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What to Expect from the IRS and its New Commissioner

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Alert author Lawrence B. Gibbs was Commissioner of the Internal Revenue Service from 1986 – 1989 under President Ronald Reagan.

Introduction

John Koskinen has been sworn in as the new Commissioner of the Internal Revenue Service (IRS). As is usually the case, the tax community has begun to anticipate what to expect from the IRS under the new Commissioner. In his testimony to the Senate Finance Committee last month, the new Commissioner provided an unusually straightforward description of the IRS challenges he foresees as well as indications of how he intends to begin to deal with them. Recent public statements by him have reinforced his views of these challenges and his initial approach to them.

Commissioner Koskinen has an excellent reputation for his past successes in the private and public sectors as a "turn-around" expert. His prior experience in the private sector included turning around organizations that had survived the then-largest bankruptcy, had once been the world's largest homebuilder, endured the first major enforcement effort under ERISA, and suffered as the then-largest failed life insurance company in history. His experience in the public sector included his appointment as Deputy Director of the Office of Management and Budget (OMB); his activity as the Chairman of the Board of Freddie Mac when the Federal Housing Finance Agency (FHFA) became conservator of Freddie Mac and Fannie Mae; his responsibility for the country's transition to 2000 (the "Y2K" issue); and his tenure as the Deputy Mayor and City Administrator for the District of Columbia.

In his testimony, Commissioner Koskinen has identified three important challenges facing the IRS today: (1) the decline in IRS budget resources, (2) the increase in IRS workload, and (3) the loss of public trust and confidence in the IRS growing out of last year's IRS "scandal" and the ongoing Congressional investigations of the allegations. All three challenges are interrelated. Over the last three years, the annual budget of the IRS has declined by 8 percent or almost $1 billion, resulting in the net loss of about 21,000 employees over the last three years, of which 11,000 were lost in the last year alone. At the same time, the workload of the IRS has been steadily increasing, due in no small part to the demands placed on IRS resources by the implementation of non-revenue-producing government spending programs such as the Affordable Care Act. In coping with the cumulative effect of these challenges and in light of the fact that personnel costs comprise most of the IRS budget, the IRS has slashed other costs, such as training and support expenses, in order to minimize potential reductions in personnel. Over the last three years training costs have been reduced by over 80 percent, and travel and other support costs have been reduced significantly. As indicated by the U.S. Treasury Inspector General for Tax Administration (TIGTA) in its report last May, which precipitated the events leading to the IRS scandal, part of the cause of the exempt-organization problems in Cincinnati was the lack of training and support provided to front-line employees who were processing the applications for social welfare exemption by conservative groups.

The three challenges also share other similarities that are likely to make them difficult to address. First and foremost, each stems at least in part from the overriding fiscal challenge our country faces today as our national debt and annual operating deficits continue to increase. Solutions to this fiscal challenge are complicated by the division among our politicians and their constituents over whether to increase taxes, reduce spending, or both, in order to address our escalating debt and deficits. Therefore, a second similarity that the three challenges share is that they go to the heart of the intense partisan political disagreements that have made solutions to our fiscal challenges so difficult to develop. Ongoing attempts to address the increased cost of our mandatory entitlement programs by capping or reducing the so-called discretionary annual costs of operating the Federal government have led to continuing resolutions, sequester, a government shutdown, and proposals to reduce the salaries and benefits of government workers. As a result, a third shared similarity is that discretionary cost cutting, combined with the impact of the IRS scandal, have led to a significant morale problem at the IRS that has manifested itself in the loss of experienced personnel from the front-lines to the executive suite of the IRS.

Solutions to the three challenges identified by the new Commissioner appear likely to be difficult and incapable of prompt resolution. Each of the three challenges is the result of complicated, long-standing problems that are likely to require complex, longer-term solutions.

Impact on Taxpayers and Tax Practitioners

How might these three challenges -- the increasing IRS workload, the decreasing IRS resources, and the IRS scandal -- affect you? First and foremost, there simply are not enough IRS resources today to handle the volume of work for which the IRS is responsible. Up until recently, the IRS dealt with this challenge by reducing resources pretty much across the board.

> **Expect changes designed to conserve resources.** Even before the new Commissioner was sworn in, the IRS had announced that it is more likely to prioritize the programs it will support rather than across-the-board reductions. For example, the IRS announced that it planned to significantly reduce the amount and type of taxpayer service programs that would be available in the upcoming filing season. Another example is ongoing change in the scope of the IRS private letter ruling program to enable Chief Counsel to cope with its increasing workload and decreasing resources. Even the recent change in the Large Business and International Division's (LB&I's) procedures involving the threat of summons for tardy Information Document Request (IDR) responses is at least in part driven by concerns over efficient use of limited resources. More, similar changes should be expected in the future. The tax community will have to remain vigilant to learn about programs the IRS may change, reduce, or eliminate that will affect not only services upon which each of you may have relied in the past but also the manner in which you relate to, or deal with, the IRS in the future.

> **Expect delays and frustration.** Another impact of the three IRS challenges is likely to be delay and difficulty in solving problems. For example, the IRS National Office has dedicated hundreds of employees on full or part-time basis to respond to requests by Congress, the FBI, and litigants as a result of the IRS scandal. At the same time, there is a hiring freeze, which means that when someone in the IRS National Office leaves, the unfinished work he or she left behind often is simply divided among those who remain. In short, the already thin National Office workforce is being stretched, in some places almost to the breaking point, and backlogs and significant delays are developing. As a result, getting your problems into and out of the National Office has become increasingly more difficult.

Resolving technical tax problems in the field may also be increasingly difficult. The IRS training budget cuts in the magnitude of over 80 percent in the last three years may well result in deficiencies in the technical knowledge and capabilities in the field that are likely to be even more significant than they have been in the past. Compounding the problem are the IRS morale issues, which make it difficult to find someone (even with available time) willing to take on difficult issues. Unless training can be restored and sustained, technical deficiencies could become a major problem for the IRS. Such problems could persist until the IRS (or more aptly, Congress) recognizes that investment training produces benefits for both the IRS and taxpayers.

Conclusion

Significant changes are in store for the IRS that will need to be monitored closely. IRS executives may feel compelled to make decisions about resources, and the outcome of their decision making is likely to affect you. If the IRS must make program cuts, should the cuts be made to taxpayer service and training programs, or to compliance and enforcement programs, or to the IRS information technology programs that recently have become more successful, or to programs in all three of these areas? Traditionally, the IRS has tried to protect its compliance programs from resource cuts, especially since the politicians want the IRS to continue to maximize revenue produced by compliance activities. But is it fair to reduce resources to provide service to taxpayers who are trying to comply with their tax obligations and at the same time risk having insufficiently trained IRS agents

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conduct audits, pursue enforced collection actions, or conduct investigations against taxpayers? If -- or, as some would say, when -- the IRS feels compelled to make these kinds of decisions, will the IRS instead begin to consider major operating and structural changes rather than simply cut the costs of existing programs? Within the last year there have been calls within Congress and elsewhere for the IRS to again consider a major reorganization of the manner in which it conducts its operations. To the new Commissioner's credit, he has described a more deliberate process to identify the root causes of the challenges facing the IRS today, as well as alternatives, before suggesting solutions. However, our reaction is that you should stay tuned for the possibility that changes -- and perhaps major changes -- could be forthcoming at the IRS over the next few years.