

Some Background

TAX GAP AND TAX SHELTERS

What does the IRS do and how can it be improved?

Q. What does the IRS do and how can it be improved?

A. The IRS administers the federal tax laws that the Congress enacts.

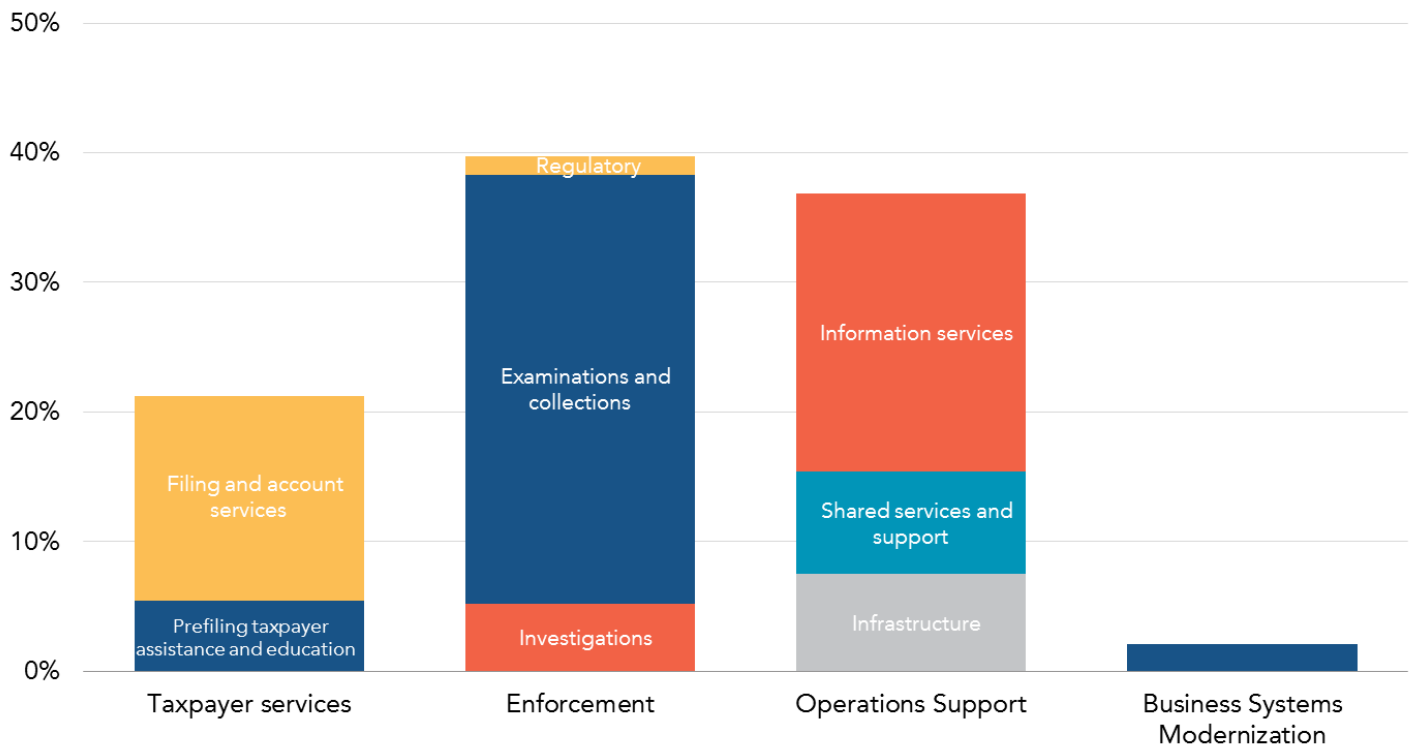
The Internal Revenue Service (IRS) administers the federal tax laws that Congress enacts. The IRS performs three main functions—tax return processing, taxpayer service, and enforcement. In addition, the IRS conducts criminal investigations and oversees tax-exempt organizations and qualified retirement plans. The IRS budget and workforce have been shrinking, even as the tax law has become more complex and the agency has taken on new tasks.

FIGURE 1

Components of the IRS Budget by Activity

Share of total budget, fiscal year 2018

Percentage



Source: Internal Revenue Service. 2018 Data Book, "Table 28. Costs Incurred by the Internal Revenue Service, by Budget Activity," May 2019.

Some Background

TAX GAP AND TAX SHELTERS

What does the IRS do and how can it be improved?

IRS ACTIVITIES

Nearly 40 percent of the IRS's \$11.7 billion budget in 2018 went to enforcement (figure 1). About 83 percent of the enforcement budget was for examinations of taxpayer returns (audits) and collections. The IRS spent the remainder on criminal investigations and regulatory activities, including monitoring tax-exempt organizations and qualified retirement plans.

About 37 percent of the budget funded operations support, including information technology, services, facilities, and organizational support. Another 21 percent supports taxpayer services, including prefilling taxpayer assistance and education and filing and account services. Finally, another 2 percent went to business systems modernization to upgrade information and technology services.

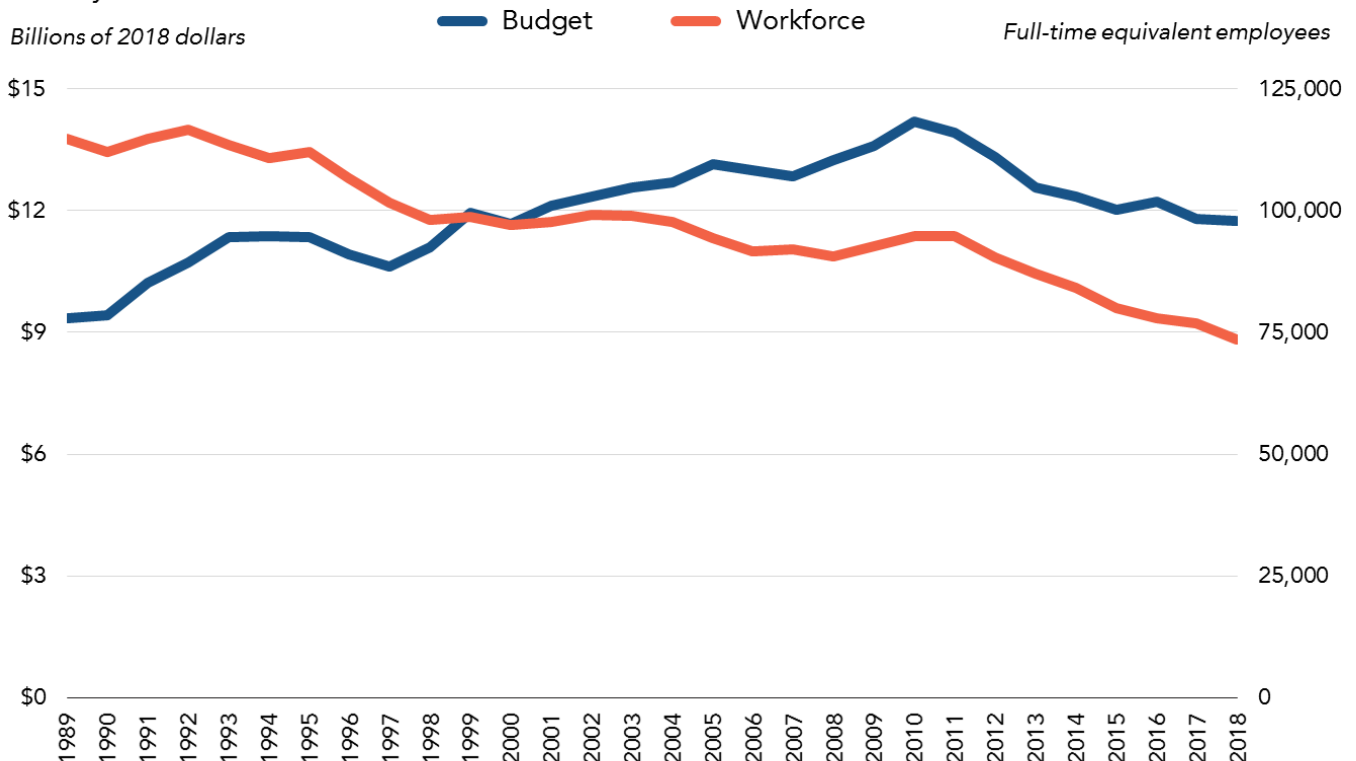
THE DECLINE IN SPENDING AND WORKFORCE AND WHY IT IS A PROBLEM

The total IRS budget has been shrinking in real terms in recent years. Between 2010 and 2018, spending on the IRS declined by 17 percent from \$14.2 billion to \$11.7 billion in 2018 dollars. Over a longer time period, IRS employment dropped by 36 percent, from about 115,000 full-time equivalent employees in 1989 to less than 74,000 in 2018 (figure 2).

FIGURE 2

IRS Budget and Workforce

Fiscal years 1989 to 2018



Source: Internal Revenue Service. 2018 Data Book, "Table 29. Collections, Costs, Personnel, and U.S. Population, Fiscal Years 1989–2018," May 2019.

Note: Budget data are total obligations against appropriated funds, and are adjusted for inflation using the gross domestic product chain-type price index.

Some Background

TAX GAP AND TAX SHELTERS

What does the IRS do and how can it be improved?

While IRS resources have shrunk, the agency's workload has increased. With the taxpayer population increasing, the IRS must process more returns, administer more deposits and refunds, and expend more resources to keep taxpayers compliant. Changes in the economy and society have created other challenges for tax enforcement and compliance. These include the globalization of corporate activity, an increase in the share of income taxed through partnerships and other pass-through entities, and changes in family structure. The latter changes have made it harder for IRS to determine whether taxpayers are entitled to tax benefits based on complex criteria, including household living arrangements, family relationships, and support tests.

A major source of increased workload has been the IRS's expanded role in administering social programs. The IRS today manages a wide range of benefits for low- and middle-income families and families with children. These include the earned income tax credit, the child tax credit, the child and dependent care tax credit, tax subsidies for higher education, and premium subsidies under the Affordable Care Act. When Congress creates new programs for the IRS to administer, it often does not provide additional funding to administer them.

The 2017 Tax Cuts and Jobs Act presented the IRS with new challenges. The IRS has had to write new regulations to administer provisions that are ambiguous and sometimes contradictory. Some provisions that are especially difficult are the new 20 percent deduction for income from pass-through businesses and the complex new international tax provisions. In fiscal years 2018 and 2019, Congress provided a total of nearly \$400 million in additional appropriations to help IRS administer the new tax law, but that additional funding was temporary and will not reverse the long-term decline in the IRS budget.

WHAT CAN BE DONE?

The IRS is a complex and unwieldy bureaucracy that cannot easily transform into a modern high-tech organization. Some measures, however, could improve tax administration. Congress could enact legislation to simplify the tax law, as the National Taxpayer Advocate and some reform commissions have proposed. Congress could increase funding to reverse recent budget cuts and prevent a steep drop in the agency's enforcement presence. More funds for enforcement could more than pay for themselves in increased revenue collections. Congress could also give the agency more flexibility in personnel management and additional resources to help modernize their information technology, including relaxing existing pay ceilings for top technology personnel.

Updated May 2020

Data Sources

Internal Revenue Service (IRS). 2019. [2018 Data Book](#).

Further Reading

Holtzblatt, Janet and Jamie McGuire. 2016. "Factors Affecting Revenue Estimates of Tax Compliance Proposals." Congressional Budget Office Working Paper 2016-05.

National Taxpayer Advocate. 2020. "2019 Annual Report to Congress." Washington, DC: Internal Revenue Service.

Toder, Eric. 2017. "IRS: What it Does and How to Reform It." Washington, DC: Urban-Brookings Tax Policy Center.

Some Background

TAX GAP AND TAX SHELTERS

What does the IRS do and how can it be improved?

Copyright © 2020. Tax Policy Center. All rights reserved. Permission is granted for reproduction of this file, with attribution to the Urban-Brookings Tax Policy Center.