FROST LAW

News
TAX

President Biden's Tax Compliance Agenda Envisions Sophisticated IRS Capable of Increased Enforcement Activities

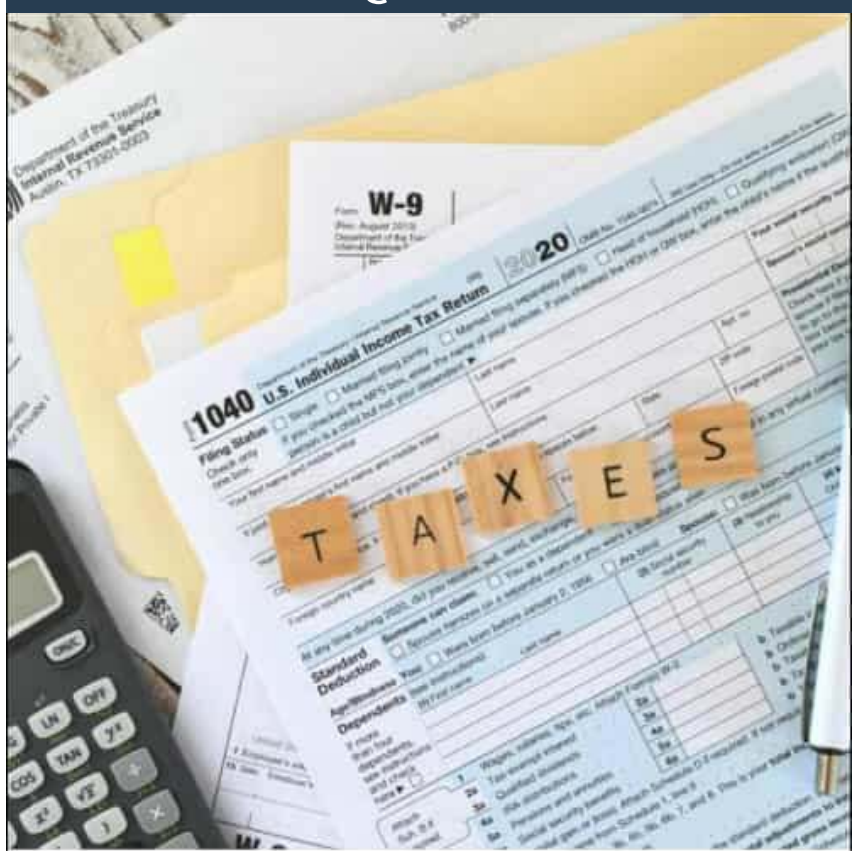
Eli Noff, Esq., CPA, Partner, Mary Lundstedt, Esq., Associate

On May 20, 2021, the U.S. Treasury Department released a report, "The American Families Plan Tax Compliance Agenda" (Treasury Report), detailing President Biden's recently proposed tax compliance initiatives which are intended to "overhaul tax administration in the United States to create a more equitable tax regime." 1 According to the Treasury Report, a significant (approximately $80 billion), 10-year investment aimed to strengthen IRS enforcement measures would result in $700 billion of additional tax revenue to offset the approximately $600 billion "tax gap." 2 The Treasury Report states that the proposed tax compliance measures are intended to primarily target compliance on "less visible" income sources—i.e., those non-labor income sources typically disproportionately benefiting high earners. Without restraints in place, though, there's always a possibility that a larger IRS workforce in conjunction with enhanced technological capabilities is likely to subject a more diverse group of taxpayers to increased enforcement activity. While it is still unclear when, and even how, 3 the proposed provisions may be enacted, it is prudent to familiarize oneself with the agenda's "transformational" elements which, if enacted, would increase IRS resources and information:

1. Revitalizing the IRS

The Treasury Report notes that "[t]he first step in the President's tax administration efforts is a sustained, multi-year commitment to rebuilding the IRS, including nearly $80 billion in additional resources over the next decade." Importantly, the Treasury Report states that this investment would be directed to include: (a) hiring specialized enforcement personnel, such as auditors capable of conducting examinations of high net worth individuals and complex entity structures; (b) modernizing outdated information technology (IT); and (c) investing in meaningful taxpayer service. All three of those interrelated components are crucial for the sustained IRS revitalization envisioned by the Biden administration. And to reach its goals here, the administration's proposal includes two

Info@AskFrost.co



funding mechanisms, a $6.7 billion "program integrity allocation" and a $72.5 billion "dedicated stream of mandatory funds," which are intended to achieve this rebuilding of the IRS.

a) Hiring Initiatives

According to the Treasury Report, the IRS currently employs fewer auditors than at any time since World War II. However, since that time, the need for enforcement resources has grown dramatically due to "a growth in sophisticated evasion opportunities." Specific examples of advanced evasion techniques, described in the Treasury Report:

include the use of foreign bank accounts to shield income from IRS scrutiny and the adoption of international, intra-company dealings that shift income solely for tax purposes but can be made to appear legitimate in ways challenging for the IRS to detect.

The proposed "program integrity allocation" would directly assist with hiring and retaining 5,000 or more new enforcement personnel. Additionally, the "dedicated stream of mandatory funds" would also provide enforcement resources to fortify IRS examination of large corporations, partnerships, and global high-wealth/high-income individuals. The Treasury Report emphasizes that the additional IRS support is meant to enhance "enforcement against those with the highest incomes, and audit rates will not rise relative to recent years for those earning less than $400,000 in actual income."

b) Modernizing Outdated IT and Improving Taxpayer Service

Additionally, as proposed, the compliance initiatives would dedicate nearly $6 billion of the mandatory funds to modernizing outdated and inefficient IT. The Treasury Report indicates that "modernization funding will allow the IRS to address core technology challenges and transform IRS provision of meaningful taxpayer services and tax enforcement efforts." More specifically, upgraded IT would "allow the IRS to make data more easily available for service and enforcement purposes and to move toward near real-time processing." In conjunction with the hiring initiatives discussed above, the practical result would be that modernized IT tools would support a larger and more sophisticated IRS workforce—ultimately enabling the IRS "to leverage the information it collects to better identify tax returns for compliance review."

The Treasury Report also clarifies that revitalization "demands a renewed commitment to meaningful taxpayer service." President Biden's agenda proposes to improve communication between taxpayers and the IRS—specifically, with its increased staff from the hiring initiatives, the IRS would supply additional dedicated customer service representatives to assist taxpayers with newly expanded credit programs such as the Child Tax Credit and the Earned Income Tax Credit.

2. Increased Information Reporting

The second step detailed in the President's tax administration efforts is increased information reporting. The Treasury Report clarifies that increased information reporting "involves shining light on opaque income streams, including proprietorship and partnership business income." The substantial tax gap (estimated at about $200 billion annually) for partnership, S-corporation, and proprietorship income

is directly related to an absence of information reporting resulting in obscured gross receipts and expenses, according to the Treasury Report.
Significantly, the proposed reporting regime would build upon the framework of the existing Form 1099-INT reports that financial institutions use to report interest income. If implemented, a new "annual return would report gross inflows and outflows on all business and personal accounts from financial institutions, including bank, loan, and investment accounts." Note that the Treasury Report indicates that an exception would exist for accounts below a de minimis gross flow threshold.

Moreover, the Treasury Report highlights that the proposed reporting regime would also apply to foreign financial institutions and crypto-asset exchanges, and custodians. Indeed, the Treasury Report projects a "rise in importance" of cryptocurrency transactions in the next 10 years. As such, similar to rules applicable to cash transactions now, the agenda proposes rules to require businesses receiving crypto assets with a fair market value in excess of $10,000 to report those transactions.

3. IRS Regulation of Tax Preparers and Other Compliance Measures

Another compliance measure meant to "complement the transformational nature of the investments and information regime" includes authorizing the IRS with "authority to regulate and establish minimum competency standards for all paid tax preparers." And in the case of "ghost preparers"—those preparers who fail to sign returns they prepared—additional ghost preparer penalties are proposed.

Finally, a myriad of other proposed changes to strengthen tax collection are proposed, which are beyond the scope of this review. However, one should note here that included among these proposals are: (1) requiring that payment recipients certify their taxpayer identification numbers (TINs) to payers issuing third-party information reports, and (2) imposing unpaid corporate tax liability on shareholders in certain tax shelter cases.

Conclusion

The Biden administration envisions a revitalized and larger IRS—comprised of sophisticated staff and upgraded IT, especially capable of exposing "opaque" income streams and increasing and accelerating enforcement activities. Again, as proposed, the administration indicates that its initiatives are not intended to increase the audit rates relative to recent years for taxpayers earning less than $400,000 in actual income. In that case, certainly high-income taxpayers should take note now and brace for a noticeable increase in enforcement activity if the measures are implemented. For instance, those taxpayers should be prepared now to consider whether they might need legal advice and analysis to support positions on tax returns or come into compliance.

More News Articles