IRS budget cuts result in $34.3 billion in lost tax revenue from large firms

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Budget cuts at the Internal Revenue Service threaten the agency's effectiveness and have led to billions of dollars in lost tax revenue, new research from the Indiana University Kelley School of Business shows.

The research is among the first to quantify the amount of tax revenue lost—not just because the IRS is auditing fewer returns but because it has fewer resources to identify potential errors and to follow up on returns with taxpayers. The research is also the first to quantify the amount of corporate tax revenue lost during the audit process per dollar of IRS budget cuts.

"We're quantifying the effect of budget cuts on collections by trying to better understand how cuts impact the entire enforcement process—from audit rates to ultimate settlements between taxpayers and tax authorities," said Casey Schwab, an associate professor of accounting at Kelley.

The research study, "How do IRS resources affect the corporate audit process?" accepted by *The Accounting Review*, relies on confidential IRS audit data from tax return years 2000 through 2010 of large, publicly traded corporations. It estimates that the IRS could have increased collections from just this subsample of firms by $34.3 billion if provided with an additional $13.7 billion in overall resources. The $34.3 billion estimate accounts for approximately 19.3 percent of the estimated corporate tax gap from 2002 through 2014.

"The scope of the audits is substantially reduced," Schwab said. "The IRS has fewer resources to actually dig into the details. While the IRS appears to still target the most aggressive positions, they can't audit as many positions within the return. They just don't have the resources."

Adjusted for inflation, the IRS budget of $11.3 billion in 2019 is smaller than in 2000 and 19 percent below its highest level of funding in 2010, according to the Government Accountability Office. It now has 21 percent fewer employees than it did eight years ago. The number of examiners has declined by 38 percent since 2010.

"Given the continued cuts to the IRS budget, the amount of lost tax revenue from public companies could be even higher than what we estimate," said Bridget Stomberg, also an associate professor of accounting at Kelley. She jointly conducted the study with Schwab; Michelle Nessa, an assistant professor at Michigan State University; and Erin Towery, an associate professor at the University of Georgia and an academic research consultant to the Internal Revenue Service.

The professors said their research should be of interest to Congress when it decides on the amount of resources to allocate to the IRS. Their findings are particularly relevant given that any resource constraints the IRS currently faces will be magnified by the increased responsibilities it has as a result of tax reform.

"We're seeing a lot less regulation in many areas," Stomberg said. "Cutting budgets is one way to handicap an agency without eliminating it altogether."

"By eliminating the role of the IRS, you're effectively reducing corporate tax burdens. On the one hand, this could be used to spur economic growth," Schwab said. "On the other hand, there's a notion that everyone should pay their fair share. The IRS is fundamental in preventing businesses from engaging in transactions that aggressively reduce their tax liability."

Provided by Indiana University

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