# The IRS Budget: Taking Stock

By Jason B. Freeman, JD, CPA | Column Editor

The Internal Revenue Service (IRS) budget has been cut by nearly one-fifth since 2010 in inflation-adjusted dollars. The steady, five-year decline in IRS funding levels recently ended, however, with Congress passing a year-end omnibus spending bill that generally maintains the current IRS budget. The bill also provides modest funding increases that are earmarked specifically to improve customer service and to prevent identity theft. Unlike the omnibus spending bill, competing proposed Congressional appropriations bills had threatened to further reduce the IRS's 2016 budget, possibly to the lowest inflation-adjusted level since 1990. While those proposed bills did not pass, the threat of future budget cuts continues to loom large over the agency.

Over the past five years, the IRS has seen its workforce reduced by more than 13,000 full-time equivalent employees. (It is losing five employees for every one new employee it brings on board.) At the same time, it has been charged with major new responsibilities, such as implementing the *Foreign Account Tax Compliance Act* (FATCA) and the tax-related provisions of the *Affordable Care Act* (ACA). Its training budget has been slashed by over 80 percent; audit levels are rivaling historic lows; and, according to IRS Commissioner John Koskinen, the agency is operating with outdated information technology (IT) systems that have "many applications that were running when John F. Kennedy was president."

These challenges are real; their implications, even more so. Our nation relies upon the IRS to collect revenue to service its debt and to fund numerous agencies and programs. This past year, the IRS processed nearly 200 million tax returns and collected over $3 trillion, 93 percent of the federal government's revenue. That revenue is used to fund everything from national defense and disaster relief to Social Security, Medicare and veterans benefits, to servicing the nation's debts. In this respect, the IRS plays a unique role among our federal agencies. It is unique in another way as well: It may be the only federal agency whose budgetary dollars actually generate a direct financial return on investment (ROI). In more respects than one, it seems, the IRS budget is not a zero-sum game – and it may be the single most important policy issue that we face in the world of tax administration.

Without question, in recent years the IRS has been asked to do more and more with less and less. But, of course, it does not immediately follow that a bigger budget is the answer. Increasing efficiency, some argue, is another solution. Many who support IRS budget cuts also point out the need to exercise oversight and control over (if not punish) the agency, particularly in light of recent allegations against it. They also cite the need to control the federal deficit.

On the other side of the debate, however, many counter that Congress already has significant oversight authority over the IRS and that "[t]he victims of ... underfunding are not the IRS and its employees – the victims are U.S. taxpayers." Such critics also argue that budget cuts, if intended to address the deficit, will prove "shortsighted and counterproductive." A lack of funding, the argument goes, will lead to a significant drop in tax collections – actually *increasing* the federal deficit and harming long-term compliance levels.

The IRS is unique when it comes to the budgetary calculus since it may be the only federal agency that produces a direct financial ROI. Every dollar appropriated to the IRS actually generates more than a dollar of revenue in return. This is the so-called "multiplier effect." The IRS reports an overall multiplier of $4 for every dollar allocated to its budget, and the effect is even more pronounced in some areas, such as major enforcement programs.

It achieves this ROI in many ways: For example, by conducting audits, which are currently at levels that rival historic lows, engaging in other enforcement activities to ensure that taxes owed are converted to taxes paid and providing various taxpayer assistance programs. The latter is a sometimes overlooked, but extremely important, part of the equation. The IRS has historically helped taxpayers who want to comply with their tax obligations (but who often do not know how) through programs like Taxpayer Assistance Centers and helplines. All of these activities play an important role in the effort to increase voluntary compliance – the backbone of our tax system.

## The IRS Workforce

Personnel costs account for about three-fourths of the IRS's budget. So it should come as no surprise that in light of these budget cuts, the agency has been forced to dramatically reduce its workforce. In fact, it is operating with approximately 13,000 fewer full-time-equivalent employees than it had in 2010. As mentioned previously, it is losing five employees for each one it brings on board.

To add insult to injury, since the IRS's training budget has been slashed, this affects the productivity of those employees who do remain. The training budget, although up slightly from FY 2014, remains 83 percent lower than its 2010 levels. That is a particularly difficult fact for an agency that administers a tax code that undergoes, on average, more than a change a day.

The consequences of these drastic cuts in staffing levels and training expenditures are real. For instance, IRS customer service representatives are currently unable to even answer about 35 percent of phone calls (a figure that is actually a year-over-year improvement because calls to the IRS have dropped sharply); the IRS is unable to process or answer over half of taxpayer correspondence in a timely manner (a 2,045 percent jump in the wrong direction since 2005); and it has now discontinued return preparation services through Taxpayer Assistance Centers, a change that disproportionately affects low income, elderly and disabled taxpayers.

## Technology and Other Challenges

There are also serious IT challenges. The IRS desperately needs to modernize its IT systems, which account for nearly 20 percent of its budget. It is largely operating on what can be described, perhaps charitably, as outdated legacy systems, some of which are running applications that the IRS commissioner says were in place before we set foot on the moon.

The IRS relies on its information systems to process tax returns, send bills, issue refunds, select returns for audit and to provide a host of telecommunications services for its business activities. Without the necessary investments to modernize its IT systems, the IRS will never perform these functions at optimal levels. And without making such outlays, its ability to meet the challenges posed by many 21st century threats – such as cyber-security attacks and identity theft – will remain inadequate.

These challenges, daunting as they are, are in many ways just the beginning. Despite the budget cuts, in recent years the agency has been tasked with new (and growing) core responsibilities. Under FATCA, the IRS's new responsibilities include collecting and analyzing data from more than 150,000 financial institutions and over 100 countries. Under the ACA, the IRS is required to administer the ACA's premium tax credit, as well as its "individual mandate" and "employer mandate." These are major undertakings that require substantial training and IT investments. It is not clear, however, that those investments are being made.

### The Future

To be frank, the IRS budget debate is perhaps the single most important policy issue that we face in the world of tax administration. The IRS serves a unique and important role among our nation's federal agencies, and we depend on the revenues that it generates to run our entire federal government. It cannot generate those revenues without adequate funding. At the same time, it must be acknowledged that many of the concerns that have been voiced about the agency manifest deep concerns that our country has held about the power of taxation since its founding. Those concerns cannot be ignored, just as the calls to fix the budget cannot.

As the Taxpayer Advocate has aptly remarked, the reality is that while "[t]he IRS will never be a beloved federal agency, because it is the face of the government's power to tax and collect[,] . . . it should [nonetheless] be a *respected* agency." Striking the balance necessary to turn this aspiration into a long-term reality remains a difficult proposition – particularly insofar as the budget goes. The fact remains that the IRS is struggling in the current budgetary environment. Its responsibilities continue to grow, while its budget fails to keep pace, its workforce declines and its technological challenges continue to mount. At some point, something will have to give. The question, of course, is what? ■

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