respect to any unreported information). Sharing is caring – even if you're not sure it's relevant, let your tax advisor know about your investment and business activities, and they can help with that determination.

If you have any questions about this posting or want to heed its advice to consult a tax attorney, you may contact the author, Kristin King.