

September 18, 2023 – Wealth Planning Commentary

The IRS Focuses Compliance Efforts and Sees Productivity Gains

On Sept. 8th, the IRS released a memo detailing the agency's priorities for the remainder of 2023 and 2024. IRS Commissioner Daniel Werfel reiterated that the agency would focus their compliance efforts on the wealthy and maintain audit rates on middle and low-income filers. In recent years, wealthy taxpayers have experienced historically low audit rates. As of May 2022, before the new IRS funding from the Inflation Reduction Act, taxpayers reporting income of \$200k-\$1mm had a less than 1% chance of an audit. Taxpayers with income between \$1-10mm had a 2% chance.

The IRS has consistently shared their intent to scrutinize high income earners and defines this group as having \$400,000 or more of income in a tax year. However, the agency is narrowing its efforts to focus on what they call "high-end collection cases." These cases include high income earners with outstanding tax debt of \$250,000 or more and a total positive income of \$1mm.

Beginning next month, the IRS plans to assess 500 of the largest US partnerships with more than \$10 million in assets. Taxpayers filing partnership returns may be subject to review if they report large balance sheet discrepancies. A balance sheet discrepancy is defined as a large difference in a year-end balance compared to a beginning balance the following year. Partnerships are often used by hedge funds, private equity and venture capital firms, real estate trusts, law firms, doctors, and consulting firms.

Starting in 2024, the IRS intends to focus on digital assets, foreign bank accounts, and labor brokers. The IRS planned to focus on these areas for years and only recently acquired the resources to execute. Earlier this year, we wrote about the IRS's [increased budget of \\$80 billion](#) that was allocated as a result of the bipartisan Inflation Reduction Act of 2022. The increased funding is spread over ten years. In May of this year, the new funding was reduced to \$60 billion because of the debt ceiling negotiations.

The new funds are beginning to benefit the IRS's productivity. The agency collected \$38 million in delinquent taxes from 175 high-income taxpayers earlier this year. This is a low amount compared to the estimated 'tax gap' of \$160 billion per year. The IRS hopes to continue closing the gap in what taxes are owed versus what is paid. The agency made significant progress on the backlog of unprocessed paper tax returns, reducing them by 80% from 13.3 million to 2.6 million in less than a year. A large portion of the IRS funding was allocated to improving customer service, and it seems to be working. Answered phone calls have increased from one in ten in 2022 to one in three this year.

The IRS is using the increased investment to enforce the existing tax code, not to develop new means of taxation. Even so, this apolitical government agency has been politicized in recent years. Some factions of Congress are calling for a further reduction of resources, even its abolishment. Next year is notably a presidential election year. The executive branch has discretion over keeping or replacing the IRS Commissioner and may influence the leadership's area of focus. We will keep you apprised of ongoing developments on the IRS and tax legislation.

Please reach out to your Wealth Manager with any questions about income tax audits.

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