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Expert Analysis

Federal Tax Enforcement: Past, Present and Future

By Jeremy H. Temkin

According to its mission statement, the Internal Revenue Service seeks to "[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all." This column has previously detailed how budget cuts over the past decade have made it more difficult for the IRS to execute this mission. See Jeremy H. Temkin, *Deterrence in an Age of Dwindling Enforcement*, New York Law Journal (March 15, 2018); Jeremy H. Temkin, *Internal Revenue Service Budget Cuts Spell Trouble*, New York Law Journal (Jan. 22, 2015).

The Inflation Reduction Act, which was signed into law last month, reverses the trend of diminishing resources by including almost $80 billion in additional funding for the IRS over the next 10 years. This new funding offers the prospect of enhanced civil and criminal tax enforcement as the law's effects are fully felt and thus presents a good opportunity to consider the current state of tax enforcement, how we got here, and what the future portends.

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Budgets and Manpower

During the fiscal year ending Sept. 30, 2011, the IRS's budget was slightly less than $13 billion, and the agency had a total of 94,709 full-time equivalent (FTE) positions, including 2,618 special agents (who conduct criminal investigations), 13,969 revenue agents (who conduct civil audits), and 5,621 revenue officers (who handle collection matters). 2011 Internal Revenue Service Data Book at 67 (Table 30). A decade later, for the fiscal year ending Sept. 30, 2021, the IRS's budget had increased only 6% (to $13.7 billion), as compared with an overall 36% increase in the federal budget, excluding $1.91 trillion in COVID-19 relief funding. Over this period, the Service's work force declined by 17% (to a total of 78,661 FTE employees), with the number of special agents dropping 23% (to 2,004); revenue agents falling 40% (to 8,321); and revenue officers plummeting 50% (to 2,783). 2021 Internal Revenue Service Data Book at 73 (Table 32).

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Beyond its reduced budget and staffing, the IRS has absorbed an increased workload. Thus, the total number of tax returns filed rose almost 9% between calendar

2011, when approximately 188.7 million returns were filed, and calendar 2019, the last year for which data was available, when approximately 205.1 million returns were filed. See 2021 Data Book at 36, 44 (Table 17). Moreover, in addition to providing resources to taxpayers seeking to comply with their tax obligations, between 2011 and 2021, the IRS was also tasked with implementing the Affordable Care Act, the Tax Cuts and Jobs Act, the Taxpayer First Act, and more recently the COVID-relief programs including three rounds of Economic Impact Payments.

Civil and Criminal Statistical Data

Not surprisingly, the IRS's dramatic decline in resources relative to its duties has been reflected in civil and criminal tax enforcement statistics. While the IRS audited almost 1.3 million of the 145.6 million individual returns (0.9%) filed during calendar 2011, as of Sept. 30, 2021, the rate at which individual returns filed during calendar 2019 were audited had dropped to 0.2% (341,845 of the 158 million individual returns filed). 2021 Data Book at 36, 44 (Table 17).

The decline in criminal tax prosecutions mirrors the fall off in civil examinations. During fiscal 2011, IRS Criminal Investigation (CI) initiated 4,720 investigations, and worked on cases resulting in 2,998 indictments, 2,350 convictions, and 2,206 defendants sentenced. 2011 Data Book at 44 (Table 18). (As the Data Book makes clear, investigations "initiated one fiscal year may not be indicted, convicted, or sentenced until a subsequent fiscal year.") In fiscal 2021, IRS CI agents initiated 45% fewer investigations (2,581), and worked on cases resulting in 38% fewer indictments (1,856), 46% fewer convictions (1,263), and 43% fewer defendants sentenced (1,268). 2021 Data Book at 56 (Table 24).

Moreover, IRS CI agents work on a wide range of financial crimes, devoting approximately 28% of their investigative time to money laundering, corporate fraud, public corruption, cybercrimes, and narcotics offenses. IRS CI 2021 Annual Report at 4. As a result, "Legal Source Tax Crimes" accounted for only 1,922 (40%) of the 4,720 investigations initiated in 2011 and 953 (37%) of the 2,581 investigations initiated in 2021. 2011 Data Book at 44 (Table 18); 2021 Data Book at 56 (Table 24).

Impact on Sentencing

Eliminating non-tax cases worked by IRS CI agents, data maintained by the U.S. Sentencing Commission tells a similar story. In fiscal 2011, the Guidelines applicable to tax offenses were used in sentencing 989 defendants and were the primary Guidelines provision applied in 802 of those sentences. 2011 U.S. Sentencing Commission Sourcebook at Table 17. By fiscal 2021, those numbers had dropped to 568 and 423, respectively. 2021 U.S. Sentencing Commission Sourcebook at Table 20.

Practitioners representing defendants in tax cases are

Internal Revenue Service sign at the IRS Building in Washington, D.C.

increasingly able to persuade sentencing judges to exercise the substantial discretion afforded them under the Supreme Court's decision in *Booker v. United States*, 543 U.S. 220 (2005). In 2011, approximately 60% of defendants sentenced for tax fraud received sentences below the applicable Guidelines range, based on either downward departures or the factors set forth in 18 U.S.C. §3553(a), with a mean sentence of 16 months and a median sentence of 12 months. 2011 Sourcebook at Table 13 and 27. By 2021, approximately 77% of defendants sentenced primarily for tax offenses were sentenced below the applicable Guidelines range, with the mean sentence falling to 14 months and the median sentence remained at 12 months. 2021 Sourcebook at Tables 15 and 31.

While each sentence imposed reflects a district judge's assessment of the background and offense conduct of the individual defendant, the Department of Justice commonly argues that defendants convicted of tax offenses should be incarcerated to deter others from cheating on their taxes. This argument is especially problematic in a world where the IRS only has the resources to initiate approximately 50 criminal investigations per state, and thus who gets prosecuted will, at least in part, be due to happenstance rather than an assessment of each putative defendant's conduct in relation to a broad cross-section of individuals who engaged in similar conduct.

Moreover, the DOJ's argument that general deterrence will be served by incarcerating the few defendants being prosecuted flies in the face of research confirming that deterrence is driven far more by an assessment of the likelihood of being caught and punished than by the severity of punishments imposed on others. See *Five Things About Deterrence*, U.S. Department of Justice: National Justice Institute (June 5, 2016); see also Benjamin Van Rooij and Adam Fine, *The Behavioral Code: The Hidden Ways the Law Makes Us Better or Worse*, Beacon Press (2021); Anne Sofie Tegner Anker, Jennifer L. Doleac and Rasmus Landersø, *The Effects of DNA Databases on the Deterrence and Detection of Offenders*, American Economic Journal: Applied Economics 2021.

Prospects for Increased Enforcement

Of the almost $80 billion in additional funding provided by the Inflation Reduction Act, $45.6 billion will be devoted to enforcement efforts, with the remainder being spent on clearing IRS backlogs, improving data processes, and providing better services to taxpayers. This includes outlays for hiring 37,000 new IRS employees in addition to replacing 50,000 retiring personnel.

The prospect of increased enforcement is, not surprisingly, unpopular among many taxpayers, and Treasury Secretary Janet Yellen has sought to reassure the public that the IRS's new enforcement capabilities will be directed towards "the high end of the income distribution," Alex Muresianu, *How To Think About IRS Tax Enforcement Provisions in the Inflation Reduction Act*, Tax Foundation (Aug. 17, 2022), and that audit rates will not increase for households earning less than $400,000 per year. Notwithstanding these assurances, politicians and commentators have attempted to whip up fear that the funds will be used to "arm" and "militarize" the Service, giving rise to "threats directed at [the IRS] and its employees" and a corresponding need to review safety and security measures for the agency's staff. In response, the head of the Tax Section of the American Bar Association underscored how the infusion of funds will improve "the ability of the Service to serve the American taxpayer" by "addressing current administrative backlogs, modernizing the agency, and enhancing its ability to do its job." C. Wells Hall III, *Statement on IRS Funding in Inflation Reduction Act*, American Bar Association (Aug. 25, 2022).

Conclusion

How the IRS will use its newfound resources to increase tax compliance remains to be seen, and the merits of any given investigation will depend on factors bearing on the individual targets being pursued as opposed to tax enforcement generally. However, the Inflation Reduction Act promises to be a game-changer for the IRS, tax professionals and taxpayers who could previously count on "audit roulette" to remain under the radar screen. To the extent the increased enforcement expands the number of cases the IRS pursues, it may reduce the perceived unfairness of having the full brunt of the DOJ's deterrence argument being borne by the few defendants who find themselves caught in the IRS's crosshairs. In the meantime, with billions earmarked to improve IRS processes and filer services, all taxpayers will hopefully benefit from improved "customer service" at the much-maligned agency.