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Chairman Whitehouse, Ranking Member Grassley, Members of the Committee: Thank you for inviting me to share my views on the importance of adequately funding the Internal Revenue Service (IRS) and the budgetary impact of the agency's efforts to pursue tax evasion by wealthy individuals and large corporations.

The Inflation Reduction Act's (IRA's) $80 billion investment in the IRS represented a substantial opportunity for the agency—and for the nation's fiscal situation.

The reality is that the vast majority of taxpayers want to make good on their tax obligations. But for years, they had a hard time doing so because of an underfunded IRS that lacked the capacity to provide the most basic assistance to taxpayers, like answering phone calls received during filing season or staffing Taxpayer Assistance Centers (TACs) in low-income and rural communities.

The IRA is changing all of that: The agency's first step with its new resources was to invest in improving the taxpayer experience. And, thanks to thousands of new hires, it has already succeeded: The IRS achieved an 87% level of service this past filing season (up from 18% in 2022).[1] Phone wait times declined 85%. The IRS served more than 100,000 more taxpayers in person this filing season than the agency was able to last year, deploying IRA funds to hire hundreds of new TAC employees and reopen centers that had previously been closed.

The agency's recent successes also include major technological progress that is already paying off, with new features like customer callbacks and business tax accounts that allow small business owners to transact with the IRS easily and efficiently online. These may seem like small victories, but I assure you that they are monumental, as they are making a real impact on the lives of your constituents each and every day.

Before the IRA investments in the IRS, the agency hadn't meaningfully modernized tax processing or taxpayer service in the last several decades, because it lacked the resources to do so. When returns were filed on paper, they were transcribed by hand by IRS employees. Those employees removed staples from paper returns manually, because staple removers were hard to come by. Some had the sole job of standing next to scanners that were decades old, because they jammed frequently and needed to be unstuck by hand.

[1] U.S. Department of the Treasury. 2023. "Filing Season 2023 Report Card: IRS Delivered Significantly Improved Customer Service." April 17, 2023; National Taxpayer Advocate. 2022. "Fiscal Year 2023 Objectives Report to Congress." Internal Revenue Service.

The idea of being able to afford chairs that weren't broken at IRS submission processing campuses seemed at the time like a pipe dream, let alone the possibility of digitizing paper-return processing, or gearing up for piloting a free, direct e-file program next filing season to allow eligible taxpayers to save hundreds of dollars on tax preparation by filing directly with the IRS.

The National Taxpayer Advocate opened her mid-year report to you this year remarking "What a difference a year makes!"[2] She is absolutely right. The impact of the IRA's investment in the agency is already reaping significant benefits. And if—but only if—the agency retains this additional funding, it will continue to deliver for the American people.

Alongside its service investments, the IRS is prioritizing high-end enforcement efforts. Although wage earners are largely compliant with their tax obligations automatically (their taxes are withheld), those who earn income in ways that are not transparent to the IRS often underreport income and as such underpay their tax obligations.[3] This costs the fisc over $600 billion annually, or more than 2% of GDP of an annualized basis. Tax evasion is not distributed equally: The top 1% of the income distribution is responsible for nearly 30% of that total.[4]

In addition to creating a significant revenue hole, the tax gap thus perpetuates deep inequities in the economy. We currently have a two-tiered tax system: Ordinary taxpayers pay all that they owe, but high-income evaders and profitable corporations often do not pay their fair share. That means any new taxes are borne only by those who are compliant. It also means that business owners who want to fulfill their civic duty and comply with their tax obligations are at a competitive disadvantage relative to those who choose to evade.

In my testimony today, I would like to make four points about noncompliance in our tax system and the importance of the IRA's investment. First, given the size of the tax gap, adequately funding the IRS is critical to our fiscal sustainability. Second, given the distribution of the tax gap, adequately funding the IRS is critical to creating a fairer economy, and the agency's nascent work to pursue high-end evasion illustrates this potential. Third, recissions of IRA funds will add meaningfully to the deficit because they will limit the agency's capacity to do this critical work. Fourth, clawing back IRA funds, or lowering the IRS's discretionary appropriations, will harm the American people by decreasing the level of service that the agency is able to provide them.

1. Funding the IRS is Critical to Fiscal Sustainability

Earlier this month, the IRS released its latest estimates of the federal tax gap. For tax year 2021, the agency projected a gross tax gap (the difference between taxes owed and what was voluntarily paid) of around $668 billion. Enforcement efforts help the IRS chip away at the tax gap, but only slightly: The net tax gap that accounts for enforced or other late payments remains at around $625 billion. Post-filing activities by the IRS bring the overall compliance rate to 87%,

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[2] National Taxpayer Advocate. 2023. "Fiscal Year 2024 Objectives Report to Congress." Internal Revenue Service.
[3] Misreporting rates are over 50% for opaque streams of income where the IRS has no third-party information it can use to assess the veracity of income reporting. See Figure 4, Internal Revenue Service. 2023. "Federal Tax Compliance Research: Tax Gap Projections for Tax Years 2020 & 2021."
[4] Sarin, Natasha. 2021. "The Case for a Robust Attack on the Tax Gap." U.S. Department of the Treasury. September 7, 2021.

but that means that 13 of every 100 dollars owed to the federal government under the laws enacted by Congress are never collected. It is this lever that the IRS is directly impacting through new IRA resources.

It is difficult to appreciate how significant a loss to the fisc $625 billion of uncollected taxes represents, so some comparisons may be helpful. One year's worth of uncollected taxes totaled 2.7% of GDP in 2021.[5] One year's worth of uncollected taxes would have covered an extension of the expanded child tax credit—lifting millions of children out of poverty—through 2025.[6] One year's worth of uncollected taxes would pay for nearly all of the non-defense discretionary spending that the federal government does. One year's worth of uncollected taxes would shrink our annual budget deficits by between one-third to one-half.[7]

And the IRS's estimates of noncompliance are an underestimate of the magnitude of tax evasion in the economy today. Although the agency has a relatively clear picture of noncompliance for individuals, it lacks the tools to measure noncompliance in other components of the tax system. The agency is explicit about this limitation, noting that data issues prevent it from a fulsome picture of noncompliance "particularly as it relates to corporation income tax, income from flow-through entities, foreign or illegal activities, [and] digital assets."[8] More generally, areas of emerging challenge for the agency—where noncompliance is likely rampant—are precisely the areas where the IRS has historically struggled to measure evasion using its traditional tax gap methodology.

As one example, the IRS's most recent detailed study of pass-through evasion was conducted in the 1980s.[9] In the intervening four decades, these structures have grown in importance: For example, partnership income as a share of business income grew from less than 5% to more than 35% today.[10] But the IRS has not had resources to devote to measuring partnership evasion, let alone thinking about how best to address it, and indeed, today the agency's partnership audit rate is approximately 0%.[11] Official estimates are that less than 5% of the income from these entities is underreported.[12] But that is surely a lower bound, given how easy it is to hide income, even from an IRS audit, when complex partnerships have structures that look like this:

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[5] Bureau of Economic Analysis. 2022. "Gross Domestic Product, Fourth Quarter and Year 2021 (Second Estimate)." U.S. Department of Commerce. February 24, 2022.

[6] Osorio, Victoria and John Ricco. 2021. "Expanding the Child Tax Credit: Budgetary, Distributional, and Incentive Effects." Penn Wharton Budget Model. October 25, 2021.

[7] Peter G. Peterson Foundation. 2023. "The Current Federal Deficit and Debt."

[8] Internal Revenue Service. 2023. "Federal Tax Compliance Research: Tax Gap Projections for Tax Years 2020 & 2021."

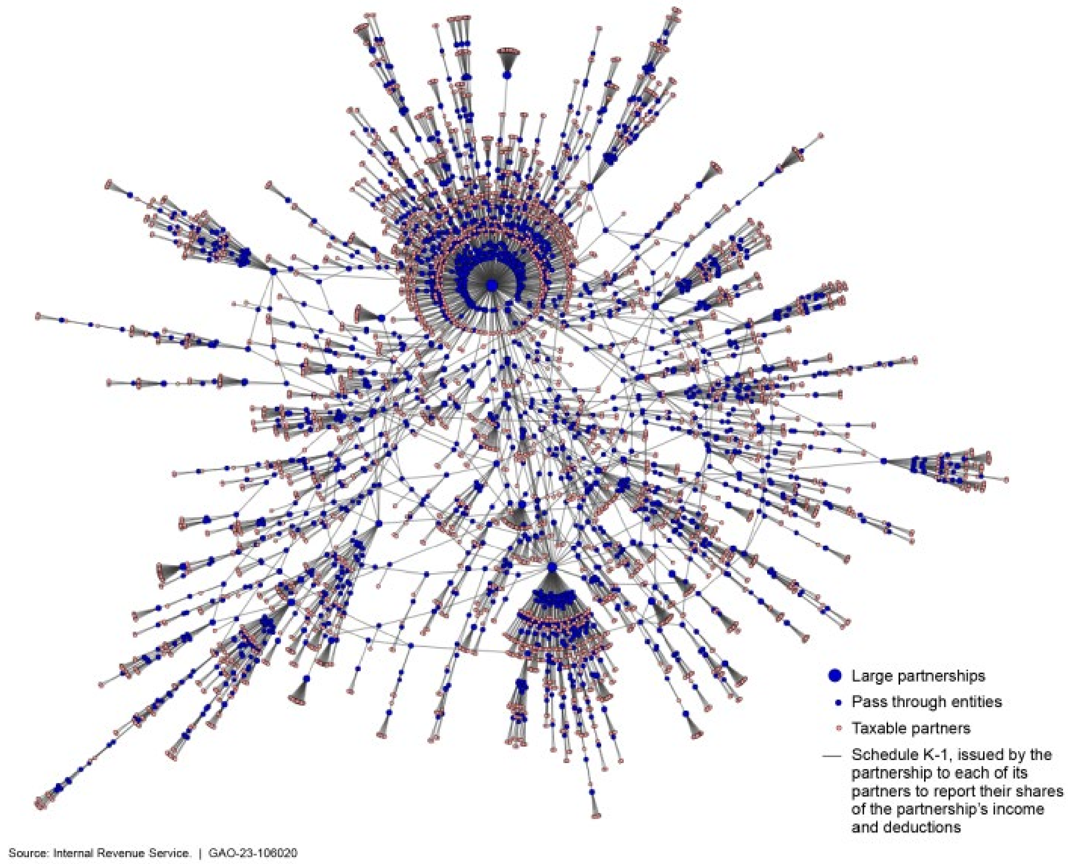
[9] U.S. Government Accountability Office. 2014. "Partnership and S Corporations: IRS Needs to Improve Information to Address Tax Noncompliance."

[10] U.S. Department of the Treasury. 2021. "The American Families Plan Tax Compliance Agenda."

[11] In tax year 2019, the last year for which the IRS's audit coverage data is complete, the agency opened audits of 3,269 partnerships of the 4.1 million partnership returns it received, an audit rate of 0.08%. Internal Revenue Service. 2023. "Internal Revenue Service Data Book, 2022."

[12] GAO recently recommended that the IRS devote resources to identifying partnership noncompliance that conventional models fail to detect, and the agency is dedicating IRA funds to this effort. U.S. Government Accountability Office. 2023. "Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships"; Internal Revenue Service. 2023. "IRS Announces Sweeping Effort to Restore Fairness to Tax System with Inflation Reduction Act Funding; New Compliance Efforts Focused on

Figure 1: Visual Illustration of a Complex Partnership[13]



Offshore evasion has historically also been underestimated: A recent paper suggests that in over 90% of cases where an auditor had looked into taxpayers with offshore accounts, the audit did not uncover any foreign asset reporting requirement when one existed.[14] All this has led experts to conclude that the tax gap is even larger than the mammoth official IRS estimates suggest: Indeed, former Commissioner Rettig famously speculated that noncompliance today totals closer to $1 trillion annually rather than the $600 billion or so that the IRS estimates.[15] While a bigger tax gap means evasion is an even greater cause for concern than the tax gap estimates suggest, it

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Increasing Scrutiny on High-Income, Partnerships, Corporations and Promoters Abusing Tax Rules on the Books." September 8, 2023.

[13] U.S. Government Accountability Office. 2023. "Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships."

[14] Guyton, John, Patrick Langetieg, Daniel Reck, Max Risch, and Gabriel Zucman. 2021. "Tax Evasion at the Top of the Income Distribution: Theory and Evidence." The authors conclude that the tax gap is underestimated by at least 10 percent as a result of hard-to-detect evasion, and that evasion is more concentrated at the top of the distribution than official estimates suggest, because those taxpayers are most able to shield their evasive activity from audits, and thus, official tax gap measures.

[15] Former Treasury Secretary Lawrence Summers also proposed a tax gap number closer to $1 trillion at a panel last week at the Center for American Progress. Summers, Lawrence and Patrick Gaspard. "How Threats to IRS Funding Endanger America's Fiscal Future." Center for American Progress. October 31, 2023.

also means that the return on investments in the agency is even greater than previously understood.

With CBO estimating that debt will reach 119 percent of GDP over the course of the next decade and with the looming insolvency of the Social Security and Medicare trust funds, the need for revenue is paramount.[16] This need is heightened in the face of rising interest rates that are increasing government borrowing costs. Adequate funding for the IRS is a critical tool to help the United States meet this fiscal moment, and it is low-hanging fruit: a guaranteed improvement in the budget outlook simply from collecting the taxes that are already owed under the laws enacted by Congress.

2. Funding the IRS is Critical to Creating a Fairer Economy

In previous work I did while at the Treasury Department, I estimated that the top 1% of the income distribution is responsible for nearly 30% of unpaid taxes, or over $2 trillion over the course of the next decade. But this, too, is a lower bound, as the misestimation of the aggregate tax gap skews our understanding of its distribution as well.

Table 1: Distribution of the Tax Gap[17]

Taxpayers ranked by income corrected for estimated unreported income	Estimated Percentage of Unpaid Taxes	Estimated Unpaid Tax ($B, 2019)
P0-10	<.5%	< 3
P10-20	<.5%	< 3
P20-30	1.0%	6
P30-40	1.7%	10
P40-50	2.4%	14
P50-60	3.8%	22
P60-70	5.5%	32
P70-80	8.2%	48
P80-90	12.9%	75
P90-95	11.5%	67
P95-99	24.7%	144
P99-99.5	7.4%	43
P99.5-100	20.6%	120
Top 1%	**28.0%**	**163**

Given the concentration of the tax gap, the enforcement trends in the decade-plus leading up to the passage of the IRA were especially troubling. The agency's enforcement budget declined around 30% between 2010 and 2022, leading to a similar decline in enforcement staffing, such

[16] Clausing, Kimberly A. and Natasha Sarin. 2023. "The Coming Fiscal Cliff: A Blueprint for Tax Reform in 2025." The Hamilton Project.
[17] Sarin, Natasha. 2021. "The Case for a Robust Attack on the Tax Gap." U.S. Department of the Treasury. September 7, 2021.

that the IRS had fewer revenue agents in the field than at any time since World War II.[18] Unsurprisingly, over this period there was an across-the-board decrease in the IRS's enforcement capacity.

But the decline was the most pronounced for high-end enforcement work, where a single audit can require hundreds of hours of work by a team of experienced revenue agents. Because the IRS lost these employees at the highest rates during years of funding cuts, its capacity to do this work plummeted most precipitously.

Myriad examples make this clear: Audit rates of individuals making $10 million or more declined by 80% over this period, while audit rates for low-earning recipients of the Earned Income Tax Credit declined by less (around 50%).[19] Similarly, between 2017-2020, over 1.4 million high-income evaders failed to file returns (the easiest type of evasion to detect), and in doing so cost the fisc $66 billion. A small subset of this group—2,000 of the most aggressive high-wealth evaders—were responsible for nearly $1 billion of that total.[20] Prior to the IRA's passage, the IRS lacked the capacity to aggressively pursue even this type of blatant evasion. Similarly, in 2010, large corporations were essentially always audited each year; since then, the IRS's capacity to do this work was slashed in half.[21] And though audit rates for complex partnerships were never high (they peaked at around 1.5% in 2010), they have dropped to basically zero today.[22]

Our progressive tax system is an important vehicle for redressing inequities in our economy. Indeed, the IRS is the largest administrator of federal benefits, and it was responsible for disbursing $1.5 trillion in financial lifelines to families in need during the COVID-19 pandemic.[23] But today, in important ways that system is adding to inequities rather than redressing them. This is because resource constraints have impeded the IRS from enforcing the tax laws equitably across the income and wealth distributions.[24]

The IRA represented a historic investment in tax administration aimed at reversing these trends. And it is already succeeding.

In the last nine months, the IRS has collected $160 million in back taxes from millionaires. While that magnitude may seem small relative to the billions in unpaid taxes that this group is

[18] Sarin, Natasha and Mark J. Mazur. 2023. "The Inflation Reduction Act's Impact on Tax Compliance—and Fiscal Sustainability."
[19] Id.
[20] Senator Ron Wyden Letter to IRS Commissioner Danny Werfel. September 28, 2023.
[21] Sarin, Natasha and Mark J. Mazur. 2023. "The Inflation Reduction Act's Impact on Tax Compliance—and Fiscal Sustainability."
[22] U.S. Government Accountability Office. 2023. "Tax Enforcement: IRS Audit Processes Can Be Strengthened to Address a Growing Number of Large, Complex Partnerships."
[23] Retting, Charles. 2022. "IRS Statement — IRS Commissioner Charles Rettig's final message." Internal Revenue Service. November 10, 2022.
[24] The IRS has said this explicitly, noting prior to the IRA's passage that it could not do more higher income audits because it did not have employees with the experience or skillset to do this work. Wrote former Commissioner Rettig, "Congress must fund and the IRS must hire and train appropriate numbers of [revenue agents] to have appropriately balanced coverage across all income levels." Retting, Charles. 2019. Letter to Senator Ron Wyden. September 6, 2019.

responsible for, it is proof of concept: Focusing on high-income taxpayers who fail to make good on their tax obligations will reap significant revenue. You can see that anecdotally: In one of the cases that the IRS closed last month, a single individual was ordered to pay more than $15 million in restitution for claiming personal expenses—like the construction of a 51,000-square-foot mansion boasting tennis, basketball, and bocce courts, and luxury artwork and homes for his children—were deductible business expenses.[25] You can also see it in academic estimates of the return on investment from the type of enforcement push that the IRS is undertaking: Recent work by Will Boning, Nathan Hendren, Ben Sprung-Keyser, and Ellen Stuart demonstrates that $1 of IRS spending on audits of top earners delivers more than $12 of tax revenue. And this 12:1 rate of return is if anything understated, because it excludes community deterrence effects that accrue when taxpayers and tax professionals increase voluntary compliance in response to the IRS successfully pursuing the evasion of others in their networks.[26]

The IRS has also logged substantial progress with respect to corporate malfeasance. To take one important example, the agency recently shared with Microsoft a Notice of Proposed Adjustment to flag that the company owes an additional $28.9 billion in back taxes to the IRS for what the agency deems was an illicit cost sharing agreement to avoid taxation. This is not a new case: It is decades old (the taxes in question are for the 2004-2013 period), and it won't be resolved soon.[27] But its existence illustrates what a resourced IRS will be able to do: pursue large companies and their tax consultants that skirt tax laws to their own advantage. Historically, these types of cases have been few and far between for the IRS because they require a battle over many years against very well-heeled opponents. While still akin to David and Goliath, thanks to the IRA, the scales have been tilted some in the IRS's favor. As a result, there will be more cases like this one in the agency's near-term future, and the dollars at stake are staggering: For context, the $28.9 billion Microsoft allegedly owes would by itself account for much of the estimated corporate tax gap this year.[28]

Improving the fairness of our tax system does not just mean more IRS scrutiny for taxpayers who are skirting their obligations. It also means less IRS scrutiny for the vast majority of Americans who are already paying all that they owe. The key to this is improved technology.

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[25] Internal Revenue Service. 2023. "IRS Launches New Initiatives Using Inflation Reduction Act Funding to Ensure Large Corporations Pay Taxes Owed; Continues to Improve Service and Modernize Technology with Launch of Business Tax Account."

[26] Recent work also by Will Boning, along with John Guyton, Richard Hodge, and Joel Slemrod, finds that community deterrence effects can be as large as the direct effects of IRS enforcement activities: Specifically, in-person collection visits raise as much revenue from firms sharing tax preparers as from the visited firm itself. Boning, William C., John Guyton, Ronald Hodge, and Joel Slemrod. "Heard it Through the Grapevine: The Direct and Network Effects of a Tax Enforcement Field Experiment on Firms."; Journal of Public Economics 190 (2020).

[27] Microsoft is pursuing an appeal, and the resolution is expected to take several years. Goff, Daniel. 2023. "An Update on our IRS Tax Audit." Microsoft. October 11, 2023.

[28] The most recent corporate tax gap was $37 billion. To be sure, this is not an apples-to-apples comparison, as the Microsoft back taxes are owed for a ten-year period. But the fact that a single company could be responsible for this much in unpaid taxes highlights the extent to which the official corporate income tax gap numbers are likely a substantial underestimate. Internal Revenue Service. 2023. "Federal Tax Compliance Research: Tax Gap Projections for Tax Years 2020 & 2021."

Today, the IRS has the oldest IT system in the US government, with its data stored on the Individual and Business Master Files systems that were designed a half-century ago. In addition to being expensive to maintain (the programs are written in a programming language called COBOL that is no longer taught), this infrastructure is also a real limitation on the agency's capacity to deploy data in effective ways. The technological environment today makes it difficult to compare taxpayers to each other—or even compare the same taxpayer over time—as the IRS makes enforcement choices. It is also challenging to deploy the information that the IRS already has at its disposal as it seeks to decide which tax returns necessitate a closer look: For example, in 2010 Congress passed the Foreign Account Tax Compliance Act (FATCA) to provide better visibility to the IRS about foreign accounts used by taxpayers. But the agency has over the last several years struggled to make use of this data because it has not had the capacity to match the information reported by foreign financial institutions with taxpayer returns.[29] Similarly, the IRS receives 40 million K-1 forms associated with partnership income each year, but it does not have the capacity to match this information with individual returns, so it uses it only when the IRS actually opens up an examination, not to make enforcement decisions ex-ante.[30]

More generally, when the IRS makes enforcement decisions, it relies on outdated IT, it cannot use state-of-the-art data analytics approaches, and often it does not make use of all the information that it possesses. So, too often when the agency chooses whom to audit, it is shooting in the dark, rather than acting based on the likelihood that a taxpayer may have evaded her obligations. Improving the underlying technology and processes that the IRS uses will make it a more efficient tax administrator, so that taxpayers who are already compliant with their tax obligations are less likely to get audited, and those who are evading taxes are more likely to. Contrary to what some critics of the agency suggest, that means fewer audits and less time spent with the IRS for compliant taxpayers—not more.

But this type of technological revolution is one that will take time to deliver on its promise. And it will take resources, which is why the IRA is so critical. It included $4.75 billion for "business systems modernization" to spend over the course of a decade on modernizing the agency's IT. That may seem like a lot, but it is just a down payment on the investments that must be made. Consider this: The IRS services every American household each year. JP Morgan touches less than half of them. But this year alone, JP Morgan plans to spend $15.3 billion on improving its already state-of-the-art technology.[31] The IRS needs more IT funding, not less, and yet last year the agency saw its business systems modernization account fully zeroed out in the appropriations process, which will make this type of progress harder to achieve.

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[29] U.S. Government Accountability Office. 2019. "Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad."
[30] U.S. Congress. Senate. Committee on Finance: Hearing before the Subcommittee on Taxation and IRS Oversight. *Closing the Tax Gap: Lost Revenue from Noncompliance and the Role of Offshore Tax Evasion*. 107th Cong., 1st sess., May 11, 2021. (Statement of Charles O. Rossotti, Former IRS Commissioner).
[31] Targett, Ed. 2023. "JP Morgan's Technology Spend to Hit $15.3 Billion as Storage, Compute Volumes Surge." The Stack. May 30, 2023.

3. Recissions of IRA Funds are Misguided and Will Significantly Increase the Deficit

Since the passage of the IRA, some have pushed for a recission of the agency's new funds.[32] Indeed, a few months ago, as part of the debt ceiling negotiations, there was an agreement to rescind $21.4 billion of IRA funds and redirect them from the IRS to other activities.

There is irony in this agreement being a part of the debt ceiling negotiations, because defunding the IRS makes our fiscal picture bleaker. Unsurprisingly, that is the conclusion CBO came to when it considered the budgetary impact of this clawback. It found that the IRS's decreased enforcement capacity would add to the deficit by decreasing tax collection by $40.4 billion over the course of a decade.[33,34]

While directionally correct, I have long believed that official estimates substantially underestimate the revenue at stake from increased IRS enforcement efforts—and thus understate the cost to the fisc of the recissions that some have advocated.[35]

In recent work, Mark Mazur and I estimated that the IRS would raise around $560 billion in new tax collection over the course of a decade ($480 billion, net of investment) as a result of the IRA, or more than three times CBO's estimates. There are three primary reasons for this difference. First, official estimates focus solely on the returns to new dollars spent on enforcement activities (e.g., hiring auditors and collections agents). But any gains from technological improvement (e.g., through better use of information about offshore financial accounts) or taxpayer service (e.g., more voluntary compliance through better phone service) are unscored. Second, official estimates assume very substantial diminishing marginal returns to new IRS investment.[36] But given the nadir that the IRS is starting from, with audit rates in categories like partnership at zero percent and multimillionaire audits declining by 80% in the last decade, it is hard to see how the agency could be close to diminishing returns.[37] Finally and most importantly, official estimates have historically included no (and now, include only a miniscule) adjustment for taxpayer behavior from increased IRS enforcement efforts. But there is a wealth of evidence that suggests that increased enforcement capacity meaningfully deters malfeasance: Indeed, Treasury's own

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[32] In fact, the first piece of legislation passed by the House in this Congress was a vote to claw back nearly all of the IRA funds that the agency received. Guggenheim, Benjamin. 2023. "House Republicans use First Vote to Gut IRS Funding Boost." Politico. January 9, 2023.

[33] McClelland, John. 2023. Email to Senate Budget Committee. June 1, 2023.

[34] CBO consistently scores proposed IRS rescissions as deficit increases, see also Congressional Budget Office. 2023. "Additional Information on the Estimate of Rescinding Funding for Tax Enforcement." October 17, 2023; Swagel, Phillip L. 2023. "CBO's Estimate of the Budgetary Effects of H.R. 2811, the Limit, Save, Grow Act of 2023." Letter to Representative Jodey Arrington. April 25, 2023; Congressional Budget Office. 2023. "Estimated Budgetary Effects of H.R. 23, the Family and Small Business Taxpayer Protection Act." January 9, 2023.

[35] For a detailed account, see, e.g. Sarin, Natasha and Lawrence H. Summers. 2020. "CBO Recognizes, but Understates, Potential of Tax Compliance Efforts." Tax Notes Federal. July 20, 2020.

[36] Specifically, CBO assumes that the first $20 billion invested on the IRS will net $41 billion (a 2:1 return), but that the next $60 billion will net just $63 billion (about a 1:1 return). Congressional Budget Office. 2020. "Trends in the Internal Revenue Service's Funding and Enforcement."

[37] Academic evidence confirms this: If diminishing returns were sizable, then as the IRS decreased its enforcement efforts, one would have expected a less than 1:1 decline in additional taxes collected, as the agency would have stopped doing the least productive work first. That is not the case in the data. Sarin, Natasha, and Lawrence Summers. 2019. "Shrinking the Tax Gap: Approaches and Revenue Potential." Tax Notes Federal, November.

past estimates have suggested a deterrent effect of 3:1,[38] which is on the lower end of recent academic work. Mark and I take an even more conservative approach, assuming in our baseline estimates that the deterrence factor is just 1. But even this leads to a substantial upward revision of CBO's estimates.[39]

The fact that there is more revenue at stake from the IRA than official estimates suggest also means that there is more to lose from rescissions of this critical funding than those estimates suggest: We offer two alternative methods for computing the loss to the fisc from this summer's recission, and conclude that the revenue impact will be in the range of $280 billion ($260 billion, net of investment) to $310 billion ($290 billion, net of investment). Extrapolating from those estimates suggests an additional $14 billion recission, as was proposed last week, would add well over $100 billion to the deficit.

The idea of rescinding funds from the IRS as a "pay-for" for crucial spending priorities, like our national security interests or other important government functions, is fundamentally backwards. We can debate magnitudes, but we cannot debate the following fact: Adequately funding the tax administrator is a deficit-reducing measure that pays for itself several times over. Those concerned with our nation's fiscal future should be for investing in the IRS, not gutting it.

4. Recissions of IRA Funds—or Cuts to Discretionary Funding—are Misguided and Will Worsen Taxpayer Service

As discussed, in the last year, the IRS has made tangible improvements in the taxpayer experience. IRA resources have helped the agency hire thousands of new employees who spent this past filing season manning the phones and providing in-person assistance to taxpayers. These investments are paying off: The agency's level of telephone service has risen from a nadir to an apex, increasing to 87 percent in a single year. Average phone wait times are under four minutes. Refunds are being provided to taxpayers more quickly now than ever before.

These improvements are, of course, welcome. While phone service is not the only measure—or even the best measure—of how the IRS is able to assist taxpayers, it is one that allows us to clearly track progress. In the years leading up to the IRA's passage, taxpayers had been experiencing their worst few years of service from the IRS, with years of budget cuts and extreme pandemic disruptions bringing the agency to the brink: Between 2020-2022, only around 13 percent of taxpayers who collectively placed more than 500 million telephone calls to the IRS ever got those calls answered.[40] Compare that to last filing season, where just 13 percent of calls were *unanswered* (and I suspect that number will fall further next filing season). Online capacity will grow, as the IRS moves toward scanning all original returns it receives as paper

[38] Treasury 2019. "Program Summary by Budget Activity." U.S. Department of the Treasury, Washington, DC

[39] CBO historically did not score deterrence effects, see Congressional Budget Office. 2020. "Trends in the Internal Revenue Service's Funding and Enforcement." More recently CBO has included them but has concluded that deterrence would change the voluntary compliance rate only modestly, see Congressional Budget Office. 2021. "The Effects of Increased Funding for the IRS."

[40] National Taxpayer Advocate. 2023. "Fiscal Year 2024 Objectives Report to Congress." Internal Revenue Service.

filings, freeing employees of the need for painstaking transcription and increasing the speed at which refunds are provided.

Even critics of the IRA's investment in the IRS have sought to maintain these gains, as they have (mostly) tried to preserve the agency's new funding for taxpayer service ($3.2 billion of the IRA total) and business systems modernization ($4.75 billion of the IRA total). But clawing back any IRA funds will hurt service, just as it will the rest of the agency's functions. For one, the agency's operations support funding ($23.3 billion of the IRA total) is critical to support the "care-and-feeding" of all IRS employees. Rescinding these resources means, for example, that the agency will struggle to pay for laptops or facilities for its new customer service hires. And it will also struggle to train IRS employees in new laws that pose novel service and compliance challenges. Further, the IRS will struggle to invest in improving its research efforts, like a more timely measure of the tax gap and its distribution. That will make any IT modernization less effective, because the agency will not be able to gather the information that it needs on the impact of its new investments in ways that allow it to make adjustments to compliance and service efforts going forward.

More generally, focusing on the different IRS funding accounts where dollars sit obscures the integrated nature of the agency's operations, and the ways in which its service efforts, technology efforts, and compliance efforts are closely intertwined. Taxpayer service and compliance are flip sides of the same coin: Answering taxpayer questions and helping to resolve compliance issues early in the filing process, well before an audit, are critical components of providing better service to taxpayers. These improvements also mean that voluntary compliance will rise, and therefore, the tax gap will shrink.

It is impossible to preserve the gains that the IRS has made by rescinding nearly all, or even some, of the IRA's resources. It is similarly impossible to preserve these gains without sufficient discretionary funding, as inadequate annual funding will require the IRS to redirect mandatory resources aimed at transformational change to instead maintain day-to-day operations. Taxpayer morale will be impacted, as will the morale of IRS employees who are finally in a rebuilding phase after years of cuts to funding and staffing that forced them to find ways to do all that they could for taxpayers without the resources they needed to do their jobs effectively.

Through its recent investment in the IRS, Congress has meaningfully improved our fiscal future and the functioning of our tax system. Rather than be depleted, these investments should be preserved and supplemented. That requires maintaining—and growing—the IRS's discretionary funding and, in the years ahead, reversing recent cuts to its mandatory funding. Only then will the agency be able to cover the cost of day-to-day operations while simultaneously transforming into a 21st century tax administrator. The American people are already benefiting from the agency's monumental progress, and they will continue to benefit in the years ahead.