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Thank you for the opportunity to speak with you today. I am the co-founder of Policy Impacts, an organization based at MIT that seeks to improve the quality of government decision-making using high quality evidence on the costs and benefits of potential policy changes. I sit here not with the goal of advocating for any particular policy, but sharing what I believe to be the best evidence of the costs and benefits of those policies.

In June of this year, our research team, which includes Will Boning, Ellen Stuart, and Ben Sprung-Keyser, released a comprehensive analysis of the returns to IRS audits of taxpayers across the income distribution. We studied the costs of conducting each in-person audit in the US and the revenues associated with those audits for the universe of IRS audits going back to 2010. For each audit, we produced a comprehensive measure of the cost of that audit from internal IRS accounting information as well as detailed activity logs, which record the enforcement activities of all IRS auditors. These costs include all stages of the audit, including the initial exams, any subsequent appeals, and collections stages of the audit. And, they include not just the direct costs of auditors time but a comprehensive accounting of non-labor costs, including management, training, computing, travel, building rent, etc. In addition to costs, we estimate a comprehensive measure of the revenue generated from each audit. This includes both the upfront revenue provided during the audit and the effect of audits on future tax revenue paid by audited individuals – i.e. the future deterrence effects of audits.

Ultimately, our paper estimates that marginal expenditures on in-person audits directed towards top-earning taxpayers, those above the 90th income percentile, are likely to return at least $12 in revenue for each $1 in costs.[1] In contrast, audits of individuals with below-median income deliver around $5 for each $1 in costs. Importantly, a large portion of this increased revenue comes through the impact that audits have on future taxpayer behavior: for each $1 the IRS collects during an audit, they eventually receive an additional $3 in the future from higher taxes paid, likely because taxpayers learn during the audit about their actual tax liabilities.

Our work also studies whether expanded enforcement expenditures would face diminishing returns: We do so by analyzing the large decline in audit rates from 2010-2014 tax years. We show that when the IRS heavily cut back on its audits, the rate of return on IRS expenditures didn't change. While ramping up IRS enforcement may include some additional upfront costs such as training new auditors, these results suggest that if the IRS expands its audits back to

[1] We find larger returns in the top 1%. The initial returns are above 6:1 in the top 1% and, although the deterrence estimates are statistically imprecise, they suggest an estimate of the total return in excess of 18:1.

2010 levels, we should expect the rate of return on IRS audits to remain relatively stable and in line with our estimates.

Our estimates are larger than what has been estimated in previous literature and that led to the CBO scoring of the expanded IRS enforcement in the Inflation Reduction Act. The CBO has suggested that expanded IRS enforcement in the IRA would deliver roughly $180B in revenue from $46B in costs, for a ratio of 3.9. Our results suggest the true return on this spending could be as much as three times higher. The primary difference in our estimates is that the CBO has been reluctant to include estimates of deterrence effects in their forecasts, noting that the magnitude of these effects is "highly uncertain". We believe our estimates address this uncertainty and show that across a broad range of years and taxpayers, roughly 3x more revenue is collected from a taxpayer after the upfront revenue they pay during their audit. Applying our estimates to the IRA suggests net revenues closer to the $500B range.

We also consider the implications of our results for the efficiency of raising revenue through audits. The high return per dollar spent suggests that the "deadweight loss" associated with tax audits is low relative to the revenue raised. This suggests that in addition to the equity concerns of ensuring compliance with the tax code, increasing audit enforcement is a relatively efficient way to raise revenue.

To sum up, our analysis shows much greater returns to IRS audits than previously estimated, particularly for the highest earners – and we found no evidence that marginal returns would be diminished if the IRS expanded enforcement back to 2010 levels.

Disclaimer: This testimony draws on results from NBER Working Paper #31376, "A Welfare Analysis of Tax Audits Across the Income Distribution", by William C. Boning, Nathaniel Hendren, Ben Sprung-Keyser, and Ellen Stuart. This research was conducted while an author was an employee at the U.S. Department of the Treasury. The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors and do not necessarily reflect the views or the official positions of the U.S. Department of the Treasury. Any taxpayer data used in this research was kept in a secured Treasury or IRS data repository, and all results have been reviewed to ensure that no confidential information is disclosed.