The Heritage Foundation

CONGRESSIONAL TESTIMONY

The Inflation Reduction Act: A Year In Review

Testimony Before
House Subcommittee on Health Care and Financial Services

United States House of Representatives

September 14, 2023

Preston Brashers
Senior Policy Analyst
Grover M. Hermann Center for the Federal Budget
The Heritage Foundation

My name is Preston Brashers. I am the senior policy analyst for tax policy at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Chairwoman McClain, Ranking Member Porter, and Members of the Subcommittee, thank for giving me the opportunity to testify today.

August 16th marked the one-year anniversary of the enactment of Public Law 117-169, better known as the Inflation Reduction Act (IRA). Most of the provisions of the IRA went into effect on January 1, 2023. The law is still young, but it is not too early to begin taking stock of how the actual results of the legislation stack up with the law's intended purposes.

The original aim of the IRA, as stated in the bill's title, was to reduce inflation, and deficit reduction was the principle means by which the IRA would purportedly do so. However, since August 2022 when the bill was being debated, other aims of the legislation have also been suggested.

My testimony focuses on three common claims about what the IRA legislation will supposedly achieve, namely whether:

1) The legislation will reduce inflation by cutting the deficit.
2) New IRS funding will pay for itself by cracking down only on wealthy tax cheats.
3) The law will significantly reduce greenhouse gas (GHG) emissions and slow climate change.

Deficit and Inflation Reduction?

Background

Between the 2020 and 2022 fiscal years (FYs), the federal government spent more than $5 trillion more than the Congressional Budget Office (CBO) had projected in its January 2020 report.[1] Private investors were unable or unwilling to buy up all the new debt to finance this government spending spree. Therefore, the Federal Reserve (Fed) accommodated nearly all the debt Congress accrued by purchasing U.S. Treasurys on the open market, thereby adding trillions of dollars to the money supply in the economy.[2]

The oversupply of dollars ensured that interest rates remained near zero. Low interest rates were intended to help sustain private investment even as government-imposed pandemic restrictions constrained business activity. However, while the Fed's accommodation meant that governments, households, and businesses had far more money to spend, there was no commensurate increase in economic production. Therefore, inflation spiked—a classic example of too many dollars chasing too few goods and services.

In the aftermath of the pandemic-era spending glut, year-over year-inflation reached nine percent, a 40-year high.[3] The public's discontent with the high inflation was palpable. In response, in early 2022, the Fed began to choke off the money supply and aggressively raised interest rates to tame inflation, an effort that continues to this day. In Congress, the legislation known as the Build Back Better Act, which would have added trillions of dollars of new deficit-financed spending was abandoned in early 2022, largely because of concerns about its effect on deficits and, therefore, inflation.

What Initial Budget Forecasts Suggested About Deficit and Inflation Reduction Claims

The IRA was portrayed by some as fiscally responsible legislation that would supposedly reduce inflation by cutting the deficit.[4] This argument was ostensibly bolstered by estimates from the Congressional Budget Office (CBO) and some non-governmental sources suggesting that the IRA would achieve a small fiscal surplus during a 10-year budget window.[5]

---

[1]Congressional Budget Office, "The Budget and Economic Outlook: 2020 to 2030," January 2020, www.cbo.gov/publication/56020 (accessed September 11, 2023), and Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033," February 15, 2023, www.cbo.gov/publication/58848 (accessed September 11, 2023).
[2]David Ditch and Richard Stern, "Road to Inflation: How an Unprecedented Federal Spending Spree Fostered Economic Turmoil," Heritage Foundation Backgrounder, forthcoming.
[3]Bureau of Labor Statistics News Release, "Consumer Price Index – June 2022," July 13, 2022, https://www.dol.gov/newsroom/economicdata/cpi_07132022.pdf (accessed September 11, 2023).
[4]The White House, "Remarks by President Biden in Roundtable with Business and Labor Leaders on the Inflation Reduction Act," August 4, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/04/remarks-by-president-biden-in-roundtable-with-business-and-labor-leaders-on-the-inflation-reduction-act/ (accessed September 11, 2023).
[5]Congressional Budget Office, "Estimated Budgetary Effects of Public Law 117–169," September 7, 2022, https://www.cbo.gov/system/files/2022-09/PL117-169_9-7-22.pdf (accessed September 11, 2023) and University of Pennsylvania, "Senate-Passed Inflation Reduction Act: Estimates of Budgetary and Macroeconomic Effects," Penn Wharton Budget Model, University of Pennsylvania, August 12, 2012, https://budgetmodel.wharton.upenn.edu/issues/2022/8/12/senate-passed-inflation-reduction-act (accessed September 11, 2023.)

The surpluses, however, were backloaded into the last half of the 10-year budget window. According to the CBO's official estimates, the IRA was expected to add to the deficit by about $60 billion through FY 2026. Then CBO's estimates suggested deficit reduction of about $120 billion would occur between FY 2027 and FY 2031.[6]

To the extent that one accepts the argument that the IRA would reduce inflation through deficit reduction, based on the CBO forecasts, that would not be expected to occur until the latter part of this decade. In fact, the CBO estimated that the IRA would have a negligible effect on inflation.[7] The Penn Wharton Budget Model (PWBM) estimated that the IRA would add to the deficit in each year through 2026 and projected that the IRA would produce some *upward* pressure on prices in 2023 and 2024. PWBM estimated the act would then reduce annual inflation by around 0.1 percentage points in approximately five years (2027) but have no measurable impact on inflation after 2028.[8]

When the IRA was debated and passed, high inflation was not expected to persist beyond a couple years. In its 2022 outlook, the CBO estimated that each of five measures of inflation would fall to between 2.1% and 2.5% by 2024.[9] According to the Federal Reserve Bank of New York, in August 2022, consumers' median 3-year ahead expected inflation rate was 2.8% and their median 5-year ahead expected inflation rate was 2.0%.[10] So, by the time that any expected deficit reduction took hold, the bout of high inflation was expected to have already passed.

Dubious Deficit Reduction and Spending Expirations

There is reason to be skeptical that much of the supposed deficit reduction in the later years is legitimate and will ever occur. For example:

- The IRA extended for 2023 - 2025, the COVID-era expansion of refundable Premium Tax Credits (also known as "Obamacare tax credits") to those at up to 400% of the federal poverty level.[11] By not extending the credit through the end of the budget window as with the tax and revenue-raising provisions, the IRA avoided roughly $150 billion of costs in its CBO score.[12] However, these costs can only really be avoided if a future Congress allows the credit to revert to much stricter eligibility after 2025.

---

[6]Congressional Budget Office, "Estimated Budgetary Effects of Public Law 117–169."
[7]Congressional Budget Office Letter to Senator Lindsay Graham, "Re: Economic Analysis of Budget Reconciliation Legislation," August 4, 2022, https://www.cbo.gov/system/files/2022-08/58357-Graham.pdf (accessed September 11, 2023).
[8]University of Pennsylvania, Penn Wharton Budget Model, August 12, 2022.
[9]Congressional Budget Office, "The Budget and Economic Outlook: 2022 to 2032," May 25, 2022, https://www.cbo.gov/publication/57950 (accessed September 11, 2023).
[10] Federal Reserve Bank of New York, "Survey of Consumer Expectations, https://www.newyorkfed.org/microeconomics/sce#/inflexp-1 (accessed September 11, 2023).
[11]Public Law 117–169, § 12001(a).
[12]Committee for a Responsible Federal Budget, "What's in the Inflation Reduction Act?" July 28, 2022, https://www.crfb.org/blogs/whats-inflation-reduction-act (accessed September 11, 2023), Richard Stern, "Here's the Truth About What 'Inflation Reduction Act' Would Do," Daily Signal, August 7, 2022, https://www.dailysignal.com/2022/08/07/gimmicks-in-inflation-reduction-act-mask-true-costs-massive-inflationary-deficits/ (accessed September 11, 2023), and Congressional Budget Office Letter to Senator Mike Crapo, July 21, 2022, "Re: Health Insurance Policies," https://www.finance.senate.gov/imo/media/doc/crapo_burr_graham_jct_and_cbo1.pdf (accessed September 11, 2023).

- The CBO credited the IRA with $98.5 billion of Medicare savings between FY 2026 and FY 2031 for delaying until 2032 the implementation of a Trump administration prescription drug rebate rule that already appeared dead after legal challenges, delays, regulatory rescissions, and legislative changes had already pushed its implementation date back to 2027.[13]

- The CBO credited the IRA with $52.8 billion of new revenues between FY 2027 and FY 2031 for extending the limitation on noncorporate taxpayers claiming excess business losses, a provision of the Tax Cuts and Jobs Act (TCJA).[14] Regardless of the IRA, the next Congress would have been very likely to implement this revenue raiser to offset extensions of some of the TCJA tax cuts which are set to expire around the same time.

The Exploding Cost of the Green Tax Credits

Since the IRA was passed, it has become evident that the cost of the green tax credits in the bill will far exceed what was originally anticipated. The CBO originally projected that the full array of climate-related tax credits and deductions in the IRA would add about $270 billion to the deficit between 2023 and 2031 through reduced revenues and direct outlays.[15]

Estimates of the cost of the green tax credits have since ballooned. Recent analysis by the Joint Committee on Taxation (JCT) suggests that repealing the green tax provisions would reduce the deficit by more than $534 billion through 2031 ($663 billion through 2033).[16] This score does *not* even include a retroactive repeal of tax credits accrued through June 30, 2023.

Some non-governmental estimates suggest the green tax credits will have an even larger budget impact. PWBM recently estimated that the full range of climate and energy provisions in the IRA will cost $1.045 trillion between FY 2023 and 2032, up from their initial estimate of $384.9 billion.[17] Goldman Sachs has forecast that the IRA "will provide an estimated $1.2 trillion of [climate-related] incentives by 2032."[18] It should be noted that these estimates include other incentives in the IRA besides the green tax provisions, such as grants and loans.

Transferrable Tax Credits

---

[13]See, for example, Demian Brady, "What's the Deal with the Medicare Safe Harbor Budget Gimmick," National Taxpayers Union Foundation, October 12, 2021, https://www.ntu.org/foundation/detail/whats-the-deal-with-the-medicare-safe-harbor-budget-gimmick (accessed September 11, 2023), and Congressional Budget Office, "Estimated Budgetary Effects of Public Law 117–169."

[14]Congressional Budget Office, "Estimated Budgetary Effects of Public Law 117-169."

[15]Ibid.

[16]Author's calculations. Joint Committee on Taxation, "JCT Estimates Impact of Repealing IRA Energy Tax Provisions," May 25, 2023, https://www.taxnotes.com/tax-notes-today-federal/energy-taxation/jct-estimates-impact-repealing-ira-energy-tax-provisions/2023/06/02/7gtlx (accessed via Tax Notes, September 11, 2023).

[17]Penn Wharton Business Model, "Update: Budgetary Cost of Climate and energy provisions in the Inflation Reduction Act," April 27, 2023, https://budgetmodel.wharton.upenn.edu/estimates/2023/4/27/update-cost-climate-and-energy-inflation-reduction-act (accessed September 11, 2023).

[18]Goldman Sachs, "The US Is Poised for an Energy Revolution," April 17, 2023. https://www.goldmansachs.com/intelligence/pages/the-us-is-poised-for-an-energy-revolution.html (accessed September 11, 2023).

Unlike appropriated funds, there is no hard cap on how much tax credits could cost.[19] The fact that businesses generally can only use tax credits to reduce tax liability to zero (but not below) has limited previous green tax credits. However, the IRA changed that dynamic by introducing transferrable tax credits. Markets are forming to help companies sell these tax breaks to more profitable companies at a slight discount.[20] This will allow the companies to continue benefiting from the tax credits as long as *other* companies have tax liability to offset. This will contribute to the rising cost of the green tax credits, and it will incentivize investments in projects that may flounder, adding further to the law's overall deficits and its negative economic impact.

Questionable IRS Interpretations

One factor behind the rising IRA price tag is the IRS's questionable implementation of some of its provisions. For example, when the IRA passed, the tax credits for electric vehicles (EVs) were not generally expected to have a high take-up rate because of strict limitations on the foreign content of critical minerals used in the EVs' batteries, requirements for domestic manufacturing or final assembly, and income limitations for the purchaser.[21] However, the IRS has dramatically weakened these EV eligibility requirements.

- In December 2022, Treasury announced it would delay issuance of guidance on the battery component rules, so the critical-mineral country requirements would not take effect until later in 2023.[22] The IRS finally provided the rulemaking on April 17, 2023, meaning that EV sales between January 1 and April 16 could qualify for the credits even if the EVs failed the domestic content requirements.[23]

- The IRA did not impose the same strict domestic content and assembly requirements on commercial EVs as for other EVs purchased by consumers. The IRS then created a regulatory loophole by stipulating that EVs that businesses lease to consumers are to be considered

[19]At a February 2023 briefing, CBO Director Phillip Swagel explained that CBO and the Joint Committee on Taxation expect that firms' ability to monetize new tax credits will account for a pattern of declining corporate revenues. "Congressional Budget Office Director on Outlook," C-SPAN, February 15, 2023, https://www.c-span.org/video/?526068-1/cbo-director-releases-economic-outlook-report-us-risks-default-summer (accessed September 11, 2023). While CBO's initial modeling of these credits would have attempted to account for this difference, the lack of precedent adds significantly to the uncertainty of such estimates. In addition, the ability of loss-making companies to monetize these credits will magnify the additional costs of regulatory maneuvering to expand the credits beyond the legislative intent (discussed below).

[20]Richard Rubin, "Biden Climate Law Sparks New Market for Trading Tax Credits," Wall Street Journal, September 14, 2022, https://www.wsj.com/articles/biden-climate-law-sparks-new-market-for-trading-tax-credits-11663155828 (accessed September 11, 2023).

[21]See for example Fitch Ratings, "IRA May Limit EV Sales and Margin Gains for US Autos," August 29, 2022, https://www.fitchratings.com/research/corporate-finance/ira-may-limit-ev-sales-margin-gains-for-us-autos-29-08-2022 (accessed September 11, 2023).

[22]Alexander Rifaat and Lauren Lorricchio, "White House Offers EU Potential Reprieve on EV Tax Credits," Tax Notes, December 30, 2022, https://www.taxnotes.com/tax-notes-today-federal/credits/white-house-offers-eu-potential-reprieve-ev-tax-credits/2022/12/30/7fj17 (accessed September 11, 2023).

[23]Internal Revenue Service Notice of Proposed Rule Making, "Section 30D New Clean Vehicle Credit," April 17, 2023, https://www.federalregister.gov/documents/2023/04/17/2023-06822/section-30d-new-clean-vehicle-credit (accessed September 11, 2023).

commercial vehicles.[24] As a result, the eligibility restrictions related to critical mineral content, final assembly location, and income limitations can be circumvented by leasing EVs instead of purchasing.[25]

- The IRS further opened the door for foreign automakers to qualify for the EV credits by taking an expansive interpretation of the term "free trade agreement." Japan and South Korea do not have comprehensive free trade agreements with the United States, yet they will apparently be counted as having a free trade agreement because the countries signed extremely narrow trade deals covering EV minerals.[26]

A Drag on Sound Investment

Companies that are propped up by large government subsidies do not become more efficient or globally competitive in the long run. Instead, lacking vigorous market competition and the self-correction that it forces, subsidized companies only grow more reliant on continuing state assistance.[27] Every dollar of capital that investors funnel into green-energy companies because of the IRA is a dollar that is diverted from elsewhere in the economy where it could have generated a higher expected return on investment (before taxes and subsidies), higher incomes, and higher tax revenue.

The CBO's scoring does not account for reduced revenues associated with such macroeconomic effects.[28] To the extent that the IRA drives capital away from high-return investments, it may cause higher-than-expected increases in interest payments and debt-servicing costs and slower growth in typically high-growth industries that rely heavily on new capital from financial markets.

Furthermore, significant scored deficits were only avoided with new taxes, mostly imposed on businesses. These drags on economic supply will only add to inflationary pressure, not reduce it.

The Path Inflation Was on Before the IRA

Even before the IRA was passed or took effect, there was some evidence that inflation was beginning to subside. In an August 10, 2022 speech, six days before the IRA was signed into law, President Joe Biden noted, "Today we received news that our economy had zero percent inflation in the month of

---

[24]Internal Revenue Service Fact Sheet, "Frequently Asked Questions Related to New, Previously-Owned and Qualified Commercial Clean Vehicle Credits," February 3, 2023, https://www.irs.gov/pub/taxpros/fs-2022-42.pdf (accessed September 11, 2023).
[25] See, for example, John Voelcker, "Leasing an EV Is a Workaround That Could Get You That Tax Credit," Car and Driver, June 10, 2023, https://www.caranddriver.com/news/a44131850/leasing-an-ev-tax-credit/ (accessed September 11, 2023).
[26]David Lawder, "US, Japan sign trade deal on electric vehicle battery minerals", Reuters, March 28, 2023, https://www.reuters.com/business/autos-transportation/us-japan-strike-trade-deal-electric-vehicle-battery-minerals-2023-03-28/ (accessed September 11, 2023) and Heekyong Yang and Zoey Zhang, "Chinese firms ramp up investment in South Korea to get US EV tax credits" Reuters, July 31, 2023, https://www.reuters.com/technology/chinese-firms-ramp-up-investment-skorea-get-us-ev-tax-credits-2023-07-31/#:~:text=South%20Korea%20has%20a%20free,for%20the%20federal%20tax%20credits (accessed September 11, 2023).
[27]Samuel Gregg, *The Next American Economy* (New York City: Encounter Books, 2022), pp. 59–123.
[28]Megan S. Lynch and Jane G. Gravelle, "Dynamic Scoring in the Congressional Budget Process," Congressional Research Service *Report for Congress* R46233, May 24, 2022, https://sgp.fas.org/crs/misc/R46233.pdf (accessed September 11, 2023).

July."[29] The president was technically correct, though by virtually all available metrics inflation remained elevated and the fight to tame inflation had a long way to go.

Monetary policy is the primary weapon used to fight inflation, and the Fed continues to fight this battle today.[30] The federal funds rate target was 2.25% - 2.5% when the IRA passed, and today, just over one year later, it is up to 5.25% - 5.5%.[31] This tightening of monetary policy is chiefly responsible for the reduction in inflation that has occurred in the past year, as the Fed has reduced the amount of currency in circulation and liquid deposits (the M1 money supply) by roughly 10% since August 2022.[32] The question is whether the IRA is making the Fed's fight against inflation easier or harder.

Deficits and Inflation: The Evidence So Far

It is impossible to know the counterfactual of what would have happened to the budget and to the economy if the IRA had not been enacted. With that caveat, the budget, inflation, and interest rate numbers in 2023 have been worse than expected. Despite the IRA's new taxes on companies' financial statement income, the new tax on stock buybacks, new IRS funding, and more taxes on natural gas, oil, and coal, between January and July of 2023, total federal tax receipts have fallen by about 13 percent compared to the same period last year. Meanwhile, federal outlays are *up* by about 13 percent.[33] The deficit is $2 trillion in the past year, whereas the Office of Management and Budget projected that between FY 2022 and FY 2023 the deficit would rise from $1.38 trillion to $1.57 trillion.[34]

One of the factors in the rising deficit is rising interest rates and the soaring cost of servicing the debt. Interest rates are significantly higher today than they were expected to be in 2022. In its May 2022 outlook, the CBO forecast that the interest rate on 10-year Treasury notes would average 2.9 percent in 2023.[35] Yet the 10-year Treasury yield is currently about 4.3%.[36] The current federal funds rate target of 5.25% - 5.5% is well above the 3.8% rate that the Federal Reserve Board expected for 2023.[37] Despite the Fed's aggressive rate increases, the core personal consumption expenditures (PCE) index, the Fed's preferred gauge of inflation, remains more elevated than the Federal Reserve Board projected

[29] Bloomberg, "Biden Says There Was Zero Inflation in July," August 10, 2022, https://www.bloomberg.com/news/videos/2022-08-10/biden-says-there-was-zero-inflation-in-july-video (accessed September 11, 2023).
[30] Nick Timiraos, "Powell Says Fed Will 'Proceed Carefully' on Further Rate Rises," Wall Street Journal, August 25, 2023, https://www.wsj.com/economy/central-banking/powell-says-fed-will-proceed-carefully-on-any-further-rate-rises-31b6fc6a (accessed September 11, 2023).
[31] Board of Governors of the Federal Reserve System, "Open Market Operations," https://www.federalreserve.gov/monetarypolicy/openmarket.htm (accessed September 11, 2023).
[32] Board of Governors of the Federal Reserve System, "Money Stock Measures – H.6 Release." https://www.federalreserve.gov/releases/h6/current/default.htm (accessed September 11, 2023).
[33] U.S. Department of the Treasury Bureau of the Fiscal Service, "Monthly Treasury Statement: Receipts and Outlays of the United States Government For Fiscal Year 2023 Through July 31, 2023, and Other Periods," August 10, 2023, https://www.fiscal.treasury.gov/files/reports-statements/mts/mts0723.pdf (accessed September 11, 2023).
[34] Office of Management and Budget, "Historical Tables: Table 1.1–Summary of Receipts, Outlays, and Surpluses or Deficits," https://www.whitehouse.gov/omb/budget/historical-tables/ (accessed September 11, 2023).
[35] Congressional Budget Office, "The Budget and Economic Outlook: 2022 to 2032."
[36] Wall Street Journal, "U.S. 10 Year Treasury Note: TMUBMUSD10Y" https://www.wsj.com/market-data/quotes/bond/BX/TMUBMUSD10Y (accessed September 11, 2023).
[37] Board of Governors of the Federal Reserve System, "Monetary Policy Report – June 2022," https://www.federalreserve.gov/monetarypolicy/2022-06-mpr-part3.htm (accessed September 11, 2023).

in June 2022.[38] Together, the evidence shows that the Fed's battle against inflation in the past year has been more difficult than expected. There is little evidence to suggest that the IRA has aided the Fed in its battle against inflation. If anything, the weight of the evidence indicates that the IRA has added to deficits and exacerbated inflation.

IRS Funding to Crack Down on Wealthy Tax Cheats?

Background

The IRA provided about $79.6 billion in supplemental funding to the IRS, $45.6 billion of which was specifically dedicated to enforcement activities such as audits, collections, litigation, criminal investigations, asset monitoring, and compliance activities.[39] The IRS in 2021 estimated that the amount of funding provided in the IRA would allow the agency to increase collections by $316 billion over the course of a decade, including $83 billion in the 10th year.[40] At the same time, advocates of IRS funding have contended that taxpayers earning less than $400,000 (who account for about 98 percent of U.S. taxpayers) would not be subject to more audits.[41] In fact, the new collections will be substantially less than what was claimed by the IRS, and if IRS enforcement is substantially increased taxpayers earning less than $400,000 *will be* negatively impacted.

The Tax Gap and the National Reporting Program

The "gross tax gap" is the estimated amount of taxes that are legally owed that are not paid voluntarily and on time. The "net tax gap" nets out the portion that is eventually paid. Notably, the net tax gap does not account for the many taxpayers that *overpay* on their taxes. Beyond that, the concept of the tax gap is highly subjective, and its empirical measurement is deeply flawed.

The IRS's estimate of the tax gap is based on statistical analysis of rigorous audits performed on a stratified random sample of the population known as the National Reporting Program [NRP] sample.[42] The recommended adjustments from these audits are used as a gauge of tax noncompliance.

[38]Bureau of Economic Analysis, "Personal Consumption Expenditures Price Index, Excluding Food and Energy, https://www.bea.gov/data/personal-consumption-expenditures-price-index-excluding-food-and-energy," August 31, 2023 (accessed September 11, 2023).
[39]The nine-year supplemental funding was provided in addition to regular annual appropriations. The law also provides $3.2 billion to the IRS for taxpayer services and $4.8 billion for business systems modernization, but these pieces have been less controversial. Congressional Research Service, "IRS-Related Funding in the Inflation Reduction Act," IN11977, updated October 20, 2022, https://crsreports.congress.gov/product/pdf/IN/IN11977 (accessed September 11, 2023).
[40]The comparatively high revenues projected by the IRS in the 10th year compared to earlier years reflect the IRS's expectations of how long will be needed to hire additional agents and adequately train them, as well as the time needed to bring new programs and systems online. U.S. Department of the Treasury, "The American Families Plan Tax Compliance Agenda," May 2021, https://home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf (accessed September 11, 2023).
[41]The White House went so far as to claim that "no family or small business making less than $400,000 per year will see their taxes go up by a single cent." News release, "Fact Sheet: How the Inflation Reduction Act Will Help Small Businesses," White House, September 12, 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/12/fact-sheet-how-the-inflation-reduction-act-will-help-small-businesses/ (accessed September 11, 2023).
[42]Congressional Research Service, "Federal Tax Gap: Size, Contributing Factors, and the Debate over Reducing It," In Focus, January 4, 2023, https://crsreports.congress.gov/product/pdf/IF/IF11887 (accessed September 11, 2023).

Extrapolating from those audits, the agency most recently estimated an overall annual net tax gap between 2014 and 2016 of $428 billion.[43] The methodology used to arrive at this estimate of the tax gap greatly overstates the amount of revenues the IRS could raise with additional funding.

Detection-Controlled Estimation Adjustments

The IRS applies a "detection-controlled estimation" (DCE) adjustment when estimating the tax gap. The idea behind the DCE adjustment is that when different auditors examining similar types of returns recommend different levels of adjustments on those returns, it is assumed to be because less skilled or less experienced examiners have failed to detect all the issues present in the returns they examined.[44] Therefore the IRS adjusts upwards the estimated underreported income in returns examined by auditors with lower adjustment rates to match the examiners with the highest adjustment rates.[45] The DCE adjustments have a large effect on the estimated tax gap. Academic researchers have estimated that the DCE adjustments roughly *triple* the estimates of income underreporting.[46]

There are strong reasons to doubt the validity of using DCE adjustments to estimate the tax gap, let alone to estimate how much additional revenue the IRS could realistically raise with expanded audits. Notably, the audits in the NRP sample are referred to as "audits from hell" because they are so stringent.[47] By applying the DCE adjustments, the IRS is tacitly suggesting that even these notoriously stringent audits are too tame and ought to result in three times more additional collections.

As stated by the IRS, "Not all underreported income is detected by every audit, even audits of the scope and quality conducted under the NRP." Tax laws and regulations are unimaginably complex, and accountants, lawyers, taxpayers, and the IRS frequently disagree about the proper interpretation of rules to a given case. Tax courts often side with taxpayers and against the IRS in disputes. Yet, if the tax gap is accurate, only the most aggressive IRS auditors are right, and everyone else—including other IRS auditors—is wrong. The estimated tax gap *excluding* the DCE adjustment could roughly be viewed as an estimate of how much additional collections are possible assuming all Americans were subject to painful audits every year (an administrative impossibility) and ignoring the lost revenues from the economic harm that would cause.

---

[43] Internal Revenue Service, Research, Applied Analytics, and Statistics, "Tax Gap Estimates 2014–2016 (And Projections for 2017–2019)," Publication No. 5364, August 2022, https://www.irs.gov/pub/irs-pdf/p5364.pdf (accessed September 11, 2023).

[44] Daniel Hemel, Janet Holtzblatt, and Steve Rosenthal, "The Tax Gap's Many Shades of Gray," September 30, 2021, University of Chicago Coase-Sandor Institute for Law and Economics Research Paper No. 938, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3934044 (accessed September 11, 2023).

[45] Supervisory review and appeals routinely lead to reductions in assessed taxes relative to examiners' recommended adjustments. The IRS's tax-gap estimates are based on the recommended adjustments, not the final assessments. To the extent that some overzealous examiners recommend adjustments that cannot be upheld upon review, the IRS's estimated tax gap overstates the amount of additional collections that could conceivably be collected by bolstering IRS enforcement. Moreover, the IRS's use of DCE adjustments may lead to widespread imputation of the recommended adjustment rates of overzealous examiners. See Hemel, Holtzblatt, and Rosenthal, "The Tax Gap's Many Shades of Gray."

[46] Daniel Hemel, Janet Holtzblatt, and Steve Rosenthal, "The Tax Gap's Many Shades of Gray," and John Guyton et al., "Tax Evasion at the Top of the Income Distribution: Theory and Evidence," National Bureau of Economic Research Working Paper No. 28542, March 2021, https://gabriel-zucman.eu/files/GLRRZ2021.pdf (accessed September 11, 2023).

[47] David Lawder, "IRS Chief Asks Treasury Watchdog to Probe Audits of Ex-FBI Officials", Reuters, July 7, 2022, https://www.reuters.com/world/us/irs-chief-asks-treasury-watchdog-probe-audits-ex-fbi-officials-2022-07-07/ (accessed September 11, 2023).

The $400,000 Income Limitation

The IRS has ostensibly committed not to raise audits on the roughly 98 percent of Americans earning less than $400,000. Treasury Secretary Janet Yellen sent a letter to the former IRS commissioner saying that additional funding and resources shall not be used to increase audit levels on small businesses or households earning less than $400,000 relative to historical levels.[48] Based on the distribution of adjustments recommended in NRP audits, this would leave about four-fifths of the tax gap (excluding the DCE adjustments) off-limits from new IRS enforcement.[49] This realistically leaves no room for the IRS to raise anywhere near the level revenues that it suggested, even if it dramatically increased audits on high-income taxpayers.

In fact, IRS Commissioner Daniel Werfel gave congressional testimony suggesting that the commitment not to raise audits on those making less than $400,000 may have an expiration date, stating for example that, "Our focus will be on other high-dollar areas *for quite some time*." When pressed to give a specific timeframe, Werfel said, "I would say in the 3-to-4-year timeframe I will have enough information in the capacity-building that we're doing for high-income filers that I'll be able to say what's next.[50]

Less Qualified Auditors

Previous estimates from the IRS suggest that with the additional funding the agency could increase its full-time equivalent staffing by 87,000—more than doubling the agency's size in less than a decade.[51] With a large increase in IRS enforcement staffing, there would also be an increase in demand for accountants, auditors, enrolled agents, and tax lawyers to work in the private sector to deal with additional IRS enforcement activity.

The agency will face stiff competition to attract enough qualified new employees to fill all the new open positions.[52] In a recent webinar on the Future of IRS Funding, former IRS Commissioner Charles Rettig spoke about the hiring challenge, noting that the IRS needed to offer a more generous slate of benefits to new employees, mentioning tuition reimbursement, student loan repayments, elder care,

48 News release, "Secretary of the Treasury Janet L. Yellen Sends Letters to IRS Commissioner in Support of Funding for IRS to Improve Taxpayer Service and Combat Evasion by High Income Earners and Corporations," August 10, 2022, https://home.treasury.gov/news/press-releases/jy0918 (accessed September 11, 2023).

49 Table A2 of DeBacker et al. (below) indicates that about 14.6 percent of adjusted gross income misreporting relates to taxpayers whose true adjusted gross income is in the 99th percentile, and an additional 13.6 percent relates to taxpayers between the 95th and 99th percentiles. Jason DeBacker et al., "Tax Noncompliance and Measures of Income Inequality," Tax Notes, February 17, 2020, https://www.taxnotes.com/tax-notes-federal/compliance/tax-noncompliance-and-measures-income-inequality/2020/02/17/2c3y5 (accessed September 11, 2023).

50 "Hearing on Accountability and Transparency at the Internal Revenue Service with IRS Commissioner Werfel," April 27, 2023, Committee on Ways and Means, U.S. House of Representatives, https://waysandmeans.house.gov/event/hearing-on-accountability-and-transparency-at-the-internal-revenue-service-with-irs-commissioner-werfel/ (accessed September 11, 2023).

51 U.S. Department of the Treasury, "The American Families Plan Tax Compliance Agenda."

52 Richard Rubin, "IRS Faces Tight Job Market and Competition for Talent as It Recruits Thousands," *Wall Street Journal*, September 17, 2022, https://www.wsj.com/articles/irs-faces-tight-job-market-and-competition-for-talent-as-it-recruits-thousands-11663407003 (accessed September 11, 2023).

and continued remote work. Rettig said of the hiring challenge, "It's going to be a tussle. The first wave of hirings would be easier than the second, third or fourth wave years down the road."[53]

Indeed, with each successive hire, the IRS should expect to bring in new employees that, on average, are less qualified and less predisposed to IRS work. Newly hired auditors will almost certainly tend to be less effective at identifying unpaid taxes than existing, more experienced IRS agents, further diminishing the amount of new revenues that can be reasonably anticipated from the new funding.

The Illegal Economy

The IRS tax gap does *not* capture underreported income from illegal activities, such as if an illegal narcotics dealer fails to report taxable income from his drug business.[54] This omission may leave out about $40 billion from the tax gap.[55] (In many cases, illegal activity would not be uncovered by a typical audit, so the amount that is realistically recoverable is substantially less.) Notably, the pledge not to increase audits on those making less than $400,000 suggests that the IRS's new enforcement funding would not be used to step up enforcement against low and midlevel illegal activity.

Of course, the government has the same interest in pursuing tax fraud and criminal activity whether the culprit has an adjusted gross income of $399,000 or $401,000. This is not a minor point, as about two-thirds of tax convictions involve narcotics or otherwise illegal source income.[56] Furthermore, the IRS would not be able to tell whether a drug dealer's income (or anyone else's) was above or below $400,000 without an audit or investigation, underscoring the challenge of dramatically stepping up enforcement on those above the $400,000 threshold without negatively impacting those below the threshold.

Changes to IRS Enforcement: The Evidence So Far

The IRS released its strategic operating plan on April 6, 2023. This plan described how the agency intended to use the supplemental funding provided in the IRA. The plan showed that through the end of FY 2024 the IRS intended to spend heavily from its taxpayer services appropriations, spending 52% of its 9-year budget for taxpayer services in just over two years. In the same period, it planned to spend less than 4% of its enforcement budget. The plan itself provided very little detail about how it intended to employ the enforcement budget.[57]

In fact, a report from the Treasury Inspector General for Tax Administration (TIGTA) that was published on August 31 showed that through the first half of FY 2023, the IRS had not hired enough revenue agents in the divisions typically tasked with enforcing high-income and corporate taxes to

[53]Cara Griffith, "The Future of IRS Funding: Transcript," Tax Notes, February 8, 2023, https://www.taxnotes.com/tax-notes-today-federal/tax-system-administration/future-irs-funding-transcript/2023/02/08/7fxy9?highlight=webinar (accessed September 11, 2023).
[54]Daniel Hemel, Janet Holtzblatt, and Steve Rosenthal, "The Tax Gap's Many Shades of Gray.
[55]Ibid.
[56]Internal Revenue Service, "IRS Data Book 2022," Table 24, March 2023, https://www.irs.gov/pub/irs-pdf/p55b.pdf (accessed September 11, 2023).
[57]Internal Revenue Service, "Inflation Reduction Act Strategic Operating Plan FY2023 – 2031," April 5, 2023, https://www.irs.gov/pub/irs-pdf/p3744.pdf (accessed September 11, 2023).

offset attrition.[58] Furthermore, according to TIGTA, "The Small Business/Self-Employed Division's Fiscal Year 2023 Examination Plan showed no significant increase in the number of high-income individual audits. Additionally, the [Large Business and International] Division's resource allocation plan is not detailed enough for TIGTA to assess the IRS's intended efforts to examine high-income individuals with the increased enforcement funding."

Since the IRS has yet to build up enforcement, middle-income taxpayers likely have not yet been subject to significantly more audits. However, neither have high-income taxpayers, meaning there also has not yet been the promised uptick in tax collections from wealthy taxpayers and corporations.

Significant Reduction in Greenhouse Gas Emissions and Global Temperatures?

Background

The green tax credits, grants, and loans in the IRA were intended to reduce GHG emissions to advance the United Nations' goal of limiting the rise in global temperatures to 1.5 degrees Celsius above pre-industrial levels by 2100.[59]

Before the law's passage, U.S. emissions had already been falling for decades, driven largely by market forces including the increased penetration of natural gas allowed by improved extraction technology.[60] Meanwhile, developing nations have accounted for a growing share of global emissions: China accounts for about 25% of global emissions as of 2021.[61] The U.S. accounts for about 11 percent, down from about 17 percent in 2000.[62]

A Fraction of a Fraction of a Degree

Even assuming the worst about global warming, the U.S. could eliminate GHG emissions today and it would have almost no impact on global temperatures by the end of the century, reducing global temperatures by no more than about 0.2 degrees Celsius by 2100.[63] Of course, the IRA's green tax credit provisions will come nowhere near eliminating U.S. emissions. A project led by Princeton University's Zero-carbon [sic] Energy Systems Research and Optimization Laboratory ("Zero Lab")—a research lab that seeks to "accelerate rapid, affordable, and effective transitions to net-zero

58U.S. Treasury Inspector General for Tax Administration, "The IRS Needs to Leverage the Most Effective Training for Revenue Agents Examining High-Income Taxpayers," August 31, 2023, https://www.tigta.gov/reports/audit/irs-needs-leverage-most-effective-training-revenue-agents-examining-high-income (accessed September 11, 2023).

59The White House, "Fact Sheet: President Biden to Catalyze Global Climate Action Through the Major Economies Forum on Energy and Climate," April 20, 2023, https://www.whitehouse.gov/briefing-room/statements-releases/2023/04/20/fact-sheet-president-biden-to-catalyze-global-climate-action-through-the-major-economies-forum-on-energy-and-climate/ (accessed September 11, 2023).

60Nicolas Loris, "Pursuing Policies to Drive Economic Growth and Reduce Emissions, Heritage Foundation *Backgrounder* No. 3444, October 16, 2019, https://www.heritage.org/energy-economics/report/pursuing-policies-drive-economic-growth-and-reduce-emissions.

61Hannah Ritchie and Max Roser, "Greenhouse Gas Emissions," Our World in Data based on Climate Analysis Indicators Tool, August 2020, https://ourworldindata.org/greenhouse-gas-emissions (accessed September 11, 2023).

62Ibid.

63Even U.S. Climate Envoy John Kerry has acknowledged that the elimination of GHG emissions by the U.S. and other developed nations would not have no meaningful climate impact. Kevin Dayaratna, Katie Tubb, and David Kreutzer, "The Unsustainable Costs of President Biden's Climate Agenda," Heritage Foundation *Backgrounder* No. 3713, June 16, 2022, https://www.heritage.org/energy-economics/report/the-unsustainable-costs-president-bidens-climate-agenda.

carbon energy systems"—estimates that the IRA will reduce U.S. emissions by about 6.3 billion metric tons of CO_2-equivanent during the course of a decade.[64] This would mean a less than 14 percent reduction in GHG emissions for the decade.[65]

In other words, supposing the IRA's provisions remained intact and remained equally effective for the rest of this century, the total effect on global temperatures likely would not be more than one-seventh of one-fifth of a degree (less than 0.03 degrees).

No Matter the Cost?

Even such a tiny effect on global emissions and temperatures would require funding of the green tax provisions not just for a decade but for the rest of the century, meaning several trillion dollars more taken from the American people to finance the green agenda. Lawmakers must weigh the benefits against the costs.

Even before the IRA, America already faced spiraling deficits that will require lawmakers to confront difficult budget tradeoffs on policies like Social Security funding and potentially large middle class tax hikes if spending is not controlled. The U.S. is running a $2 trillion annual deficit, and even assuming a full expiration of TCJA tax cuts, no new wars, no financial crises, and no major economic downturns, the CBO projects the nation's debt will be double the size of GDP within about 30 years.[66] This is not sustainable. The costly green agenda cannot feasibly be funded without overburdening America's middle class.

Global Emissions and Climate: The Evidence So Far

According to Carbon Monitor, U.S. emissions were down in 2023 by about 105 million metric tons as of July 31 compared to the same time last year.[67] That would suggest that the U.S. has so far achieved about $\frac{1}{60}$ of the total reduction in GHG emissions that the Princeton Zero Lab projected for the decade. However, the IRA is not the driving factor behind even this drop. The main reason for the decline in 2023 is that the U.S. experienced a mild winter, reduced heating costs, and a sluggish economy.[68]

Despite the decrease in U.S. emissions, according to Carbon Monitor, total global emissions in the first seven months of 2023 are up by about 99 million metric tons relative to the same period last year. That increase is driven by a 6.7 percent increase in emissions in India, a 3.7 percent increase in China, and a 3.2 percent increase in Russia.[69]

[64]Jesse D. Jenkins et al., "Preliminary Report: The Climate and Energy Impacts of the Inflation Reduction Act of 2022," REPEAT Project, Princeton, NJ, August 2022, https://roar-assets-auto.rbl.ms/documents/34985/REPEAT_IRA_Prelminary_Report_2022-08-12.pdf (accessed September 11, 2023).
[65]According to the U.S. Energy Information Administration, without the IRA, the U.S. was expected to have about 45.2 billion metric tons of CO2-equivanent GHG emissions in the decade. U.S. Energy Information Administration, "Annual Energy Outlook 2023," March 2023 https://www.eia.gov/outlooks/aeo/IIF_IRA/ (accessed September 11, 2023).
[66]Congressional Budget Office, "The Budget and Economic Outlook: 2023 to 2033."
[67] Carbon Monitor, "CO2 Emissions Variation (%) In All Sectors," https://carbonmonitor.org/variation, August 25, 2023 (accessed September 11, 2023).
[68] E&E News, "U.S. carbon emissions fall for first time in Biden era," July 7, 2023, https://www.eenews.net/articles/u-s-carbon-emissions-fall-for-first-time-in-biden-era/ (accessed September 11, 2023).
[69] Carbon Monitor, "CO2 Emissions Variation (%) In All Sectors."

* * * * * * * * * * * * * * * * * * *