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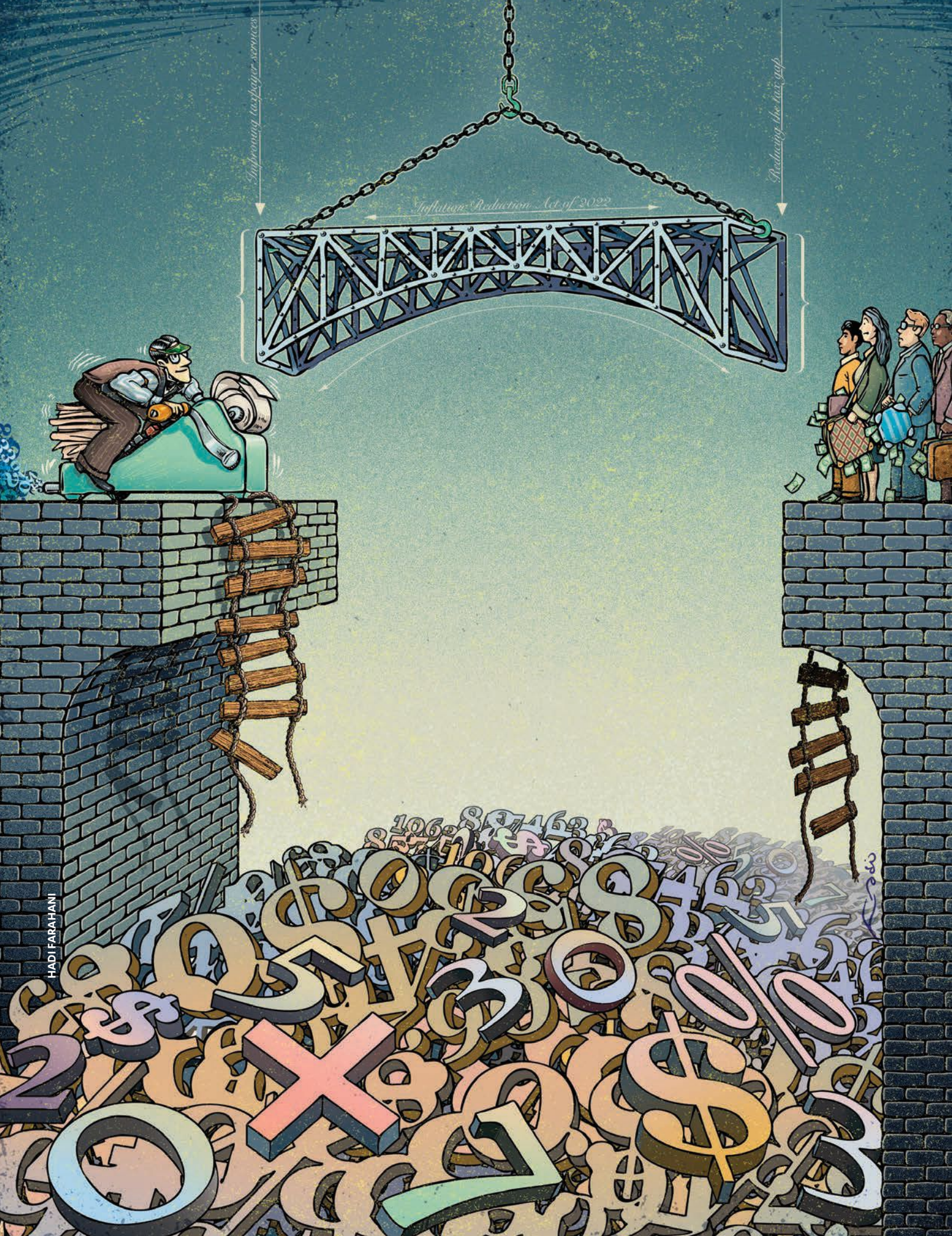
BY SANDRA R. BROWN AND HUNTER KEASTER

**IRS's Strategic
Operating Plan
demonstrates that
improving taxpayer
services and reducing
the tax gap through
stricter enforcement
are mutually
beneficial goals**

Closing the Gap

FOR MANY YEARS, THE INTERNAL REVENUE SERVICE has had to cope with severe budget cuts and a shrinking workforce in the face of an ever-increasing workload, but this is now changing. On August 16, 2022, President Joe Biden signed into law the Inflation Reduction Act of 2022, which provided nearly \$80 billion dollars of funding for the IRS over the next 10 years, though this has since been reduced to \$60 billion dollars.¹

Sandra R. Brown is a principal at Hochman Salkin Toscher Perez, P.C., and a former acting U.S. attorney and chief of the Tax Division for the Central District of California. Hunter Keaster is a law clerk at Hochman and former editor-in-chief of Davis Journal of Legal Studies.



Improving taxpayer services

Reducing the tax gap

Inflation Reduction Act of 2022

HADI FARAHANI

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On April 4, 2016, following and based on testimony by then-IRS Commissioner John Koskinen,² the Center on Budget and Policies stated:

The Internal Revenue Service (IRS) budget has been cut by 17 percent since 2010, after adjusting for inflation, forcing the IRS to reduce its workforce, severely scale back employee training, and delay much-needed upgrades to information technology systems. These steps, in turn, have weakened the IRS's ability to enforce the nation's tax laws and serve taxpayers efficiently, as the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration, the IRS Oversight Board, and the Government Accountability Office have all documented.³

This point was straightforward and correct. The IRS funding cuts meant and, in fact, resulted in a decline in taxpayer services and weakened tax enforcement.

To address these issues, the Inflation Reduction Act provided that more than half of the funds would be for enforcement of tax laws and the remainder for operations, taxpayer services, technology, and development of a direct free e-file system. The IRS projected that these improvements and increased enforcement would bring in \$203.7 billion in revenue from 2022 to 2031.⁴ Despite the fact that the enforcement aspects of such funding were clearly focused on cracking down on those whom the IRS perceived as not complying with the tax laws and, thus, were significant contributors to the ever-increasing tax gap, which is the difference between the amount of tax voluntarily reported and timely paid and the amount that should be paid, a flurry of questions arose as to what exactly the IRS would do with this funding and what the IRS's enforcement priorities would be.

During his ceremonial swearing-in on April 4, 2023, as the 50th IRS commissioner, Danny Werfel announced that the IRS's plans for the funding under the Inflation Reduction Act would be issued later that week, stating there would be "real world improvements for every taxpayer, every tax professional, and every IRS employee."⁵ That same day, Secretary of Treasury Janet Yellen gave clear marching orders to Commissioner Werfel, stating that he will be focused on "dramatically improving taxpayer service and ensuring that large corporations and the wealthy pay the taxes they owe."⁶ Like the statements of the Center on Budget and Policies

seven years earlier, the point of these statements was straightforward: Increased IRS funding will mean improved taxpayer services and vibrant and fair tax enforcement. This is a good start.

On April 14, 2023, the IRS released its "Strategic Operating Plan" (SOP) which describes how the majority of the funds from the Inflation Reduction Act will be directed at making large improvements to taxpayer services and expanding tax enforcement dramatically.⁷ Crucially, these two goals are not divergent and are, in fact, mutually beneficial.

Taxpayer Enforcement

As a result of years of underfunding, the IRS has been operating with antiquated and oftentimes inadequate technology. From manually digitizing paper returns to a lack of responsive customer service, technological shortcomings have held the IRS back from providing accessible taxpayer services and hampered the agency's ability to close the tax gap with efficiently targeted audits and investigations aided by modern technology. Addressing the issue, the agency plans to use the approximately \$60 billion funding from the Inflation Reduction Act to increase examinations for wealthy individuals and partnerships/corporate taxpayers, dramatically improve customer service responsiveness, transition to a "paperless" processing system, and, among other taxpayer service initiatives, better assist taxpayers in understanding their obligations and eligible benefits.

The hope is that more informed taxpayers and tax professionals will result in greater levels of compliance, which will reduce the need for extensive audits and investigations. Simultaneously, increasing audits and investigations will hopefully give taxpayers more incentive to remain or become compliant. Theoretically, the feedback loop that improved taxpayer services and expanded enforcement creates should shrink the tax gap. The symbiotic relationship between ameliorating taxpayer services and optimizing enforcement cannot be understated—one cannot exist without the other—but the question is: How will the IRS prioritize these distinct goals?

The Tax Gap

In 2022, at the time the Inflation Reduction Act became law, there were 2,100 special agents in the IRS's Criminal Investigation (CI) division, the federal law enforcement agency responsible for investigating criminal violations of the Internal Revenue Code. The enforcement funding

under the Inflation Reduction Act also included plans to hire roughly 1,200 CI special agents over the next five years to effectuate an overall "focused" and strengthened enforcement, with audits (which CI does not conduct) of noncompliant high-wealth filers and, for that matter, non-filers, all of which is essential to closing the tax gap, being the primary enforcement tool.

Thus, despite rumors to the contrary, the IRS will not be hiring an army of armed agents to aid in these enforcement efforts. Instead, as Commissioner Werfel stated, while improving taxpayer service and expanding enforcement are important goals for the IRS, "87,000 armed agents kicking in the door of your grandma" is "not on the agenda."⁸

For the tax year 2021, the estimated true tax liability was over \$4.565 trillion for all taxpayers, of which 84.9 percent, or \$3.877 trillion, was paid voluntarily and timely.⁹ That translated into a gross tax gap of \$688 billion. That tax gap is \$192 billion more than it was a little more than five years ago from 2014 to 2016.¹⁰ According to the IRS, even this current tax gap number does not fully reflect non-compliance in all areas.¹¹

Wealthy taxpayers and complex partnerships have benefited from decreasing audit rates in the past decade.¹² The IRS hopes to shrink the tax gap in part by refocusing its enforcement efforts funded by the Inflation Reduction Act on these groups.

As with all rumors of a beefed-up enforcement wing of the IRS, average taxpayers may feel some concern that they will experience an audit or heightened scrutiny from the agency. However, Commissioner Werfel assured the public that funds from the Inflation Reduction Act are aimed at reversing the effects that historical underfunding has had on audits of wealthy filers, not increasing audits beyond historic levels on middle- and low-income filers.¹³ Overall, the agency is directing attention to "the areas of greatest abuse," which Werfel has determined to be compliance for wealthy filers and large partnerships.¹⁴

The IRS has already increased enforcement activity against wealthy taxpayers with more than \$1 million in income and more than \$250,000 in recognized tax debt. In total, the agency contacted 1,600 taxpayers who fall into this category to begin collecting taxes owed.¹⁵ The enforcement activity has been effective thus far. Approximately one year after the passage of the Inflation Reduction Act, the agency

has collected \$122 million from 100 of the 1,600 new high-income cases.¹⁶

In addition to more audit activity for the wealthiest filers, the issue of non-filing is also on the IRS's list of recommended enforcement priorities. Of the 8,720 high-income non-filers for tax years 2017-2020, each had a potential balance of unpaid taxes in excess of \$500,000.¹⁷ The IRS has found that the top 500 high-income non-filers for each of these years represents a select group of individuals earning millions of dollars every year and who collectively owed in excess of \$900 million.¹⁸

While noncompliant wealthy individuals are a major concern for the IRS, Commissioner Werfel is also targeting large corporations and complex partnerships with enforcement funding. Primarily, the agency's Large Business & International Division's Large Corporate Compliance program is expanding with the help of new funding. With the recruitment of new accountants in 2024, the program will start 60 new audits of some of the largest corporate taxpayers.¹⁹ Large corporate taxpayers who have been audited in the past through the program have "average assets of more than \$24 billion and average taxable income of approximately \$526 million per year."²⁰ In addition, the IRS announced that it will ensure that U.S. subsidiaries of large foreign companies are not underreporting taxes through a well-known transfer pricing scheme.²¹

With respect to expanding partnership audits, one key goal is addressing their high no-change rate. Traditionally, audits of partnerships end in no adjustments being made. In fact, the Government Accountability Office and the Treasury Inspector General for Tax Administration found that four out of every five partnership audits result in no change.²² However, this is not because partnerships are uniquely compliant. Rather, it is because of the extreme difficulty in identifying which partnerships to investigate in the first place. Due to the complex structure of many large partnerships, effective case selection has proved difficult for the Large Business & International Division. With funding from the Inflation Reduction Act, the division hopes to use improved data analytics and a larger team to identify noncompliance and conduct more productive audits more efficiently.²³ Key to the success of these goals is the need for hiring highly trained auditors who can conduct effective examinations of a group of sophisticated taxpayers under the addi-

tional constraints of both sides needing to navigate the complex changes enacted under the Bipartisan Budget Act of 2015,²⁴ which requires partnerships that file returns for tax years starting January 2018 to follow the rules under the BBA's centralized partnership audit regime.

The IRS also stated that it wants to help taxpayers avoid tax scams by using money from the Inflation Reduction Act to fund more awareness campaigns on fraudulent tax schemes while also focusing efforts on holding accountable the pro-

pects that this technology will assist in examinations of 75 partnerships in the U.S. with average assets equaling more than \$10 billion among them. The use of artificial intelligence in enforcement activities is indicative of a larger trend brought to the agency by Commissioner Werfel to modernize tax administration. With the tax gap increasing, any cutting-edge technology that can save time is essential to achieving the agency's goals.

The IRS stated that the 2021 tax gap of approximately \$688 billion represents

The expansion of enforcement on wealthy individuals and complex partnerships/corporate taxpayers combined with renovated taxpayer services will see the IRS taking a more active role in the improvement of tax administration.

motors of these schemes and other nefarious actors who participate in these schemes.²⁵ Restoring faith in the agency's ability to effectively communicate and assist taxpayers is essential to the stated goal in the SOP of improving taxpayer service and transforming tax administration.

One notable scheme that the IRS is attempting to stop is the aggressive marketing and abuse of the Employee Retention Tax Credit (ERC). The ERC is a complex credit that was created to help businesses who were struggling due to the COVID-19 pandemic to retain employees. Third-party promoters and marketers pushed the credit on many business owners and, currently, "thousands of ERC claims have been referred to audit."²⁶ In response, the agency has created a new withdrawal option for those who have submitted an "ERC claim but have not yet received a refund" to "avoid future repayment, interest and penalties."²⁷ Meanwhile, the agency is trying to increase taxpayer awareness about who is eligible for a legitimate ERC claim and to practice extreme caution when approached by aggressive promoters.²⁸

The IRS's focus on utilizing technology is not limited to its improvements to taxpayer service. The IRS announced that, through a pilot program, it would use funds from the Inflation Reduction Act for artificial intelligence and machine learning in identifying compliance issues among large partnerships.²⁹ The agency

a "significant jump from previous estimates."³⁰ Thus, the increased enforcement activities of the agency are not without warrant. While approximately 85 percent of taxpayers pay their taxes voluntarily and on time, the agency is focused on bringing the outstanding 15 percent into compliance.³¹ Commissioner Werfel said that the increasing tax gap "underscores the importance" of funds from the Inflation Reduction Act that the agency hopes to put towards enforcement.³²

Increased enforcement activity is not, however, the only way to bring noncompliant taxpayers into compliance. With improved service, taxpayers will be able to obtain a better understanding of their obligations and, ideally, be given concise and clear guidance on how to meet them. Noncompliance is not always intentional. A more informative and accessible IRS will ultimately be a more successful agency. As such, making improvements to tax administration that are felt by the average, usually compliant taxpayer is a vital goal that the agency has targeted moving forward.

Taxpayer Service Improvements

In addition to expanding enforcement on wealthy taxpayers and complex partnerships/corporate taxpayers, the IRS aims to dramatically improve taxpayer service with funding from the Inflation Reduction Act. Included in these improvements is the "paperless processing initiative" that

could save 200 million pieces of paper each year by ensuring all paper-filed returns are digitized upon receipt and adding e-file capability to more than 20 tax forms.³³ The IRS's digitalization efforts will make processing returns more efficient, and customer service representatives will be able to address taxpayer concerns more readily with access to digital information and data analytics.

Data from the Office of Management and Budget and the Congressional Budget Office show that in 1981 there were ap-

In the meantime, the IRS has other plans to meaningfully improve taxpayer service and optimize tax administration. One of the five core objectives of the SOP is to "help taxpayers meet their obligations and receive tax incentives if they are eligible."³⁷ The IRS has outlined various projects and milestones that will help them achieve this objective. Notably, the IRS plans to expand self-service options that will allow taxpayers to access records, communicate securely with the agency, and schedule payments through an online

Act. The agency has launched pop-up walk-in centers at locations that are about 100 miles from the closest walk-in centers to better aid rural and remote communities, and increased the hours of current centers, including being open on Saturdays more often.⁴² Within the first year of receiving funds from the act, the agency hired 745 employees to taxpayer assistance centers, and they have served approximately 235,000 more taxpayers in fiscal year 2023 as compared with fiscal year 2022.⁴³

It is important to remember that the IRS's primary goal with the newly allocated funds is to close the tax gap, and, in one way or another, the changes ultimately are targeted towards meeting that end. If taxpayers are better able to understand their obligations before compliance issues arise, audits and examinations should be needed less. Additionally, if high compliance-risk groups are aware of increased audit rates, it is likely they will have incentives to expend more effort to become or remain compliant. Though not explicitly stated in the SOP, the two central areas of change are mutually necessary and self-reinforcing. Hopefully, taxpayers will not feel comfortable relying on what they may have seen in the past as a nominal audit risk.

The expansion of enforcement on wealthy individuals and complex partnerships/corporate taxpayers combined with renovated taxpayer services will see the IRS taking a more active role in the improvement of tax administration. Taxpayers have more options than ever to communicate with the IRS that will likely increase cooperation and goodwill among the public. The concrete improvements that the agency seeks to realize are vital not only for their material benefits but also for their value in enhancing the reputation and regard of the IRS.

In its first year of receiving funding from the Inflation Reduction Act, the IRS has spent approximately \$2.1 billion of what was allocated.⁴⁴ Of this amount, \$697 million (22 percent of the \$2.1 billion) has been spent on improving taxpayer services. Thus far, only \$115 million has been spent on enforcement as the agency is still ramping up its use of the funds. The U.S. Treasury Department stated that "hiring accountants, forensic auditors, and other high-end enforcement staff takes time" and expects enforcement spending to increase in fiscal year 2024.⁴⁵ Regardless, the agency's plans under the direction of Commissioner Werfel should dramatically change the tax landscape for

The old-fashioned face-to-face help that taxpayers also want, and may need, is a stated goal for the second year of the IRS's implementation of the Inflation Reduction Act.

proximately 86,000 IRS employees processing 166 million returns and that as of 2021 there were 15,000 employees handling 262 million returns.³⁴ As of August 16, 2023, the IRS scanned 225 times more forms (almost 850,000) than it had at the same time in 2022 and increased the number of letters and forms that taxpayers can digitally respond to from 10 to 51. Prior to undertaking the paperless processing initiative, IRS employees keystroked numbers by hand to manually process paper returns. While taxpayers may still file paper returns, by 2025 the IRS hopes to digitize all paper forms immediately after they are received by using updated scanning technology and services.³⁵

On top of improving customer callbacks for up to 95 percent of callers seeking live assistance from the IRS, Laurel Blatchford, the chief implementation officer for the Inflation Reduction Act at Treasury, highlighted the reopening of IRS Taxpayer Assistance Centers, its progress in ensuring wealthy taxpayers pay their taxes, and the launch of new digital tools as improvements made possible under the funding from the act.³⁶ A more responsive and dynamic agency should ensure fewer taxpayers fall through the cracks into noncompliance in the first place. As such, the tax gap may begin to shrink notwithstanding any increased enforcement activity by the agency. The greater the proportion of taxpayers who pay their taxes voluntarily, the more targeted enforcement efforts can be on the most severe offenders.

customer account. Additionally, new voice and chat bots are available to taxpayers who are seeking assistance with routine yet urgent questions.³⁸

A shared principle underlies many of the IRS's digitalization efforts: Taxpayers "should be able to interact with the IRS just as they would with most other customer-centric businesses and financial institutions."³⁹ Commissioner Werfel acknowledged that "the amount of paper still being used in the IRS often feels more like the 1970s and 1980s" and that many of the improvements made possible by funding from the Inflation Reduction Act will help bring the agency to the 21st century.⁴⁰

In October 2023, the IRS took a step towards bringing taxpayer service into the 21st century when it launched the first phase of its business tax account program. When the program is fully realized, taxpayers will be able to interact with the agency digitally and complete various tasks through the interface, ranging from scheduling or canceling tax payments to granting tax information authorizations and/or power of attorney.⁴¹ Responding to notices or letters from the agency is becoming easier for the average taxpayer as new digital mobile-friendly forms make correspondence more accessible.

Technology is not the only focus for increased taxpayer services. The old-fashioned face-to-face help that taxpayers also want, and may need, is a stated goal for the second year of the IRS's implementation of the Inflation Reduction

decades to come by making our tax system what it had been and should always be: the most respected in the world. ■

¹ Fiscal Responsibility Act of 2023, Pub. L. 118-5, 137 Stat. 31, (2023).

² Testimony of I.R.S. Commissioner John A. Koskinen on the IRS budget and current operations, hearing before the Senate Finance Committee (Feb. 10, 2016), available at <http://www.finance.senate.gov/imo/media/doc/2016%20JAK%20testimony%20SFC%20on%20FY17%20budget%20021016x.pdf>.

³ Chuck Marr & Cecile Murray, *IRS Funding Cuts Compromise Taxpayer Service and Weaken Enforcement*, Ctr. on Budget and Policy Priorities (Apr. 4, 2016), <https://www.cbpp.org/research/federal-tax/irs-funding-cuts-compromise-taxpayer-service-and-weaken-enforcement>.

⁴ Congressional Budget Office, *Cost Estimate, Summary, Estimated Budgetary Effects of H.R. 5376, the Inflation Reduction Act of 2022* (Aug. 5, 2022), available at https://www.cbo.gov/system/files/2022-08/hr5376_IR_Act_8-3-22.pdf.

⁵ Press Release, Prepared remarks of IRS Commissioner Danny Werfel – Swearing-in, I.R.S. (Apr. 4, 2023), available at <https://www.irs.gov/newsroom/prepared-remarks-of-irs-commissioner-danny-werfel-swearing-in>.

⁶ Press Release, U.S. Treasury Dep't, Remarks by Secretary of the Treasury Janet L. Yellen at the Swearing-In Ceremony for IRS Commissioner Danny Werfel (Apr. 4, 2023), available at <https://home.treasury.gov/news/press-releases/jy1385>.

⁷ I.R.S., *INTERNAL REVENUE SERVICE INFLATION REDUCTION ACT STRATEGIC OPERATING PLAN FY2023-2031* (2023), available at <https://www.irs.gov/pub/irs-pdf/p3744.pdf> [hereinafter *INFLATION REDUCTION ACT*

STRATEGIC OPERATING PLAN].

⁸ Craig Clough, *IRS Not Sending 87K Armed Agents After Grandma, Chief Says*, LAW360 (Oct. 26, 2023), <https://www.law360.com/articles/1737499/irs-not-sending-87k-armed-agents-after-grandma-chief-says>.

⁹ MELANIE R. KRAUSE ET AL., *FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP PROJECTIONS FOR TAX YEARS 2020 & 2021*, I.R.S. 8 (2023), available at <https://www.irs.gov/pub/irs-pdf/p5869.pdf>.

¹⁰ *Id.* at 11.

¹¹ I.R.S. News Release IR-2023-187 (Oct. 12, 2023).

¹² Charlotte Morabito, *Here's Why IRS Tax Audits Have Fallen Over the Past Decade*, CNBC (Apr. 1, 2023), <https://www.cnbc.com>.

¹³ I.R.S. News Release IR-2023-166 (Sept. 8, 2023) [hereinafter *IR-2023-166*].

¹⁴ *Id.*

¹⁵ I.R.S. News Release IR-2023-194 (Oct. 20, 2023) [hereinafter *IR-2023-194*].

¹⁶ *Id.*

¹⁷ Letter from Sen. Ron Wyden, Chair, Fin. Comm., to I.R.S. Comm. Danny Werfel (Sept. 28, 2023), available at https://www.finance.senate.gov/imo/media/doc/wyden_letter_to_irs_on_high_income_nonfilers_final_092823.pdf.

¹⁸ *Id.*

¹⁹ *IR-2023-194*, *supra* note 15.

²⁰ *Id.*

²¹ *Id.*

²² Jonathan Curry, *As Partnership Audits Ramp Up, IRS Sets Sights on No-Change Rate*, TAX NOTES (Oct. 19, 2023), <https://www.taxnotes.com>.

²³ *Id.*

²⁴ Pub. L. 114-74, tit. XI, 129 Stat. 584 (2015).

²⁵ *INFLATION REDUCTION ACT STRATEGIC OPERATING PLAN*, *supra* note 7, at 36.

²⁶ I.R.S., News Release IR-2023-193 (Oct. 19, 2023).

²⁷ *Id.*

²⁸ *Id.*

²⁹ *IR-2023-166*, *supra* note 13.

³⁰ Jory Heckman, *IRS Looks to Shrink \$688B 'Tax Gap' Through Increased Enforcement Hiring*, FEDERAL NEWS NETWORK (Oct. 12, 2023), <https://federalnewsnetwork.com/hiring-retention/2023/10/irs-looks-to-shrink-688b-tax-gap-through-increased-enforcement-hiring>.

³¹ *Id.*

³² *Id.*

³³ Press Release, Remarks by IRS Commissioner Danny Werfel on the Paperless Processing Initiative, I.R.S. (Aug. 2, 2023), available at <https://www.irs.gov/newsroom/remarks-by-irs-commissioner-danny-werfel-on-the-paperless-processing-initiative> [hereinafter *Werfel Remarks*].

³⁴ Stephen K. Cooper, *House Panel Clears Bill To Cut IRS Funding To \$11.2B*, LAW360 (July 13, 2023), <https://www.law360.com/tax-authority/articles/1699300/house-panel-clears-bill-to-cut-irs-funding-to-11-2b>.

³⁵ *Werfel Remarks*, *supra* note 33.

³⁶ I.R.S., News Releases IR-2023-127 (July 14, 2023) [hereinafter *IR-2023-127*], *IR -2023-126* (July 14, 2023).

³⁷ *INFLATION REDUCTION ACT STRATEGIC OPERATING PLAN*, *supra* note 7, at 12.

³⁸ *Id.*

³⁹ *Werfel Remarks*, *supra* note 33.

⁴⁰ *Id.*

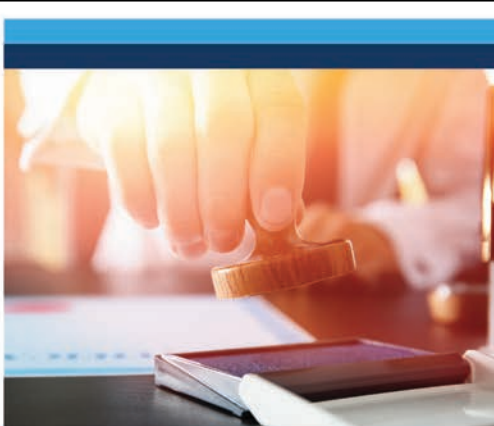
⁴¹ *IR-2023-194*, *supra* note 15.

⁴² *IR-2023-127*, *supra* note 36.

⁴³ *IR-2023-194*, *supra* note 15.

⁴⁴ Lauren Loricchio, *IRS Spent \$2.1 Billion in IRA Funds in First Year*, *Reports Show*, TAX NOTES (Oct. 5, 2023), <https://www.taxnotes.com>.

⁴⁵ *Id.*



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