Behind the Scenes of he IRS’s Crackdown on Wealthy Taxpayers

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The IRS has gone to great lengths to publicize a new effort to get wealthy taxpayers who have skipped out on their tax obligations to pay up. But who are those taxpayers, and why is the IRS only going after them now?

Far from simply being a knee-jerk response to recent political pressure to collect some scalps from the high-net- worth crowd, the IRS’s high-income taxpayer compliance initiative has been years in the making, according to Darren Guillot of Alliantgroup LP.

“We put together this current effort because we wanted to do this, not because of congressional pressure,” Guillot, who oversaw the effort as deputy commissioner of the IRS Small Business/Self-Employed Division at the time, told *Tax Notes*.

The IRS was given $45.6 billion in additional funding for enforcement in the Inflation Reduction Act, and with it,

a clear expectation from the law’s drafters in Congress that the agency would transform how it approaches tax noncompliance by high-income taxpayers and large businesses.

In the months following enactment, the IRS and agency officials periodically highlighted the new effort to ensure that millionaires pay what they owe.

Senate Finance Committee Chair Ron Wyden, D-Ore., also recently published IRS data showing that high-income noncompliance received shockingly little attention from the IRS between 2017 and 2020.

According to IRS Commissioner Daniel Werfel, the IRS hadn't already addressed that glaring gap in compliance for two reasons: "Resources and priority-setting," he told reporters October 26 at the Council for Electronic Revenue Communication Advancement conference.

"There's always been a need, but now we're putting the sweat equity and the resources behind it," Werfel said.

In the Making

A taxpayer's wealth has long been a factor in prioritizing casework in the

IRS's collections function, according to Guillot, who retired from the agency in September. However, the IRS began experimenting with giving high-income nonfilers even greater priority in collection cases in early 2020. Then, in response to a March 2021 recommendation by the Treasury Inspector General for Tax Administration, it agreed to go further, expanding that effort to high-income taxpayers with a balance due.

"Collection from high-income taxpayers who owe delinquent taxes is another inventory priority that demands this type of attention," TIGTA wrote in its March 2021 report, recommending that the IRS consider conducting a revenue officer compliance sweep in areas with high concentrations of high-income taxpayer cases and insufficient revenue officers able to handle the caseload. A compliance sweep is when the IRS temporarily assigns greater priority and resources to addressing a specific issue of noncompliance.

TIGTA also recommended that the IRS reevaluate the model used in case selection to improve how well it predicts the tax debt recovery rate for very-high- income taxpayers with a balance due.

In its response to TIGTA, the IRS agreed to consider launching a compliance sweep specifically aimed at high-income taxpayers with known, unpaid tax debts in fiscal 2021.

But in the midst of the pandemic, the IRS just didn't have the wherewithal to get that effort underway to the extent that it had hoped, according to Guillot. The agency was underfunded, understaffed, and, among other barriers, many of its revenue officers were new and inexperienced, he said.

Gearing Up

The arrival of the Inflation Reduction Act funding in August 2022 was fortuitous because it carried with it an expectation of focusing more enforcement attention on wealthy taxpayers, along with the funding flexibility to do so. The IRS's fiscal 2023 budget included both the base annual budget and the Inflation Reduction Act money, giving the agency more room to hire and budget for salaries and travel expenses to send revenue officers into the field.

The IRS set the bar for its high-income, balance-due compliance sweep at taxpayers with at least $1 million in income and $250,000 in recognized tax debt. Roughly 1,600 taxpayers were selected for the initial tranche of enforcement action.

Guillot publicly announced the launch of the high-income, balance-due program in late October 2022, and the effort quickly got underway the following month. By midsummer 2023 the IRS was touting its early results, announcing that it had collected $38 million in delinquent taxes that were owed by 175 millionaires as part of that initiative. A few months later, the agency announced that it had another set of 1,600 high-income, balance-due taxpayers in its sights for fiscal 2024.

The two March 2021 TIGTA recommendations were the impetus for what the IRS is doing now, Guillot emphasized.

“We agreed that . . . maybe our models aren’t perfect. So we’ll do a special sweep for high-income taxpayers, we’ll gather data from it, and we’ll see if the models are as good as we thought they were,” Guillot said. That’s what revenue officers working the high-income, balance-due initiative are doing now, he added.

“And my goodness, the results are $122 million in less than a year, and from just 100 of those 1,600 cases so far. So it’s pretty successful,” Guillot said.

Who Wants to Be a Millionaire?

A millionaire who refuses to pay their taxes is unlikely to generate much sympathy. But while the IRS has highlighted examples of egregious tax avoidance in recent updates — like a taxpayer who skimped out on paying taxes while at the same time buying a Bentley and a Maserati — the reasons for not paying or filing among that crowd can be diverse.

“It was definitely a mixed bag,” said Gerald W. Kelly of Kelly Dorsey PC, a former revenue officer. The most common excuse among these high- income taxpayers was simply that they were living above their means, he said, explaining that while they might have earned hundreds of thousands of dollars in income, their lifestyle expenses had increased commensurately, and they ended up spending all of it to maintain that.

Another common scenario is a taxpayer who doesn’t file or pay one year.

They may think what they’ve done is so bad that if they file the next year, it will bring that mistake to the IRS’s attention, Kelly said. Then they assume the worst: that the IRS will send them to prison or seize all their assets if it finds out, so they stop complying altogether, hoping the IRS won’t notice.

High-income taxpayers also might not file returns or pay their taxes because of a major life event like an illness, according to Robert A. McKenzie of Saul Ewing LLP. Then, instead of filing and paying, they may opt to prioritize maintaining their lifestyle, said McKenzie, another former revenue officer.

Another example is a taxpayer in the midst of a divorce, which can delay the tax preparation process because each spouse needs records from the other to complete their returns, McKenzie said. “Trying to get a joint return filed by a divorcing couple is not always the easiest thing in the world when they’re busy trying to — at least psychologically

— kill each other,” he noted.

In still other cases, taxpayers with a lot of money just make bad financial decisions, McKenzie said. “I’ve had clients fail to file because they knew they were facing a $400,000 liability, but they saw this opportunity to invest in something that they put their money in instead," he said. "There are some very bad life choices by some of these people."

Ultimately, all of these high-income taxpayers know that they've messed up. "I can't think of one case I had where the taxpayer wasn't aware of their obligation to file and pay every year," Kelly said.

Ranking Resources

Although millionaire nonfilers and nonpayers might seem like an obvious priority for the IRS, they still must be balanced against other, competing collection priorities.

One of the agency's highest priorities continues to be employment taxes withheld by businesses. Those are "the biggest source of revenue going into the treasury," Guillot said. In recent years, 70 percent of taxes paid to the IRS have come from employment taxes withheld in trust by employers, so that's "an area of the revenue that needs to be safeguarded," he said.

Revenue officers are "the tip of the spear" for protecting that source of revenue, and in any given year, employment tax work constitutes the majority of cases assigned to them, Guillot said. By pursuing those cases, the IRS is protecting the Social Security tax base and the source of revenue that covers taxpayers' income tax refunds.

“The IRS is required to push that money out even if it doesn’t come in, so that’s an area of risk that they stay on top of, and that’s why it’s a very, very high priority,” Guillot explained.

And unlike employment tax delinquency cases, which are typically straightforward, cases involving wealthy taxpayers are often fairly complex and not always as cut and dried as they might initially seem. The IRS might have some documentation about a taxpayer suggesting that they’re not paying what they owe, but many high-income taxpayers don’t have details about their income available on information returns.

“They might be investors in partnerships that don’t issue [Schedules] K-1, or they may have their own investments in, say, rental properties, and they’re collecting rents, but no Forms 1099 are being issued,” McKenzie said. There also may be offsetting losses and deductions that don’t show up that shrink their taxable income, he added.

With insufficient revenue officers on staffto pursue all cases, the IRS has to set priorities, McKenzie said.

“With that level of resources, would you then dedicate a lot of resources to a very time-intensive thing of chasing somebody when you don’t know whether they owe taxes or not until you get all the financial data?” McKenzie asked. “If I were a revenue officer with a caseload of cases, and I could show a lot of results by bringing in a lot of money and collecting known tax liabilities, or know that I'm going to spend many hours to pursue a liability of an unknown amount, I know what I’d do.”