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BLOG

IRS's Strategic Operating Plan Includes Objective Targeting High-Income Taxpayers and Large Corporations and Partnerships

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On April 6, 2023, the Internal Revenue Service (IRS) released its strategic operating plan ("Plan") containing 42 key initiatives and 190 key projects designed to transform the agency, improve customer service, refocus priorities, and deploy resources made available under the recently legislated Inflation Reduction Action of 2022 (IRA).

On August 16, 2022, Congress enacted the IRA, which allocated nearly $80 billion of funding to the IRS over the course of 10 years. As a result of this influx of funding, Treasury Secretary Janet Yellen requested that the IRS set forth an operational plan identifying specific initiatives and associated timelines, as well as how resources will be spent over the next decade.

The initiatives and projects of the Plan are organized around five primary IRS objectives. Notably, Objective Three of the Plan seeks to expand enforcement on taxpayers with complex tax filings and high-dollar noncompliance – i.e., high-income taxpayers and large corporations and partnerships. To achieve Objective Three, the IRS intends to increase compliance coverage in areas involving complex issues and returns, including those relating to complex partnership structures, large corporations, and high-income and high-wealth individuals. Capitalizing on resources and funding made available under the IRA, the IRS plans to improve its enforcement capabilities and risk identification through better use of data analytics, technology, and centralized operations and by increasing its expertise to examine these complex issues and returns.

The IRS outlined seven initiatives it seeks to accomplish in furtherance of its goal outlined within Objective Three. These include:

Objective Three Initiatives

3.1. Employing centralized, analytics-driven, risk-based methods to aid in the selection of compliance cases. The IRS seeks to develop a centralized, integrated approach to prioritize and assign cases, make the most appropriate compliance contact, and enable dynamic allocation of the workforce to address complex compliance issues. Within Initiative 3.1, the IRS has identified several key projects, which include: (1) establishing a centralized function for compliance planning and strategy; (2) building a unified compliance organization that enhances centralized case-planning and strategy, and enables the IRS to refine business processes; (3) establishing a dynamic model for workforce allocation; (4) centralizing compliance analytics and developing a process to regularly model the population of tax returns; (5) developing a process for continually refining compliance analytics models based on feedback and new information; and (6) developing and implementing a plan to improve the IRS Whistleblower program.

3.2. Expanding enforcement for large corporations. Due to limited resources, the IRS noted that large corporate enforcement activities have decreased in recent years, with audit rates falling from 10.5% in 2011 to 1.7% in 2019. To remedy this decrease in audit rates, the IRS seeks to use data and analytics to improve its understanding of large corporations' voluminous and complex tax filings. Within Initiative 3.2, the IRS has identified two key projects, which include: (1) hiring, onboarding, and training the necessary staff to achieve appropriate compliance coverage rates; and (2) refining approaches for large corporate enforcement and exploring new treatments using data and analytics.

Initiative 3.2 follows the previous indications from the IRS that enforcement for large corporate taxpayers will be and remain a major enforcement priority. In May 2019, the IRS unveiled a new Large Corporate Compliance (LCC) program announcing the application of new data analytics tools and use of qualitative criteria for determining the population of corporate taxpayer enforcement. Intended to further the IRS's ability to focus resources on noncompliance from returns posing the highest compliance risk, the implementation of the LCC program followed the IRS's previous Strategic Plan for Fiscal Years 2018 – 2022 years to use data analytics and qualitative information and decision-making to select high-risk returns. Initiative 3.2 is projected to further these goals and better assist the IRS in efficiently focusing its resources.

3.3. Expanding enforcement for large partnerships. As a result of limited resources and the substantial increase of partnership return filing by 32% in the last decade alone, the IRS noted that large partnership enforcement activities have decreased, falling to an audit rate of just .05% in 2019. To remedy this decrease in audit rates, the IRS seeks to improve its tools and processes for auditing and enforcement actions of large partnerships, such as hiring specialized compliance employees and training other employees on pass-through entities. Within Initiative 3.3, the IRS has identified two key projects, which include: (1) hiring, onboarding, and training the necessary staff to achieve appropriate compliance coverage rates; and (2) developing approaches and new treatments for large partnership enforcement by leveraging data and analytics.

Initiative 3.3 follows the previous indications from the IRS that enforcement for large partnerships will be and remain a major enforcement priority. On October 21, 2021, the IRS issued an internal memorandum[1] providing interim guidance on the implementation of the Large Partnership Compliance (LPC) Pilot Program. In addition to noting the agency's intent to examine returns using data analytics and machine learning, the memorandum described the IRS's plan for identifying large partnerships for enforcement, for establishing procedures for selection, delivery, and examination of returns, and for collecting feedback from personnel on improving procedures and the exam process. Priorities raised within Initiative 3.3 follow the IRS's previous communications highlighting the need to consider exam processes and tools to better audit target partnership returns and to develop tools to enhance the identification of noncompliant returns.

3.4. Expanding enforcement for high-income and high-wealth taxpayers. The IRS noted that, because it has not had sufficient resources to address high-income and high-wealth taxpayers, taxpayers earning $1 million or more were subject to an audit rate of just 0.7% in 2019, down from 7.2% in 2011. To remedy this decrease, the IRS seeks to use data and analytics to improve its understanding of the tax filings of high-wealth individuals and pursue noncompliance through audits and non-audit contacts. Within Initiative 3.4, the IRS has identified two key projects, which include: (1) hiring, onboarding, and training the staff needed to achieve appropriate compliance coverage rates; and (2) refining approaches to high-income and high-wealth enforcement and using data and analytics to explore new treatments.

3.5. Expanding enforcement in areas where audit coverage has declined to levels that erode voluntary compliance. The IRS observed that maintaining compliance coverage and enforcement of all taxpayers not only ensures that every taxpayer complies with the tax laws but also conveys the message that the IRS will detect and address noncompliance. The IRS noted that audit coverage has declined in areas such as employment taxes, excise taxes, and estate and gift taxes. To remedy this decline in audit coverage, the IRS expects to utilize specialized compliance employees across these areas, among others, and will pursue noncompliance through a variety of mechanisms. Within Initiative 3.5, the IRS has identified two key projects, which include: (1) hiring, onboarding, and training the necessary staff to achieve appropriate compliance coverage rates using all available treatments tools; and (2) developing enforcement approaches and compliance treatments tailored to each area where enforcement will be expanded.

3.6. Pursuing appropriate enforcement for complex, high-risk, and emerging issues. The IRS acknowledged that its limited resources have prevented it from tracking many known, high-risk noncompliance issues, such as digital asset transactions, listed transactions, and certain international issues. With the increased funding, the IRS expects to prioritize its resources to increase enforcement activities, including criminal investigation, for issues known to have high, ongoing risks of noncompliance or complexity, and it will establish processes for responding to emerging issues quickly with appropriate and tailored compliance treatments. Within Initiative 3.6, the IRS has identified four key projects, which include: (1) mobilizing resources to focus on high-risk and emerging issues that have not received appropriate enforcement attention; (2) improving, expediting, and scaling detection of emerging issues, including building stronger feedback processes from across the IRS; (3) establishing processes to respond more rapidly to emerging issues and develop treatments that can be deployed quickly and integrated into enforcement efforts; and (4) hiring, onboarding, and training the necessary staff to achieve appropriate compliance coverage rates.

3.7. Promoting fairness in enforcement activities. The IRS recognizes that it has an obligation to administer tax laws in a fair manner, as it is central to the agency's mission. To that end, the IRS seeks to use research and data to enforce the tax laws for all taxpayers, curtailing any potential disparities in tax administration, and improving compliance among taxpayer groups that have had historically less compliance coverage. Importantly, the IRS emphasized that the additional funds will not be used to increase audits of small businesses or households with income below the $400,000 threshold and that the funds will be used for the IRS to assess whether its enforcement actions are disproportionately burdening or advantaging certain demographic populations, geographies, or customer categories. Within Initiative 3.7, the IRS has identified three key project areas, which include: (1) developing procedures to regularly evaluate the fairness of systems, selection tools and programs, and compliance strategies and treatments; (2) improving enforcement practices to ensure fairness in compliance and enforcement; and (3) hiring, onboarding, and training staff who enable enforcement strategies that match risk and degree of noncompliance.

Newly appointed IRS Commissioner Daniel Werfel is scheduled to testify at a Senate Finance Committee hearing on April 19, 2023, regarding President Biden's fiscal 2024 budget for the IRS and the recent filing season ending on April 18, 2023. In his first appearance before Congress in his new role, Commissioner Werfel will likely have to defend the Plan and its objectives.

KEY TAKEAWAY

The IRS has signaled that it will begin hiring and training on initiatives within Objective Three, with new audits being identified and undertaken in 2024. For preexisting programs, such as the LCC and LPC programs, examinations have begun. Taxpayers should be aware of the agency's increased focus on compliance efforts in the months ahead.

For further information, please contact the authors or your Winston relationship attorney.

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[1] LB&I-04-1021-0017.

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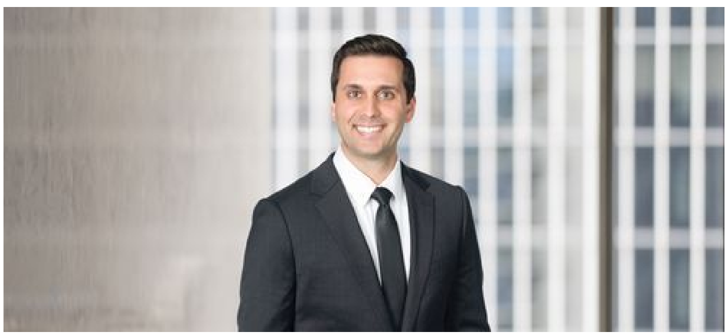

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