Highlights

- Strategic Operating Plan Released
- IRS Direct File Pilot Program
- Employee Retention Credit Crackdown
- IRS Tackles Tax Gap
- Significant Tax Case Pending Before Supreme Court

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IRS Busy Despite Any Significant Legislative Action In 2023

Just because Congress failed to act on passing any significant legislation affecting taxes, although they did take some money away from the Internal Revenue Service, it does not mean there was not a lot going on in the tax world.

In fact, 2023 saw some significant actions taken by the IRS. Early in 2023, the agency got new leadership in the commissioner slot as Daniel Werfel, nominated in late 2022, was confirmed. That was followed by the much anticipated release of the Strategic Operating Plan that detailed how the additional funds provided by the Inflation Reduction Act would be spent.

Other issues emerged in 2023 that forced the IRS to take action, including the spike in potentially fraudulent claims for the Employee Retention Credit that forced the agency to pause the processing of these claims to do a closer examination of them. Another issue coming to the forefront is yet another delay in the implementation of the 1099-K rules. 2023 also saw the Supreme Court take on a tax case.

Here is a look back on some of the significant stories of 2023.

CONFIRMATION OF DANIEL WERFEL

Daniel Werfel took over as IRS commissioner after being confirmed by the Senate on March 9, 2023. And while his confirmation hearing saw little in the way of controversy or confrontation, he only passed by a 54-42 vote in the upper chamber of Congress, mirroring a similar margin that advanced his nomination out of the Senate Finance Committee in February.

Werfel previously led the IRS in an acting commissioner role under President Obama from May 22, 2013, to December 23, 2013, taking over the agency after an Inspector General report highlighted alleged mismanagement and bias in determining

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"The [Strategic Operating Plan] provides a roadmap on how the agency plans to spend the supplemental funding of its annual budget as provided by the IRA."

the tax-exempt status for non-profit organizations. His government experience also included serving as controller of the Office of Management and Budget for four years prior to being named acting commissioner.

INFLATION REDUCTION ACT STRATEGIC OPERATING PLAN

Commissioner Werfel's first major action in his new role was ushering the Inflation Reduction Act Strategic Operating Plan through to its release on April 4. The plan provides a roadmap on how the agency plans to spend the supplemental funding of its annual budget as provided by the IRA.

The goal of the plan is to "provide taxpayers with world-class customer service" and reduce the deficit by "hundreds of billions by pursuing tax evasion by wealthy individuals, big corporations, and complex partnerships," Deputy Secretary of the Treasury Wally Adeyemo said at the time of the Strategic Operating Plan's release.

The SOP is expected to "provide taxpayers with world-class customer service" and reduce the deficit by "hundreds of billions by pursuing tax evasion by wealthy individuals, big corporations, and complex partnerships," said Adeyemo.

The plan is organized under five key objectives:

- Dramatically improving services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible;
- Quickly resolving taxpayer issues when they arise;
- Focusing expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap;
- Delivering cutting-edge technology, data, and analytics to operate more effectively; and
- Attract, retain, and empower a highly-skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.

The plan outlines a series of initiatives and projects aligned to each objective, including 42 key initiatives, 190 key projects, and more than 200 specific milestones designed to achieve the objectives set forth by the IRS.

Improved customer service, compliance efforts, and technology updates are also essential to achieving the goals set forth in the Strategic Operating Plan.

"In the first five years of the 10-year plan, taxpayers will be able to securely file documents and respond to notices online," said Werfel. Taxpayers will also be able to securely access and download account data and account history. "For the first time, the IRS will help taxpayers identify potential mistakes before filing, quickly fix errors that could delay their refunds, and more easily claim credits and deductions they may be eligible for," he said.

The Strategic Operating Plan also includes targeted efforts to ensure fair tax law enforcement and compliance with existing laws. The plan focuses on "areas where compliance has eroded the most," specifically compliance issues involving "wealthy individuals, complex partnerships, and large corporations," said Werfel. The IRS will increase hiring efforts for experienced accountants and attorneys to ensure enforcement "at the top." Werfel further noted that the IRS does not intend to increase the audit rate for small businesses or households making less than $400,000.

Finally, the Strategic Operating Plan utilizes Inflation Reduction Act funding to modernize the agency's technology infrastructure to protect taxpayer data. In the first five years of the 10-year plan, the IRS aims to eliminate paper backlogs that have delayed taxpayer refunds by digitizing forms and returns when they are received and transitioning to fully digital correspondence processes.

Of the limited actions taken by Congress in 2023, one saw the supplemental funding being cut by about 25 percent as part of a compromise to get an increase in the debt ceiling passed. The IRA had allocated about $80 billion to the IRS in supplemental funding, but that was reduced by more than $20 billion in the June legislative action.

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DIRECT FILE

One of the provisions of the Strategic Operating Plan that has drawn some scrutiny is the IRS's plan to offer taxpayers the ability to input their tax information and directly file their tax returns with the IRS, as opposed to going through a third party. The pilot program to test the capabilities for Direct File was announced in October.

Residents in select states will have the option to participate the direct file program, which is being set up as part of the provisions of the Inflation Reduction Act, in the upcoming 2024 tax filing season. The nine states included in the pilot are states that do not have a state income tax, including Alaska, Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, Washington, and Wyoming. The pilot will also include four states that have a state income tax – Arizona, California, Massachusetts, and New York – and in those states, the direct file pilot will incorporate filing state income taxes.

The agency is expecting several hundred thousand taxpayers across the thirteen states to participate in the pilot.

"We will be working closely with the states in this important test run that will help us gather information about the future direction of the direct file program," Commissioner Werfel said during an October 17 press teleconference. "The pilot will allow us to further assess customer and technology needs that will help us evaluate and develop successful solutions for any challenges posed by the direct file option."

Werfel stressed that there is no intention for the IRS to require taxpayers use the direct file option and if the pilot proves successful and the agency moves forward with the program, it will simply be another option in addition to everything that currently is available for taxpayers to file tax returns without eliminating any of those other options.

He noted that the pilot will be aimed at individual tax returns and will be limited in scope. Not every taxpayer in those pilot states will be able to participate.

"The pilot will not cover all types of income, deductions, or credits," Werfel said. "At this point, we anticipate that specific income types, such as wages from Form W-2 and important tax credits, like the earned income tax credit and the child tax credit, will be covered by the pilot."

According to an IRS statement issued the same day, the agency also expects participation will include Social Security and railroad retirement income, unemployment compensation, interest income of $1,500 or less, credits for other dependents, and a few deductions, including the standard deduction, student loan interest, and educator expenses.

EMPLOYEE RETENTION CREDIT

The Employee Retention Credit (ERC), a program enacted to help companies suffering from lost revenues during the COVID-19 pandemic keep employees on their payroll, drew the attention of IRS officials after a spike in the filing of claims for the credit forced the agency to pause processing claims to take a closer look at what is going on.

At the heart of the investigation on so-called "ERC mills," companies that have been advertising on radio and television offering to file ERC claims on behalf of companies with promises of payment from the IRS and little risk of those claims being investigated or audited.

In September, Werfel said the agency has received about 3.6 million claims by taxpayers taking advantage of the program and there are more than 600,000 that have yet to be processed, "virtually all of which were received within the last 90 days. That means about 15 percent of all ERC claims received since the start of the program three and half years ago have been received in the last 90 days. That's an incredibly large number to have so far beyond the pandemic and nearly two years after the time periods covered by the program."

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"Residents in select states will have the option to participate the direct file program..."

At the time of the announcement, compliance work investigating the claims had already begun. Werfel stated that as of July 31, 2023, the IRS Criminal Investigation Division has initiated 252 investigations involving more than $2.8 billion worth of potentially fraudulent ERC claims. Fifteen of those cases have resulted in federal charges, with six cases resulting in convictions, and an average sentence of 21 months for those reaching the sentencing phase. He also stated that the agency has referred thousands of claims for audit.

As part of the compliance efforts, the agency introduced two programs to help businesses who, upon their own investigation, determined that they might not be eligible for the ERC that was previously filed by them or from an ERC mill. For those who have not had their claims processed, they can withdraw their claims with no penalty.

For those who have already received funds, there is a special voluntary program that runs through March 22, 2024, and allows businesses to pay back erroneous funds at 80 percent of the claim received. If the IRS paid interest on an ERC claim already paid and the business is taking advantage of this voluntary program, that interest does not have to be repaid.

The Voluntary Disclosure Program "is a limited time offer," IRS Commissioner Daniel Werfel said during a December 21 press teleconference. "From discussions we've had with taxpayers and tax professionals around the country, we understand that there are many employers eager to correct their error but remain concerned about their ability to pay back the portion of the credit that has been lost to promoters that brough them into this mess."

The 80 percent accounts for fees that a so-called ERC mill may have collected to help a business file an ERC claim that they were ultimately not eligible for and is a reflection that the business may not actually have received the full amount of the claim.

Those who cannot make the payment in full at the time of the application approval will have to option to make installment payments, with penalties and interest applying.

In addition, as part of the application process, program participants must name names.

"Those employers participating in the disclosure program must provide the IRS with the names and details of any advisors who advised or assisted them with their claim," Werfel said. "This will help with our ongoing efforts to gather information on promoters who created this situation by aggressively pushing people to apply for the credit."

Any employer who has already received ERC funds they were not entitled to can apply to be a part of the Voluntary Disclosure Program if they meet the following criteria:

- The employer is not under criminal investigation and has not been notified they are under criminal investigation;
- The employer is not under an IRS employment tax examination for the tax period in which they're applying to the Voluntary Disclosure Program;
- The employer has not received an IRS notice and demand for repayment of part or all of the ERC; and
- The IRS has not received information from a third party that the taxpayer is not in compliance or had not acquired information directly related to the noncompliance from an enforcement action.

Those wishing to participate in the program will need to fill out Form 15434, Application for Employee Retention Credit Voluntary Disclosure Program. Application forms must be submitted electronically through the IRS Document Upload Tool.

Employers that outsource their payroll who want to apply to the program must apply through their third-party payroll administrator.

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TAX GAP AND COMPLIANCE

In October, the IRS announced new initiatives to boost ongoing efforts to ensure the wealthiest corporations are properly paying the taxes they owe.

"One way we are doing this is increasing compliance efforts on the U.S. subsidiaries of foreign companies who distribute goods in the U.S. and do not pay their fair share of tax on the profit they earn on their U.S. activity," IRS Commissioner Daniel Werfel said during an October 19, 2023, teleconference with reporters. "These foreign companies report losses or exceedingly low margins year after year through the improper use of transfer pricing to avoid reporting an appropriate amount of profit."

The agency will be sending compliance alerts to about 150 U.S. subsidiaries of foreign corporations to encourage self-compliance with appropriate tax laws, he said.

Werfel also mentioned that the agency will be expanding its large corporate compliance program to include companies with more than $24 billion in assets and about $526 million per year in taxable income for audit. The agency will be hiring accountants to enable the agency to launch audits on an additional 60 of the largest corporate taxpayers.

In a separate statement, the IRS said it was "cracking down" on taxpayers filing for the domestic production activities deduction that was repealed in 2017. The agency stated that it has received "hundreds of claims collectively seeking more than $6 billion in refunds, with a significant portion of filers claiming the deduction for the first time."

The agency also noted its continued prioritization of high-income individuals who have either failed to file their taxes or paid their tax debt. The efforts focus on those with more than $1 million income and more than $250,000 in recognized debt. Werfel said during the call that efforts thus far have generated $160 million in taxes collected.

The agency also highlighted its efforts targeting high-income taxpayers.

IRS Commissioner Daniel Werfel, during a September 7, 2023, teleconference with reporters, said that the new compliance push "makes good on the promise of the Inflation Reduction Act to ensure the IRS holds our wealthiest filers accountable to pay the full amount of what they owe," adding that the agency will simply be enforcing already-existing laws.

Werfel stated that the IRS will be "pursuing 1,600 millionaires who owe at least $250,000. … The IRS will have dozens of revenue officers focused on these high-end collection cases in fiscal year 2024," which begins on October 1, 2023. "This group of millionaires owes hundreds of millions of dollars in taxes, and we will use Inflation Reduction Act resources to get those funds back."

He also said that the agency will be making a "dramatic shift" on large partnerships.

"These are some of the most complex cases the IRS faces, and it involves a wide range of activities and industries where it's been far too easy for tax evaders to cut corners," Werfel said.

To help with this effort, Werfel highlighted that the agency will be using expanded artificial intelligence programs and additional Inflation Reduction Act resources to help with the audit process for large complex partnerships.

The AI will be used to help spot trends that might not be obvious and help the agency determine which partnerships are at the greatest risk of noncompliance, starting with 75 specific partnerships with assets of more than $10 million.

"These are some of the largest [partnerships] in the U.S. that the AI tool helped us identify," Werfel said. "These organizations will be notified of the audit in the coming weeks. These 75 organizations represent a cross section of industries, including hedge funds, real estate investment partnerships, publicly traded partnerships, large law firms, and other industries."

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Werfel also noted that starting in October, "hundreds of partnerships will receive a special compliance alert from us in the mail. The alert relates to what we have identified as an ongoing discrepancy on balance sheets involving partnerships with over $10 million in assets," adding that taxpayers filing partnership returns are showing more and more discrepancies in recent years. Approximately 500 partnerships will be receiving this mailing.

"We will need to do more in the partnership arena," Werfel said. "But this is historic. And these are examples of how the Inflation Reduction Act funding will make a difference and help ensure fairness in the tax system."

1099-K

Calendar year 2023 would continue to be a transition period for enforcement and administration of the de minimis exception for reporting by third party settlement organizations (TPSOs), maintaining the aggregate reporting threshold for Form 1099-K of $20,000 or 200 transactions. In 2024, the IRS is planning to phase in a threshold of $5,000 with the ultimate goal of reaching the threshold of $600 as required by the American Rescue Plan Act. The IRS has not yet announced when it would reach the $600 threshold.

IRS ENDS MOST UNANNOUNCED HOME VISITS

The Internal Revenue Service will end, except in very limited circumstances, the practice of making unannounced visits to taxpayers' homes and businesses, a change that went into effect on July 24, 2023.

Werfel said the change is being made in reaction to an increase in scam activity as well as for IRS employee safety.

Unannounced visits will be replaced with scheduled visits. If the IRS needs to meet with a taxpayer, that taxpayer will receive an appointment letter, known as a 725-B letter, to schedule a time for a revenue officer to meet with the taxpayer.

"This will help taxpayers feel more prepared when it is time to meet," Werfel said. "Taxpayers whose cases are assigned to a revenue officer will now be able to schedule face-to-face meetings at a set place and time. They will have the necessary information and documents in hand to reach a resolution of their cases more quickly."

In addressing what the IRS will do if a taxpayer is not reachable by mail or is not responding to a meeting scheduling letter, Werfel stated that there are other actions that the agency can take to help drive compliance, such as imposing a lien or a levy, which can be done remotely.

Werfel outlined what he described as "rare instances" when unannounced visits will continue to occur, including service of a summons and subpoena as well as in the conduct of sensitive enforcement activities such as the seizure of assets.

"These activities are just a drop in the bucket compared to the number of visits that have taken place in the past," Werfel said, noting that there were a few hundred each year compared to the tens of thousands of other visits that occurred each year under the decades-old policy.

Werfel said that this policy will not impact activities conducted by the Criminal Investigations division, which operates under its own rules and protocols.

SCOTUS HEARS CASE ON TAXING UNREALIZED INCOME

It is rare that a tax case makes it to the Supreme Court, but on December 5, it heard arguments in the case of *Charles G. Moore v. United States*, which is looking at whether the government has the right to tax unrealized income.

The case stems from provision in the 2017 Tax Cuts and Jobs Act, which imposes a current tax on 10 percent U.S. shareholders of the accumulated post-1986 deferred foreign income of controlled foreign corporations deemed to be subpart F income (the mandatory repatriation tax,

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"...the IRS announced new initiatives to boost ongoing efforts to ensure the wealthiest corporations are properly paying the taxes they owe."

or "MRT"). Historically, under the prior deferral regime, U.S. shareholders were not generally taxed on earnings on foreign subsidiaries carrying on a trade or business until those earning were distributed to the U.S. shareholders.

Moore made a greater-than-10 percent investment in an Indian corporation but never received a distribution on the investment and never owed a tax until the Tax Cuts and Jobs Act was enacted.

Leading up to the Supreme Court hearing the case, the case was dismissed at the district court level and then affirmed by the Ninth Circuit Court. That court noted that while "income" is not clearly defined in the Sixteenth Amendment, the courts have consistently held that taxes similar to the mandatory repatriation tax are constitutional.

During the Supreme Court hearing, Andrew Grossman, attorney for Charles Moore, argued that the word "income was understood at the time of the Sixteenth Amendment's adoption to refer to gains coming into the taxpayer, like wages, rents, and dividends. Appreciation in the value of a home, a stock investment, or other property is not and never has been taxed as income. The reason is that a gain is not income unless and until it has been realized by the taxpayer."

He argued that it is "undisputed that the petitioners realized nothing from their stock investment. They were taxed not because they had any income but because, in 2017, they happened to own shares in a corporation carrying retained earnings on its books. This is a tax on the ownership of property. It therefore must be apportioned."

Grossman went on to offer a basic definition of the "realization" of income as "receipt, but in other instances, it would be other types of enjoyment of an economic gain such that the taxpayer can put that gain to his or her own uses and benefits. That might be forgiveness of a loan or it might be assignment of income to a third party."

He added that "the Court has already said in multiple occasions that realization is, in fact, required for there to be income under the Sixteenth Amendment," although Justice Kagan noted that "there is quite the history in this country of Congress taxing American shareholders on their gains from foreign corporations," added that this is done to prevent Americans from stashing their money in foreign companies and not pay taxes on the gains.

He claimed that even though the corporation realized income, Moore's interest is "solely a capital interest, a property interest, and so the value of their capital has increased. It has appreciated. But, as shareholders, no, they have not realized any income."

Elizabeth Prelogar, Solicitor General of the United States, argued that the mandatory repatriation tax as enacted in the TCJA "is firmly grounded in the Sixteenth's Amendment's text and history. The amendment allows Congress to impose taxes on income. ... Several of those taxes were like the MRT in that they taxed shareholders on undistributed corporate earnings, including income taxes in 1864, 1865, 1877, and 1870. And this Court upheld Congress' power to impose those taxes."

Prelogar added that the Court "doesn't actually need to resolve any fundamental questions in this case about whether the Sixteenth Amendment requires realization. The MRT taxes income that was actually realized by the foreign corporations, and Congress permissibly attributed the tax on that realized income to U.S. shareholders just as it has done in any number of pass-through taxes throughout our nation's history."

When asked to further explain the word "realized," she said that this is "a paradigmatic case of realization ... insofar as the thing that's being taxed, the underlying tax base for the MRT, are the earnings that actually came into the corporation, the foreign corporation's coffers. So the tax base here was the substantial ordinary business income that the foreign corporation generated through its operations in the foreign country and that has been subject to tax deferral."

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She also stated that the income "has never been taxed at the corporate or entity level. Instead, what Congress did in the MRT is enact a pass-through tax that attributed the liability on that actual income that was realized to the U.S. shareholders."

Prelogar also argued that the Court needs to define "income" for all purposes or make a specific determination about "realization."

"I think it's sufficient here for the Court to say that you have before you a particular type of tax on undistributed corporate earnings that were actually realized and to look as the history and tradition that demonstrates that that fits will within Congress' income tax authority," she said.

A ruling on the case is expected in 2024.

PROPOSED AND FINAL REGULATIONS

Various regulations, both proposed and final, were issued in 2023. These regulations implemented new rules and finalized proposed rules relating to energy credits, procedural requirements, retirement plans, and digital assets, among many other topics. Some of that guidance included:

- **T.D. 9972**, Electronic Filing
- **T.D. 9973**, Consolidated Group Single-Entity Treatment Under the Section 951(a)(2)(B) Reduction Rule
- **NPRM REG-122286-18**, Retirement Plan Forfeiture Rules
- **NPRM REG-120653-22**, Semiconductor Manufacturing Credit
- **NPRM REG-120080-22**, Critical Mineral and Battery Component Requirements
- **NPRM REG-124064-19**, Repatriations of Previously Transferred Intangible Property
- **NPRM REG-101607-23**, Election to Treat Applicable Credits as Tax Payments
- **NPRM REG-101610-23**, Election to Transfer Eligible Tax Credits
- **T.D. 9976**, Reference Rate Transition for Foreign Bank Interest Expense
- **T.D. 9977**, Carryback of Consolidated NOLs
- **T.D. 9978**, Excess COVID-19 Employment Tax Credit Recapture
- **T.D. 9979**, Low-Income Communities Bonus Credit Program for Energy Investment Credit
- **NPRM REG-122793-19**, Sales and Exchanges of Digital Assets by Brokers
- **NPRM REG-100908-23**, Prevailing Wage and Apprenticeship Requirements and Corrections for Bonus Energy and Business Credits
- **NPRM REG-113064-23**, Clean Vehicle Credit Guidance
- **NPRM REG-132422-17**, QBU Gain or Loss
- **NPRM REG-132569-17**, Energy Investment Credit Rules
- **NPRM REG-112916-23**, Disallowance of Certain Partnership and S Corporation Qualified Conservation Contribution Deductions
- **NPRM REG-118492-23**, Foreign Entity of Concern Restrictions for New Clean Vehicles
- **NPRM REG-104194-23**, Part-Time Employee Participation in 401(k) Plans
- **NPRM REG-107423-23**, Implementing Advanced Manufacturing Production Credit

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