U.S. GOVERNMENT ACCOUNTABILITY OFFICE
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441 G St. N.W.
Washington, DC 20548

November 10, 2021

The Honorable Janet L. Yellen
Secretary of the Treasury

Financial Audit: IRS's FY 2021 and FY 2020 Financial Statements

Dear Madam Secretary:

This report transmits the GAO auditor's report on the results of our audits of the fiscal years 2021 and 2020 financial statements of the Internal Revenue Service (IRS), which is incorporated in the enclosed *Internal Revenue Service Financial Report for Fiscal Year 2021*.

As discussed more fully in the auditor's report that begins on page 35 of the enclosed financial report, we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2021, and 2020, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;

- although certain internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2021; and

- no reportable noncompliance for fiscal year 2021 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

During our audit, we continued to identify significant deficiencies in internal control over financial reporting concerning IRS's unpaid assessments and financial reporting systems. These deficiencies merit attention by those charged with governance of IRS.[1]

The Chief Financial Officers Act of 1990 (CFO Act), as amended by the Government Management Reform Act of 1994 (GMRA), requires the annual preparation and audit of organization-wide financial statements of executive branch departments, including the

[1]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

Department of the Treasury of which IRS is a component.[2] GMRA also requires audited financial statements of components of executive branch departments and agencies as designated by the Director of the Office of Management and Budget (OMB). IRS is one of these designated components. In accordance with the authority conferred by the CFO Act, as amended by GMRA, we have audited IRS's financial statements because of the significance of IRS's tax collections to the consolidated financial statements of the U.S. government, which GAO is required to audit.

The Consolidated Appropriations Act, 2021, enacted in December 2020, and the American Rescue Plan Act of 2021, enacted in March 2021, as well as other Coronavirus Disease 2019 (COVID-19) pandemic relief laws, contained a number of provisions, including the second and third rounds of direct payments (i.e., economic impact payments) totaling over $569 billion in fiscal year 2021, for eligible individuals to address financial stress caused by the COVID-19 pandemic.[3] As part of monitoring and oversight of the federal government's efforts to prepare for, respond to, and recover from the COVID-19 pandemic, we have issued a number of reports on federal agencies' implementation of COVID-19 pandemic relief laws, including reports providing information on, and recommendations to strengthen, IRS's implementation of the tax-related provisions.[4] Similar to our prior year findings for the processing of the first round of economic impact payments, our work in fiscal year 2021 found that IRS faced challenges issuing the second and third rounds of payments to certain eligible recipients and preventing improper payments.

We are sending copies of this report to the Chairman and Vice Chairman of the Joint Committee on Taxation, the Chairmen and Ranking Members of the Senate Committee on Finance and the House Committee on Ways and Means, and other interested congressional committees and subcommittees. We are also sending copies of this report to the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. In addition, the report is available at no charge on the GAO website at https://www.gao.gov.

[2]See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), codified, in relevant part, as amended, at 31 U.S.C. § 3515(c).

[3]Pub. L. No. 116-260, § 272, 134 Stat. 1182, 1965-1976 (Dec. 27, 2020); Pub. L. No. 117-2, § 9601, 135 Stat. 4, 138-144 (Mar. 11, 2021).

[4]GAO, *COVID-19: Additional Actions Needed to Improve Accountability and Program Effectiveness of Federal Response*, GAO-22-105051 (Washington, D.C.: Oct. 27, 2021); *COVID-19: Continued Attention Needed to Enhance Federal Preparedness, Response, Service Delivery, and Program Integrity*, GAO-21-551 (Washington, D.C.: July 19, 2021); *COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year*, GAO-21-387 (Washington, D.C.: Mar. 31, 2021); *COVID-19: Critical Vaccine Distribution, Supply Chain, Program Integrity, and Other Challenges Require Focused Federal Attention*, GAO-21-265 (Washington, D.C.: Jan. 28, 2021); and *COVID-19: Urgent Actions Needed to Better Ensure an Effective Federal Response*, GAO-21-191 (Washington, D.C.: Nov. 30, 2020).

If you or your staff have any questions concerning this report, please contact me at (202) 512-3406 or simpsondb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,

Dawn Simpson

Dawn B. Simpson
Director
Financial Management and Assurance

Enclosure

(104649)

IRS

FINANCIAL **REPORT**

FISCAL YEAR
2021

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WEBSITE INFORMATION

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ABOUT THIS REPORT

This Financial Report for Fiscal Year (FY) 2021 presents the Internal Revenue Service's (IRS) financial information in relation to its mission and the resources entrusted to the IRS. The Financial Report also highlights select accomplishments and challenges in implementing programs that promote the IRS's mission. This report is presented in accordance with Office of Management and Budget's (OMB) Circular A-136, Financial Reporting Requirements as applicable to the IRS as a component of United States Department of the Treasury (Treasury). This financial report is available online at: https://www.irs.gov/pub/irs-pdf/p5456.pdf

HOW THIS REPORT IS ORGANIZED

Message from the IRS Commissioner

Part 1: Management's Discussion and Analysis

Provides a high-level overview of the IRS's organizational structure, strategic framework, programmatic and financial performance, and management assurances related to the IRS's internal controls. Performance is reported annually in the IRS's Congressional Budget Justification and Treasury's Agency Financial Report.

Part 2: Financial Section

Begins with a message from the Chief Financial Officer, followed by the Government Accountability Office's (GAO) Auditors' Report, IRS Response to the Independent Auditors' Report, audited financial statements including the accompanying note disclosures, and required supplementary information (unaudited).

Part 3: Other Information (Unaudited)

Contains information including but not limited to data specific to Tax Credits, Tax Expenditures, the Tax Gap, Management and Performance Challenges identified by the Treasury Inspector General for Tax Administration (TIGTA), and Management's response. Payment Integrity, Fraud Reduction Report, Real Property, Civil Monetary Penalties Inflation Adjustment, and Grants Programs are reported by Treasury and can be found at: https://home.treasury.gov/about/budget-financial-reporting-planning-and-performance/agency-financial-report.

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The IRS is dedicated to serving taxpayers and the tax system, and our activities each year reflect the importance of the agency and its workers to our nation.

The IRS collected more than $4 trillion in taxes in FY 2021 and collects nearly all the revenue that supports the federal government's operations. As the past year shows, we are more than a tax administration agency. We also make it possible for the government to perform its vital functions and be effective on everything from education to defense.

The IRS and the entire nation continued to face major challenges in FY 2021 because of COVID-19. During the period between October 1, 2020 and September 30, 2021, IRS employees answered Congress' call to deliver two more rounds of Economic Impact Payments, following the first round distributed in FY 2020. Taken together, the three rounds of payments totaled more than $800 billion in help to hundreds of millions of deserving and needy Americans.

IRS employees also delivered for the nation by implementing changes to the Earned Income Tax Credit, the Child Tax Credit, and other refundable credits as part of the American Rescue Plan passed by Congress in March 2021. Our focus was on one very important change that allowed delivery of up to half of the 2021 Child Tax Credit as advance monthly payments to eligible families between July and December. The IRS issued the first payments on July 15; roughly $15 billion went out to about 35 million families around the country.

Another important aspect to our work has been enhancing the taxpayer experience. The IRS has been emphasizing service to diverse and underserved communities, and along those lines we took important steps to further improve the amount of assistance we provide in multiple languages. For the first time in the history of the IRS, we made the Form 1040 available in Spanish during the 2021 tax filing season. We also debuted Schedule LEP, Request for Change in Language Preference, giving taxpayers with limited English proficiency the opportunity to indicate a preferred language when communicating with the IRS.

To ensure fairness, enforcement of the tax laws is just as critical as the services we provide. The IRS remains committed to having a strong, visible, and robust tax enforcement presence to support voluntary compliance while also respecting taxpayer rights. During FY 2021, the IRS continued to develop innovative approaches to understanding, detecting, and resolving potential noncompliance to maintain taxpayer confidence in the tax system. We have expanded use of data, analytics, and artificial intelligence across all lanes in the audit process, from selection to examination.

Also, I am pleased to report that the IRS maintained an unmodified (clean) financial statement audit opinion for the 22nd consecutive year. Based upon the results of our internal control evaluations, I can provide reasonable assurance that the performance and financial information in this report is complete and accurate. We strengthened management controls, made progress toward achieving all U.S. financial systems and control objectives, and will continue to look for opportunities to improve.

While there is much to focus on the present, the IRS is also looking toward the future to find new ways to serve taxpayers and improve the tax system. In January 2021, we took a major step on this journey by issuing our Report to Congress as required under the Taxpayer First Act.

The report included recommendations for redesigning our organization to make improvements and enhance the taxpayer and employee experience.

Since then, we have begun the IRS NEXT initiative to revitalize and build an organization for the next generation. I am confident this journey will pay significant dividends over time. The improvements we make to the agency over the next few years will produce abundant benefits for taxpayers, the tax system, and our nation well into the future.

Sincerely,

Charles P. Rettig

Charles P. Rettig
Commissioner of the Internal Revenue Service
November 8, 2021

MANAGEMENT'S DISCUSSION AND ANALYSIS

IRS

ABOUT THE IRS

The IRS is a bureau of the Department of the Treasury. The IRS carries out the responsibilities of the Secretary of the Treasury under Internal Revenue Code (IRC) Section 7801. The Secretary has full authority to administer and enforce the internal revenue laws and has the power to create an agency to enforce these laws.

IRC Section 7803 provides for the appointment of a commissioner of Internal Revenue to administer and supervise the execution and application of the internal revenue laws.

History

The IRS is one of the oldest bureaus in the United States Government. Article 1, Section 8 of the Constitution gave the federal government the power to “lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States…” In 1862, President Lincoln and the Congress established the Bureau of Internal Revenue and the nation’s first income tax. In 1953, the Bureau of Internal Revenue’s name changed to the Internal Revenue Service. Visit the IRS History Timeline at www.irs.gov/irs-history-timeline.

Internal Revenue Service Building, 1111 Constitution Ave., Washington D.C.

MISSION AND ORGANIZATION

The IRS's mission is to provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

This mission statement describes our role and the public's expectation about how we should perform that role.

- In the United States, the Congress passes tax laws and requires taxpayers to comply.
- The taxpayer's role is to understand and meet his or her tax obligations.
- The IRS's role is to help willing taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share.

The IRS's core operations include the collection of individual and corporate taxes, processing tax returns, taxpayer assistance, enforcement of the tax laws through examination and collection, as well as criminal investigation of tax crimes. The wide IRS portfolio also includes tax-exempt organizations, tax-exempt bonds, multiple refundable tax credits, and other specialized programs.

The IRS's organizational structure closely resembles the private sector model of organizing around customers with similar needs. Four business units focus on unique groups of taxpayers, Wage & Investment, Small Business/Self-Employed, Large Business & International, and Tax Exempt & Government Entities. Additionally, the IRS has other functional organizations that have direct interaction with taxpayers and tax preparers, as well as an operations support structure that supplies direction and guidance to the IRS's administrative functions. The current IRS organization chart is available at: Today's IRS Organization | Internal Revenue Service.

IRS STRATEGIC MANAGEMENT

The IRS FY 2018–2022 Strategic Plan has six strategic goals, developed with input from all IRS business units and operating divisions. The IRS Strategic Goals guide resource decisions, programs, and operations to meet the changing needs and expectations of taxpayers and members of the tax community who serve taxpayers.

EMPOWER AND ENABLE ALL TAXPAYERS

PROTECT THE INTEGRITY OF THE TAX SYSTEM

COLLABORATE WITH EXTERNAL PARTNERS

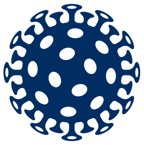
CULTIVATE A WELL-EQUIPPED, DIVERSE, FLEXIBLE AND ENGAGED WORKFORCE

ADVANCE DATA ACCESS, USABILITY AND ANALYTICS

DRIVE INCREASED AGILITY, EFFICIENCY, EFFECTIVENESS AND SECURITY

The strategic plan and performance measures are available at: IRS Strategic Plan | Internal Revenue Service.

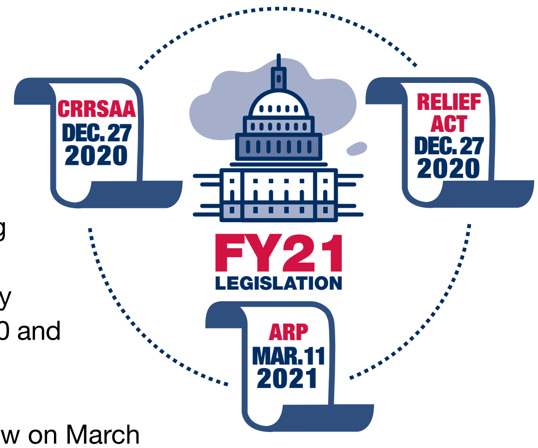
COVID-19 PANDEMIC RESPONSE UPDATE



The COVID-19 pandemic required the IRS to rapidly implement new legislative requirements and offer relief to taxpayers experiencing hardship while preserving the safety of its employees. In FY 2021, Congress and both administrations entrusted the IRS with $2.4 billion in supplemental funding to support recovery from the COVID-19 pandemic.

Implementation of New Legislation

In FY 2021, Congress passed several laws that offer relief to Americans experiencing financial hardship. The Coronavirus Response and Relief Supplemental Appropriations Act of 2021 (CRRSAA), signed into law on December 27, 2020, authorized a second round of Economic Impact Payments (EIP). This legislation required that the second round of EIP payments (EIP 2) be issued by January 15, 2021. The IRS was prepared and delivered the majority of EIP 2 in just two days following the enactment.



The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (Relief Act), enacted on December 27, 2020, made several changes to the employee retention tax credits previously made available under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), including changing and extending the Employee Retention Credit (ERC) for six months through June 30, 2021. Several of the changes apply only to tax year (TY) 2021 while others apply to both TYs 2020 and 2021.

The American Rescue Plan Act of 2021 (ARP), signed into law on March 11, 2021, authorized a third round of EIPs (EIP 3). The IRS began issuing these payments on March 12, 2021. In FY 2021, the IRS, in coordination with the Bureau of the Fiscal Service (Fiscal Service), issued over 388 million EIP 2 and 3 payments worth over $545 billion.

In addition, the ARP requires the IRS to issue a monthly advance of the Child Tax Credit (CTC) payments, consisting of half the total credit amount, to qualifying taxpayers beginning in July 2021 and continuing monthly through December 2021. Extensive coordination and collaboration across the IRS and with stakeholders, including the Fiscal Service, allowed for the prompt issuance of the Advance Child Tax Credit (AdvCTC) payments. IRS and stakeholder efforts included the development and deployment of programming changes, new processes, creation of new notices, and extensive communications and outreach to provide taxpayers with information and guidance.

In FY 2021, the IRS deployed several new tools on IRS.gov to support the administration of the AdvCTC payments made available through the ARP legislation, including:

- Child Tax Credit Non-filer Sign-up Tool to help eligible families who do not normally file tax returns register for the monthly AdvCTC payments.
- Child Tax Credit Update Portal (CTCUP) to enable families to verify their eligibility for advance payments and to unenroll from the monthly payment program. The IRS later added functionality to CTCUP to allow recipients to check the status of their payments and make updates to their address and bank account information.
- Advance Child Tax Credit Eligibility Assistant to help families verify whether they qualify for AdvCTC payments.

Administrative Relief to Help Taxpayers

After issuing the first and second rounds of EIPs, the IRS created a process called Recovery Rebate Credit (RRC) for individuals who either did not receive EIPs or received less than the full amount due. This provided the opportunity to claim the EIPs when they filed their 2020 tax return. To assist non-filers with claiming the RRC, the IRS promoted the existing Free File program via communications and outreach throughout the 2021 filing season, including adding frequently asked questions called, “Claiming the Recovery Rebate Credit If You Aren’t Required to File a Tax Return” on IRS.gov. The IRS also partnered with the Social Security Administration (SSA) to promote information on EIPs and the RRC through their related web content.

Additionally, the ARP authorized individuals who received unemployment compensation in 2020, and had a modified adjusted gross income (AGI) less than $150,000, to exclude from their income up to $10,200 of their unemployment compensation or $20,400 for married individuals filing a joint return. Since the change in legislation occurred after the start of the filing season, the IRS analyzed previously filed TY 2020 tax returns to identify and determine eligibility for the unemployment compensation exclusion, without imposing added burden on taxpayers to file amended returns. This resulted in the IRS automatically adjusting millions of taxpayer accounts to allow this exclusion and issue refunds if not claimed on the tax return. Finally, the ARP Act also suspended repayment of excess Advance Premium Tax Credit (APTC) amounts for TY 2020.

Business Tax Relief

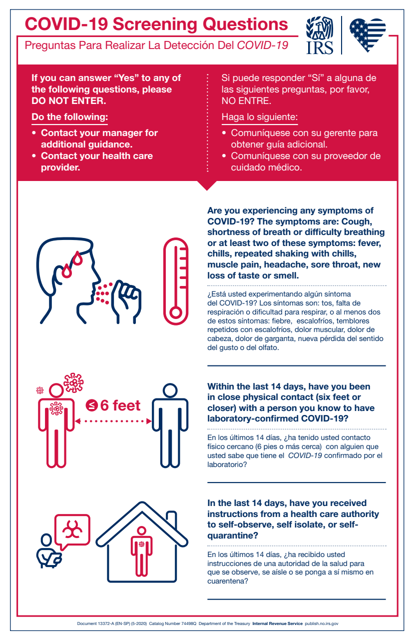
In addition to the implementation of other relief credits to alleviate financial burdens on certain taxpayers, Congress enacted Sections 2303 and 2305 of the CARES Act to offer temporary tax benefits in the form of enhanced carrybacks for Net Operating Losses and minimum tax credit recovery. Individuals, estates, and trusts can file Forms 1045, Application for Tentative Refund, and Corporations can file Form 1139, Corporation Application for Tentative Refund, to apply for a quick tax refund resulting from the carryback of a Net Operating Loss. The IRS set up a temporary deviation that allowed fax submissions for those forms and others to speed up processing.

Outreach and Education Efforts to Help Navigate Through Pandemic Issues and New Legislation

The IRS continued to work extensively with external stakeholders by collaborating with more than 10,000 partners across the nation, including organizations inside and outside of the tax community, federal agencies, state and local governments, and congressional offices. This collaboration helped reach more taxpayers regarding the availability of payments such as EIP and AdvCTC and the extended filing deadline for individuals from April 15 to May 17. The IRS placed special emphasis on underserved communities, including rural communities and those experiencing homelessness. The IRS delivered hundreds of printed products on these topics and more than 750 informational postings on IRS.gov with most translated into Spanish and some translated into Chinese Simplified, Chinese Traditional, Korean, Vietnamese, Russian, and Haitian Creole.

IRS Operations and Safety

At the onset of the COVID-19 pandemic in March 2020, the IRS took unprecedented actions to protect the health and safety of its employees and the taxpaying public. This included closing Submission Processing Centers, Taxpayer Assistance Centers (TACs), and other offices nationwide. At the beginning of FY 2021, many employees remained on health and safety leave, resulting in a significant amount of unopened mail, tax return processing delays, and correspondence. By December 2020, the IRS had resumed normal mail operations, and by May 2021, TACs were open and accepting face-to-face appointments. The work performed at IRS Submission Processing Centers is not conducive to a remote telework environment.



The IRS also has a venue for employee feedback via weekly Pulse Surveys to understand and support employees with their health, safety, and well-being. The survey results help IRS leadership in adjusting efforts and initiatives to resolve employee concerns in real-time.

PERFORMANCE OVERVIEW

The IRS collected more than $4 trillion in taxes in FY 2021 and collects nearly all the revenue that supports the federal government's operations. The IRS is one of the world's largest tax administrators. Some key performance achievements in FY 2021:

269M Federal Tax Returns and Forms Processed

$4.1T Collected in Gross Taxes

$1,691 Average Individual Refund

$75.0B Enforcement Revenue Collected

The IRS demonstrates responsible stewardship over taxpayer dollars by aligning performance measures with budgetary resources as appropriated by Congress. The IRS reports its performance data in the IRS Congressional Budget Justification and Annual Performance Report and Plan. This document is accessible at www.irs.gov/about-irs/budget-documents-and-other-resources. The IRS estimates release of the FY 2021 report in the second quarter of FY 2022.

Empower and enable all taxpayers to meet their tax obligations

The IRS empowers taxpayers by making it easier for them to understand and meet their filing, reporting and payment obligations. The IRS continues to add and enhance tools and support services to improve taxpayers' and tax professionals' interactions with the IRS on whichever channel they prefer. This goal is primarily funded by the Taxpayer Services major budget account as presented in the Statement of Budgetary Resources (SBR).

Progress toward goal: In FY 2021, the IRS released new online applications, including the CTCUP, AdvCTC Assistant, and Tax Professional Account after passage of the ARP. Overall, the Online Account (OLA) had twice the number of users than last year. The IRS also launched the www.irs.gov/paycash website that educated unbanked taxpayers with information to help them meet their tax obligations.

The following select activities and programs highlight some FY 2021 efforts to empower and enable all taxpayers to meet their tax obligations.

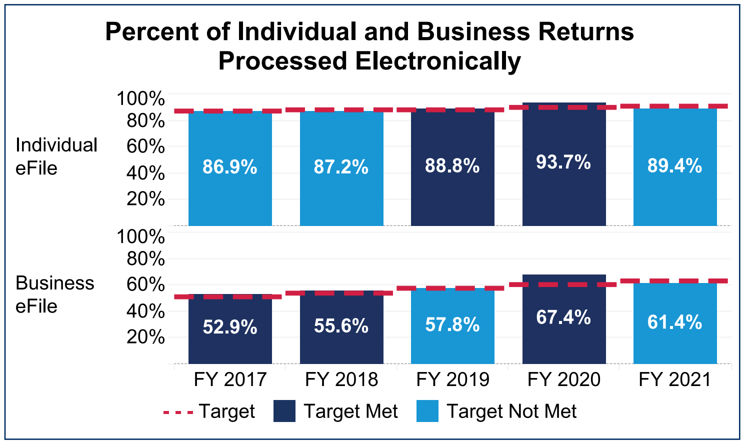
Strategic Objectives

- Simplify the process of filing, correction, and payment for all taxpayers and their representatives.
- Help taxpayers understand their rights and responsibilities through proactive education and tailored outreach.
- Expand secure digital options for taxpayers and professionals to interact efficiently with the IRS, while maintaining and improving traditional service options.

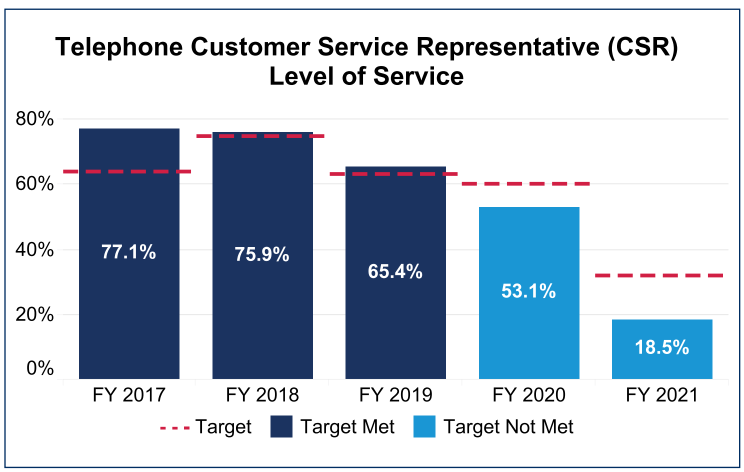
Tax Return Processing: On March 17, 2021, the IRS announced an extension of the individual filing deadline from April 15 to May 17. (The IRS extended the tax deadline for residents of Texas, Oklahoma, and Louisiana to June 15 due to severe weather.) The week ending the filing season, the IRS received 148 million individual returns. Electronically filed (e-File) returns accounted for 138.6 million of the total returns received, compared to 119.5 million in calendar year (CY) 2020. In FY 2021, the IRS received approximately 53.6 million business returns, an increase of 17.7% from last year. Electronically filed business returns trended upward to 32.9 million e-filed in FY 2021, up from 30.7 million filings from last year. The IRS received 20.7 million paper filed business returns.

The IRS Submission Processing Centers were open, but not operating at full capacity due to social distancing requirements. The IRS is currently opening mail within normal timeframes and all paper and electronic individual tax returns received prior to April 2021 have been processed providing the return had no errors or did not require further review.

Toll-Free Help Line/Level of Service: New legislation resulted in added, unplanned demand for the toll-free phone line. At the end of FY 2021, the individual taxpayer telephone demand was 52 million calls received, an increase of 270%. Business taxpayer telephone demand was 8.3 million calls received, 189% higher than last year. The number of taxpayers calling to schedule appointments at TACs was 3.9 million above the same period last year and call disconnects were 1,477% more than the prior year at 4.1 million



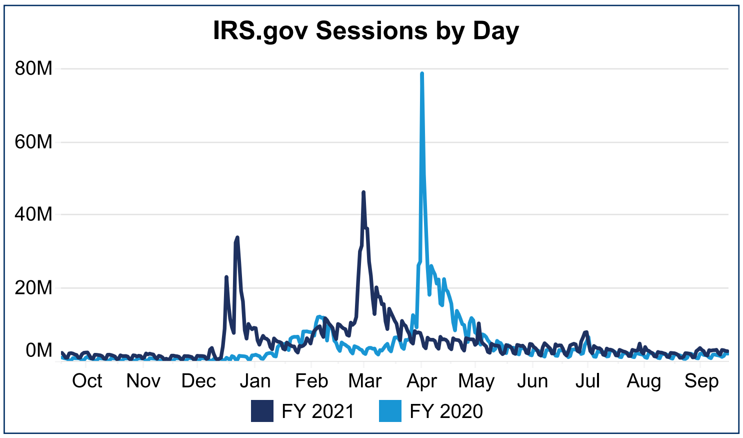
Explanation of Results: In FY 2021, the individual e-File rate was 89.4%, which is 1.2% below the target of 90.6%, and 4.6% below the same period last year. The percent of business returns filed electronically was 61.4%, which is 2% below the target of 63.4%, and 8.8% below the same period last year. The percent of returns processed electronically is calculated by dividing the number of electronically processed returns by the total number of returns processed (the sum of paper and electronic). In FY 2020, due to COVID-19, a large volume of paper receipts was not processed, resulting in a higher-than-normal percent of returns processed electronically. The excess paper receipts from FY 2020 were processed in FY 2021, resulting in a larger number of paper returns processed compared to a normal year. This caused the percent of returns filed to be below target.



Explanation of Results: In FY 2021 the CSR LOS was 18.5%, falling short of the target. New legislation resulted in added, unplanned demand for the toll-free phone lines. Total Assistor Demand was more than 200% higher than in FY 2020 with some lines seeing increases of more than 2 million calls. Call disconnects were 1,477% higher in FY 2021 at 4.1 million compared to 260,000 in FY 2020. Despite these challenges, the IRS was able to answer 3.8 million more calls in FY 2021 than the prior year. The IRS continues to monitor demand in real time, allocating resources and shifting between telephones and paper processing to address demand during times of unprecedented call volume.

compared to 260,000 in FY 2020. CSR Level of Service (LOS), which is the percent of toll-free callers that either speak to a customer service representative or receive informational messages in relation to the total number of attempted calls, was 15.4% during the filing season and 18.5% for the fiscal year, which are at record lows. While COVID-19 was the primary reason for the record low LOS in FY 2021, ever-increasing volumes of taxpayer inquiries is the root cause of the trend. IRS leadership takes taxpayer service seriously and is actively seeking solutions to improve taxpayer service.

During FY 2021, the IRS expanded the staffing at the Automated Collection System (ACS) site in Puerto Rico to 264 employees and intends to have a full ACS operation of 420 employees in Puerto Rico by the end of CY 2021. ACS employees conduct and receive calls from taxpayers with nonfiled returns or unpaid tax liabilities. This hiring effort will increase the number of calls the IRS can answer and expand the number of taxpayers the IRS is able to serve. These IRS employees will also bring much needed bilingual assistance to taxpayers located across the continental U.S., while providing additional jobs to a community hit hard by recent disasters. It is a “win-win” for taxpayers and the island of Puerto Rico.



Online Digital/Web Enhancements:

In FY 2021, the IRS expanded its online applications, including the CTCUP, AdvCTC, and Tax Professional Account. The Tax Professional Account is a secure self-service application that enables tax professionals to complete, electronically sign, and submit Power of Attorney and Tax Information Authorization requests to their clients’ individual OLA where taxpayers can review, approve, and electronically sign or reject the requests. Tax Professional Account is the first all-digital platform fully integrated with electronic signature service, handling end-to-end authorization processing in real-time, and saving time for taxpayers and tax professionals.

IRS.gov showed significant user traffic in FY 2021, with 7 of the top 10 highest-traffic days in IRS.gov history. FY 2021 daily traffic peaked at 46.4 million user sessions – the third highest traffic day in history – on March 15, 2021. The IRS updates content continuously to reflect taxpayer needs, new legislation, the evolution of tax administration, and the distribution of information related to significant events, such as EIPs, natural disasters, COVID-19 tax effects, and other circumstances. In addition, the IRS continued to expand the availability of multilingual content on IRS.gov throughout FY 2021. The IRS completed the IRS.gov “Top 100” initiative on November 12, 2020 and realized the translation of the 100 highest-traffic pages on IRS.gov into seven additional languages: Spanish, Simplified Chinese, Traditional Chinese, Russian, Vietnamese, Korean, and Haitian Creole. These pages join over 7,000 other pages of translated content available on IRS.gov, creating a robust resource for taxpayers who want to meet their tax obligations but who have limited English ability.

Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code

One of the IRS's highest priorities is to ensure taxpayers follow the tax law. The IRS continues to develop innovative approaches to understanding, detecting, and resolving potential noncompliance to support taxpayer confidence in the tax system. The IRS uses behavioral insights and robust data analysis to address noncompliance in the most proper way. The IRS assists taxpayers with navigating through the process of issue resolution, ensure they are aware of the Taxpayer Bill of Rights and the resources available to them. While working to help taxpayers who want to comply, the IRS will pursue those who intentionally violate the tax code. This goal is primarily funded by the Enforcement major budget account as presented in the SBR.

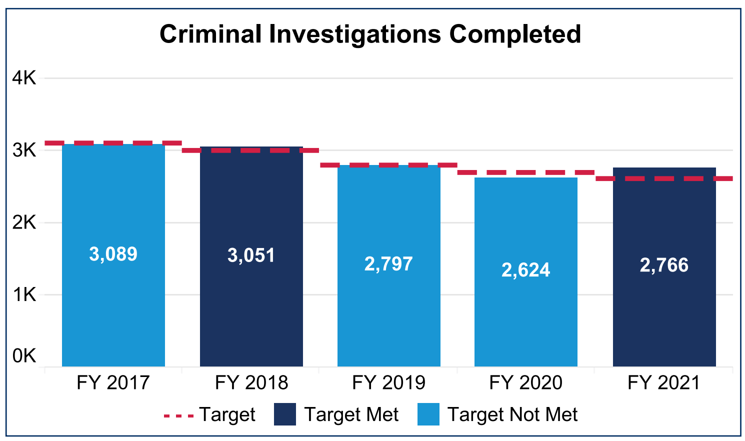
Strategic Objectives

- Identify and plan for compliance risks proactively.
- Reduce the time between filing and compliance issues resolution.
- Match potential compliance issues to the most appropriate solution informed by behavioral insights.
- Investigate criminal violations of the tax code to enforce accountability and maximize deterrence.

Progress toward goal: In FY 2021, the IRS updated identity theft models and modified filters to prevent fraudulent tax refunds. Through intensive screening and investigation, the IRS found and blocked many attempted thefts of Treasury funds, leading to multiple criminal investigations and prosecutions. The IRS also continued to support the development of guidance on international tax provisions to aid taxpayers.

The following select activities and programs highlight some FY 2021 efforts to protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code.

Criminal Investigations and Cyber Crimes: IRS Criminal Investigation (IRS-CI) investigates potential criminal violations of the Internal Revenue Code and related financial crimes to enforce accountability and maximize deterrence. This includes money laundering, currency violations, tax-related identity theft fraud, and terrorist financing that adversely affects tax administration. In FY 2021, the IRS completed



Explanation of Results: Criminal Investigations Completed was 2,766, exceeding the FY 2021 target of 2,600. Even though IRS-CI performed better than originally expected and completed more cases this year compared to FY 2020 (when COVID-19 had a larger impact on investigative activities), results are still lower, compared to prior years (10.5% decrease compared to FY 2017). COVID-19 continues to impact day to day investigative activities, thereby contributing to a higher cycle time for investigations completed. Additional factors such as years of steady decrease in the number of special agents available to work cases (due to attrition and limited hiring) as well as IRS-CI's focus on traditional tax case programs, continue to impact IRS-CI's overall performance. Nevertheless, IRS-CI continues to utilize proven case development strategies, expand case development efforts, and leverage interagency partnerships to identify, initiate, and complete significant criminal investigations in all program areas.

2,766 criminal investigations, achieved 1,263 convictions with a conviction rate of 89.4%, achieved a Department of Justice case acceptance rate of 93.6% (cases accepted for prosecution), and a U.S. Attorney case acceptance rate of 93.2%, which compares favorably with other federal law enforcement agencies. In FY 2021, the IRS Cyber Crimes unit initiated 149 criminal investigations, completed 159 criminal investigations, had 51 convictions (85% conviction rate), and an 86% publicity rate, which measures the extent of media coverage.

Improvements in Detecting and Resolving Abusive Tax Compliance Issues:
The IRS reinforced its commitment to bring focus and resources to pursuing those who promote and use abusive tax shelters by creating a new Office of Promoter Investigations. The goals are to both enforce the tax law and protect taxpayers from victimization by those who promote false statements related to tax positions. The IRS developed strategies to address abusive tax compliance issues such as Conservation Easements (including Syndicated Conservation Easements), Research and Experimentation Tax Credits, Captive Insurance (including Micro-Captives), and Offshore entities. In addition, the IRS's Innovation Lab Data Analytics Program identified thousands of taxpayers who reported wages on their individual income tax returns, but the associated payer of those wages did not file their W-2s with the SSA and did not file employment tax returns.

Transfer Pricing and Tax Uncertainty: The IRS is continuing to execute on its international compliance strategy as it relates to transfer pricing, which involves the pricing of goods, services, and intellectual property transferred between related entities of multinational enterprises (typically corporations with a common parent company). When these transactions involve transfers between a U.S. and foreign related entity, tax issues arise over how much income should be reported in each country. The U.S. and foreign tax administrations have complex tax rules about how to determine intercompany pricing which leads to how much taxable income should be reported in each country. By shifting profits to jurisdictions with lower tax rates, multinational enterprises may attempt to inappropriately avoid U.S. income taxes. It is an area of significant tax controversy. The efforts of the Transfer Pricing Risk Assessment (TPRA) team are key to guiding case selection to the most appropriate treatment stream. TPRA applies data analytic techniques to return information to efficiently identify potential transfer pricing issues for suitability considerations such as the multilateral risk assessment forum of the Organization for Economic Cooperation and Development (OECD) International Compliance Assurance Program, the U.S. Domestic Compliance Assurance program, or the Large Corporate Compliance program. The IRS compliance enforcement strategy also recognizes the importance of leveraging recent judicial guidance related to transfer pricing issues, which feed into the IRS case selection process.

Robust efforts to prevent and resolve transfer pricing and other disputes that are eligible for competent authority assistance under U.S. tax treaties complements the IRS's efforts to enhance transfer pricing risk assessment and compliance strategies. Many of these efforts during FY 2021 have focused on the transfer pricing and tax uncertainty caused by worldwide macroeconomic and commercial conditions. Acting in its role as the United States competent authority, the IRS has been a leading voice of clarity and principle in the handling of these issues within the OECD's Forum on Tax Administration and a champion of engagement, coordination, and collaboration between taxpayers and tax administrations worldwide. The IRS will remain at the center of these international efforts in the interest of tax certainty for taxpayers and governments for years to come.

Collaborate with external partners proactively to improve tax administration

The IRS is committed to strengthening and expanding its partnerships, keeping open lines of communication with stakeholders, and engaging them as collaborators. The IRS is part of a community that includes a variety of stakeholders invested in and affected by tax administration. The IRS also works with partners beyond the traditional tax community — including government entities (international, federal, state, local and tribal), the private sector, universities, and volunteer organizations as it delivers its mission. This goal is primarily funded by the Taxpayer Service major budget account as presented in the SBR.

Progress toward goal: In FY 2021, the IRS continued to expand relationships outside the traditional outreach and communication channels to deliver messages about the filing season, tax scams, COVID-19 tax relief, and other topics. The IRS also continues its efforts to improve outreach to the underserved, millennials, and those who speak English as a second language.

Strategic Objectives

- Coordinate with the tax community to facilitate service and outreach to taxpayers.
- Pursue partnerships to tackle common challenges, generate cost savings and share leading practices.
- Expand partnerships with foreign governments and international organizations to address global tax compliance concerns.

The following select activities and programs highlight some FY 2021 efforts to collaborate with external partners proactively to improve tax administration.

International Tax Compliance: In FY 2021, IRS-CI led a multi-national delegation on the development of a Financial Technologies Toolkit that will publish a learning module to help countries develop and conduct investigations involving illicit financial transactions through cryptocurrencies. The IRS also began coordinating an informal agreement between the United States and Colombia, which recently criminalized tax offenses, to develop a partnership under the joint OECD/United Nations initiative called Tax Inspectors Without Borders. This partnership and agreement include formal and informal training and the sharing of best practices. To date, developing nations have collected more than a billion dollars in tax revenues due to this initiative.

Security Summit: The Security Summit, a public-private sector partnership between the IRS, state revenue departments, software developers, tax professionals, and financial services groups, is now in its sixth year of establishing repetitive iterative processes that support taxpayer security initiatives. During FY 2021, the Security Summit focused on reducing taxpayer burden and improving tax identity theft detection through exploring added collaborative efforts with the Information Sharing and Analysis Center (ISAC) and opportunities with stakeholders to further combat tax identity theft and fraud. The IRS made significant progress through collaboration and enhancements to its tax identity theft detection processes. Since partnering with the Security Summit, the IRS has prevented more identity theft than in previous years and as a result, its data analytics are detecting fewer fraudulent refund claims.

Cultivate a well-equipped, diverse, flexible, and engaged workforce

The IRS is committed to planning, delivering, assessing, and managing its workforce effectively. Taxpayer service, enforcement, and business modernization efforts require a strong workforce. Supplying end-to-end accountability and promoting partnerships to support customers and operational goals ensures consistent service delivery throughout the human resources lifecycle to effectively attract, develop, and support a world-class workforce. This goal is primarily funded by the Operations Support major budget account as presented in the SBR.

Progress toward goal: The IRS recently developed a comprehensive training strategy to address requirements of the Taxpayer First Act (TFA) and to support employee development with training opportunities and clear career paths. The IRS implemented a project entitled "HCO 2022" to define and implement a new human resource delivery strategy for IRS employees.

Strategic Objectives

- Foster a collaborative and inclusive culture.
- Support employee development with training opportunities and clear career paths.
- Enhance succession planning and knowledge transfer processes.
- Design a talent management strategy that proactively addresses business needs and adjusts to workload demand.

The following select activities and programs highlight some FY 2021 efforts to cultivate a well-equipped, diverse, flexible, and engaged workforce.

State of the IRS Workforce: In FY 2021, the IRS employed about 81,600 employees, including 10,530 temporary, seasonal, and part-time staff. The IRS developed policies, strategies, and processes for more than 5,000 IRS employees, who conduct non-portable, mission-critical work, to return to the workplace. This effort sustained tax administration activities for America's taxpayers. The ARP and the TFA require an added complexity, a new set of responsibilities, and new resource requirements to the IRS's hiring efforts. As of September 30, 2021, the IRS hired more employees than in any of the previous five years, with over 10,700 new external hires.

Knowledge Management & Transfer Program: The IRS Knowledge Management and Transfer Program centers around four critical pillars: Share, Connect, Learn, and Improve. This program captures organizational knowledge to create a smarter, more efficient, and well-informed workforce. It uses a shared platform and standardized tools, resources, and processes with the goal of cultivating collaboration and knowledge sharing to build organizational expertise. Some tools and services include a Centralized Virtual Library with more than 112 knowledge bases, which IRS employees visited more than nine million times since its start in 2017 and a Self-Help Online Tutorial Video Library, consisting of more than 600 videos and nearly 600,000 employee views in the past five years.

Advance data access, usability, and analytics to inform decision-making and improve operational outcomes

The IRS strives to operate more efficiently, provide superior service to taxpayers and their representatives, and ensure successful implementation of changes in tax laws. Using analytics, the IRS works continuously to improve its operations: taxpayer service, enforcement efforts, and its internal operations support functions. This goal is primarily funded by the Operations Support and Enforcement major budget accounts as presented in the SBR.

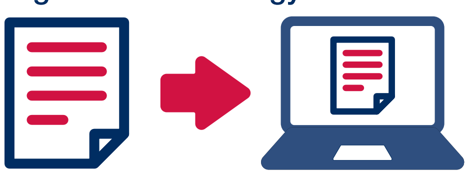
Progress toward goal: In FY 2021, the IRS made significant strides in using data analytical tools to improve the taxpayer experience.

The following selected activities and programs highlight some FY 2021 efforts to advance data access, usability, and analytics to inform decision-making and improve operational outcomes.

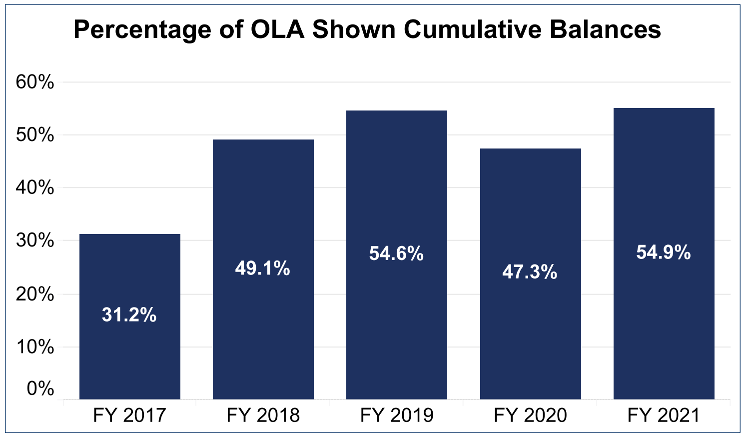
Strategic Objectives

- Update data collection and retrieval capabilities and processes to provide faster authorized access to information.
- Improve analytical tools and data competencies across the IRS.
- Emphasize the use of data analytics, in conjunction with qualitative information, to select high-priority work.

Digitalization Strategy: The IRS is moving forward with its digitalization strategy. The strategy allows flexibility within inventory management, electronic workflows, and business continuity. It also allows for seamless access to taxpayer imaged cases without added burdens on the taxpayer to supply documents. This transparency reduces risk for both taxpayers and the IRS. In FY 2021, the IRS continued implementation of Taxpayer Digital Communication – Outbound Notifications (TDC-ON), which supplies a platform to enable the delivery of digital correspondence. In FY 2021, TDC-ON completed and released the top 11 highest priority notices. Also, in FY 2021 the IRS started a Documentation Upload Tool (DUT) pilot for the Automated Questionable Credit inventory. The DUT is a fast-paced development for a new digital channel which supplies the taxpayer with a choice to upload their responses to IRS notices to IRS.gov using their personal computer or mobile device, in lieu of responding by mail or eFax. The IRS plans to introduce the DUT in phases with later iterations expanding into more workstreams.



Analytics-Driven Operational Improvements: The IRS continuously reviews, synthesizes, and shares analytics from IRS.gov to assess taxpayer experiences with IRS digital content. In FY 2021, the IRS continued to track user feedback related to EIPs and has tracked feedback on the new AdvCTC payments.



The IRS also reviewed and updated SharePoint Investment Knowledge Exchange performance metrics for the OLA. One of these metrics is the percentage of visits where taxpayers can view their cumulative balance due, shown on the home page when users log into OLA. The IRS experienced a challenge with this metric, which occurred when the first round of EIPs created a new data entry in the tax database. This prevented users from seeing their balance until the IRS was able to successfully address this technical issue, which took about two months. This year when ARP authorized more EIPs, the same issue would have occurred, but the IRS worked quickly to implement a solution on the first day of disbursing the added EIP payments. This ensured that taxpayers' ability to access their balance data and the associated performance metrics would be unaffected beyond that one day.

Drive increased agility, efficiency, effectiveness, and security in IRS operations

An increased reliance on technology creates the need for increased security, both physical and digital, to protect IRS employees and taxpayer information from threats. The IRS understands its responsibility to safeguard taxpayer and IRS data, particularly given the growing incidence and sophistication of cyber and identity theft. The IRS remains dedicated to maintaining the physical and digital security of its systems, enhancing internal controls, managing risk, and upholding accountability across the IRS. This goal is primarily funded by the Operations Support and Other major budget accounts as presented in the SBR.

Progress toward goal: In FY 2021, the IRS made notable progress on implementing the TFA, its Integrated Modernization Business Plan, and a new physical security strategy.

The following selected activities and programs highlight some FY 2021 efforts to drive increased agility, efficiency, effectiveness, and security in IRS operations.

Strategic Objectives

- Modernize and integrate technologies and systems that support secure, flexible and accurate work across IRS functions.
- Safeguard taxpayer data and protect the IRS against internal and external threats, with an emphasis on cyber defense.
- Maintain a strong focus on fiscal management and accountability.
- Simplify policies and processes to improve operational efficiency and coordination across business units.

Progress on Taxpayer First Act Implementation: The IRS published the Taxpayer First Act Report to Congress, which documents three of IRS's strategies for advancing service to taxpayers:

1. Improving the Taxpayer Experience

2. Enhancing Employee Training

3. Modifying the Organizational Structure

Throughout FY 2021, the IRS has made advancements in improving the taxpayer experience strategy. The IRS implemented a host of provisions to strengthen cybersecurity and identity protection through nationwide expansion of the Identity Protection Personal Identification Number (IP PIN) program across all 50 states (three years earlier than the legislatively mandated date), expanded the use of electronic systems, and increased digitalization by enabling the use of digital signatures and online identity verification for eServices accounts. In addition, the IRS completed several actions in FY 2021 to move forward in implementing a comprehensive training strategy. The full report includes both near-term operational plans and a long-term aspirational vision to reshape the future of the IRS. The IRS NEXT office will lead the IRS beyond implementation of the TFA provisions and will focus on both the design and implementation of a revitalized IRS organization, ensuring all activities occur in a strategic, integrated approach.

Modernization plan: The IRS made significant progress delivering on the commitments in the IRS Integrated Modernization Business Plan, as well as the fundamental responsibilities to deliver and protect the solutions and services that support the nation's tax system. However, since the IRS received only 55% of the requested funding, replanning of capabilities was necessary. With this replanning, the IRS delivered 19 modernized capabilities in FY 2019, 40 modernized capabilities in FY 2020, and 29 modernized capabilities in FY 2021. Highlighted capabilities in FY 2021 include: delivery of Enterprise Case Management Release 1, expansion of Customer Callback to total 16 phone applications, release of TDC-ON priority notices to taxpayers, completion of 69% of code conversion for the Individual Tax Processing Engine project, and deployment of CTCUP.

Physical Security: The IRS worked diligently to implement a physical security strategy, which included the accomplishment of four goals:

1. Provide IRS with security related tools, training, mechanisms, and processes to improve workforce effectiveness, agility, and retention.
2. Implement and monitor the effectiveness of physical security policies, procedures, and internal controls by crafting effective management tools to ensure appropriate monitoring of all aspects of the physical security programs.
3. Distinguish and recognize varying levels of security related performance and ensure employee accountability.
4. Coordination amongst all the functional areas involved in physical security. The security related improvements reduced burden, enhanced monitoring efficiency, and increased data reporting reliability of security programs for program owners and managers.

ENTERPRISE RISK MANAGEMENT

In compliance with the OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, the IRS conducts an annual Enterprise Risk Assessment and develops an Enterprise Risk Profile. The Enterprise Risk Profile articulates the IRS's top risks to achieving its strategic goals. Having a clear line of sight into the top enterprise risks enables IRS leadership to make informed decisions that will encourage innovation, foster change, and lead to more efficient resource allocation. The annual enterprise risk assessment process includes internal and external environmental scanning activities and a comprehensive aggregation and analysis of business unit risks. The IRS updated the 2021/2022 Enterprise Risk Profile to reflect an environment that includes significant COVID-19 effects to the IRS workforce and operations and the successful implementation of pandemic-related legislations, signaling the road to recovery. The top IRS Enterprise Risks are:

1. **Adverse Impact of Reduced Enforcement on Compliance:** The risk that reduced enforcement activities may hurt compliance, erode confidence in the tax administration system, and contribute to the tax gap.

2. **Impact and Implementation of Legislation and Other Requirements:** The risk that failure to timely and effectively implement an increasing number of complex multi-year legislative and non-statutory requirements may adversely affect the IRS's ability to fulfill core responsibilities and commitments to modernize technology, enhance service delivery and more effectively enforce the tax law, which will ultimately erode trust and confidence in the IRS. Significant legislative mandates currently include TFA, CARES Act, CRRSAA, and ARP.

3. **IT Operations and Maintenance Budget Reductions:** The risk that IRS Information Technology (IT) Operations and Maintenance budget reductions will affect the ability to run and support critical IT systems and lead to increased system downtime when issues occur.

4. **Impaired Operations:** The risk that significant disruptions, such as disasters or lapses in appropriations, combined with a reliance on paper, manual, and in-person processes, results in halted or slowed operations and recovery hindering the IRS's ability to successfully deliver its mission and make progress in critical areas.

5. **Taxpayer Experience:** The risk that the inability to execute and improve customer experience, combined with increased demand for services, may negatively affect taxpayers' ability to meet their tax obligations and erode trust and confidence in the IRS.

6. **Cyber and Data Security:** The risk that the increased complexity, sophistication, and volume of cyber threats, including insider threats, social engineering, and unauthorized access to or use of sensitive information results in data loss, refund fraud, identity theft, ransomware, or denial of service.

LOOKING TO THE FUTURE

Whether responding to a crisis like the pandemic or fulfilling routine responsibilities, the work done by the IRS for taxpayers each day illustrates the importance of every American to the IRS, and the importance of the IRS to every American. But we want to do more. As we move into FY 2022, our efforts will be focused on improving our service to taxpayers and the tax system in every area. Along the way, we must ensure we have the trust and respect of the taxpayers we serve and others who interact with us. To accomplish this, we will always exercise our best efforts on behalf of the American people.

Looking to the future, for the IRS to be successful we must continue to measure the value of taxpayer services through the eyes of the taxpayer. We will continue striving to put taxpayers first and enhance their experience through improved tools, education, guidance, and outreach. We will remain focused on assisting historically underserved communities, including underrepresented, lower-income, and limited English proficiency taxpayers. In these and many other ways, we view our efforts through the experience of those we proudly serve.

A critical component of our future efforts will be the ongoing work to modernize our systems. We will continue to implement the IRS Integrated Business Modernization Plan, which has guided our efforts in this area since we issued it in 2019. We will continue to deliver capabilities that enhance every perspective of the taxpayer experience. Taxpayers have a right to expect, and we want to deliver, the same kind of cutting-edge services they are used to receiving from their financial institution or online retailer.

Going together with modernization, the critical work we will be doing as part of IRS NEXT in the months and years to come will provide across-the-board service improvements in a cost-effective manner, for taxpayers and tax professionals alike. The IRS NEXT initiatives will make it quicker and easier for taxpayers to file a return, answer a notice from us, or pay a tax bill, improving tax administration and making the tax system run more efficiently, which helps everyone.

Our ultimate goal, of course, is to do a better job of serving taxpayers and the nation, and IRS NEXT will be the catalyst that allows us to achieve this goal. Since the IRS interacts with more Americans than nearly any other public or private organization, it is vital that we continue to improve in every aspect of our operations. The taxpayers we serve deserve nothing less.

Next year will be important for our future planning efforts for another reason: We will unveil a new Strategic Plan for the agency, covering the years 2022 through 2026. As in the past, the Strategic Plan will serve as a roadmap to help guide the agency's programs and operations. It will lay out a vision of ways to help improve our tax system and meet the changing needs of taxpayers and members of the tax community.

We remain confident the IRS will continue to deliver for our country, just as we have during other times of national urgency. We will continue striving to meet the challenges ahead with innovation and dedication. And we look forward to continuing this journey together with taxpayers and our partners in the tax community. Their ongoing support has been critical to our success. The entire IRS workforce is committed to working hard, doing our best, and doing the right thing for America's taxpayers – now and in the future.

ANALYSIS OF SYSTEMS, LEGAL COMPLIANCE, AND INTERNAL CONTROL

Federal Managers' Financial Integrity Act (FMFIA)

Background

The FMFIA requires executive branch agencies to establish and maintain internal control and financial systems to provide reasonable assurance that:

- Obligations and costs comply with applicable laws.
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation.
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports, and to maintain accountability over the assets.

OMB Circular A-123 provides implementing guidance for FMFIA and defines management's responsibility for establishing and assessing internal controls. The Circular also requires federal agencies to adhere to the GAO's Standards for Internal Control in the Federal Government, and to evaluate and report on the effectiveness of the organization's internal controls to achieve: (1) the objectives of effective and efficient operations, (2) reliable reporting for internal and external use, and (3) compliance with applicable laws and regulations (FMFIA Section 2). Additionally, agencies are required to assess whether financial management systems comply with federal financial management systems requirements (FMFIA Section 4).

Analysis of Controls

The Commissioner's Assurance Statement is supported by a comprehensive risk-based internal control evaluation plan that adheres to Treasury guidance. This plan includes a methodology that identifies and documents key controls and provides for the assessment and testing of those controls to provide reasonable assurance that the controls are designed, implemented, and operating effectively. As part of the evaluation process, the IRS considered results of this extensive testing and assessment across the IRS, as well as independent audits conducted by TIGTA and GAO.

Internal Control over Financial Reporting

In accordance with OMB Circular A-123, Appendix A, Management of Reporting and Data Integrity Risk, the IRS also assessed internal controls over financial reporting. The IRS applied Treasury's Appendix A guide to assess the effectiveness of its internal controls by testing the design, implementation, and operating effectiveness of key internal controls for material transactions to support reliable financial reporting. Based on the results of this assessment the IRS can provide reasonable assurance regarding the effectiveness of our internal control over financial reporting as of September 30, 2021.

Federal Financial Management Improvement Act (FFMIA) and Financial Management Systems

The FFMIA requires federal agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. As described in OMB Circular A-123, Appendix D, “a financial management system includes an agency’s overall financial operation, reflecting the people, processes, and technology to capture, classify, summarize, and report data in a meaningful manner to support business decisions.”

The FFMIA Section 803(c)(1) requires an annual determination of substantial compliance with Section 803(a) of the Act based on review of relevant factors. To support this determination, the IRS assesses its financial management systems annually for conformance with the requirements of OMB Circular A-123, Appendix D, Compliance with the FFMIA, and other federal financial management system requirements. Our assessment process includes the use of the FFMIA Compliance Determination Framework, (Compliance Framework) in OMB Circular A-123, Appendix D, which is a risk and evidence-based assessment model that leverages existing audits, evaluations, and reviews that auditors and agency management already perform. The Compliance Framework is an outcome-based approach to assessing FFMIA compliance through a series of financial management goals that are common to all agencies.

In applying the Compliance Framework, the IRS assesses available information from audit reports and other relevant and appropriate sources, such as the Federal Information Security Modernization Act compliance activities, to determine whether our financial management systems substantially comply with FFMIA. The IRS also assesses improvements and ongoing efforts to strengthen financial management systems and the impact of instances of noncompliance on overall financial management system performance. Based on the results of our overall assessment, the IRS concluded that its financial management systems were not substantially compliant with federal financial management system requirements as of September 30, 2021, due to significant deficiencies.

The IRS has two significant deficiencies in internal control over financial reporting related to its unpaid assessments and financial reporting systems. Specifically, these deficiencies relate to (1) limitations in the ability of IRS’s financial management systems to classify unpaid assessments and report taxes receivable in accordance with federal accounting standards, and (2) IRS’s information system business process application controls and general controls related to financial reporting systems. The IRS worked diligently during FY 2021 to continue to enhance its IT security posture and continues to implement a strategy and assessment process to verify the effectiveness of internal controls for the financial systems that affect the financial statements. This assessment supports the IRS’s overall internal control framework and helps mitigate deficiencies in the IT environment.

Other Laws

The IRS is required to comply with several legal and regulatory requirements, including the Antideficiency Act. The Management Control Executive Steering Committee, which includes top IRS administrative and programmatic leadership, provides oversight and governance for the design, implementation, and monitoring of controls to comply with these legal and regulatory requirements. The IRS is not aware of any violations of the Antideficency Act.

MANAGEMENT ASSURANCES

The IRS's management is responsible for managing risks and maintaining effective internal control and financial management systems to meet the objectives of FMFIA. We conducted our assessment of risk and internal controls in accordance with OMB Circular A-123.

Based on our assessment, we can provide reasonable assurance that, in accordance with Section 2 of the FMFIA, the IRS's internal control over operations, reporting, and compliance with laws and regulations were operating effectively as of September 30, 2021. This includes the effective operation of internal control over financial reporting, which was considered a part of our assessment. In addition, we can provide reasonable assurance that as of September 30, 2021, we are in substantial conformance with the federal financial management systems requirements of Section 4 of the FMFIA, except for two significant deficiencies related to the unpaid assessments and financial reporting systems.

As a result of these significant deficiencies, our financial management systems are not in substantial compliance with the FFMIA as of September 30, 2021. We continue to make progress in remediating these deficiencies and remain committed to focusing management's attention and resources on appropriate corrective actions. Overall, we continue our efforts to ensure high standards, minimize internal control weaknesses, and meet federal financial management requirements. Additional information on the deficiencies can be found in Part 3, Section C, of this report.

Charles P. Rettig

Charles P. Rettig
Commissioner of the Internal Revenue Service
November 8, 2021

FINANCIAL MANAGEMENT HIGHLIGHTS

The IRS received an unmodified financial statement audit opinion for the 22nd consecutive year.

The unmodified opinion includes recommendations to improve internal controls over financial reporting related to unpaid assessments and financial reporting systems. The IRS worked diligently during FY 2021 to continue to enhance its IT security posture and continues to implement a strategy and assessment process to verify the effectiveness of internal controls for the financial systems that affect the financial statements. Management's responses to risks are discussed in the Analysis of Systems, Legal Compliance, and Internal Controls and the Looking Ahead to 2022 sections of the Management's Discussion and Analysis.

Management provides assurance for the review and assessment of Internal Controls over Financial Reporting with a report that is issued annually to the Secretary of the Treasury. This report is included on the following page to demonstrate the review of internal controls that support these financial statements.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

COMMISSIONER

November 8, 2021

IRS Management's Report on Internal Control Over Financial Reporting
Fiscal Year 2021

The Internal Revenue Service's (IRS's) internal control over financial reporting is a process effected by those charged with governance and management, as well as other personnel with related responsibilities. The objectives of this process are to provide reasonable assurance that: (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

IRS management is responsible for maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. IRS management evaluated the effectiveness of the IRS's internal control over financial reporting as of September 30, 2021, based on the criteria established under 31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we conclude that as of September 30, 2021, the IRS's internal control over financial reporting was effective. The IRS has two deficiencies in its internal control over financial reporting, for Unpaid Assessments and Financial Reporting Systems, which we are actively addressing.

Charles P. Rettig — Digitally signed by Charles P. Rettig

Charles P. Rettig
Commissioner of Internal Revenue

November 8, 2021
Date

Jeffrey J. Tribiano — Digitally signed by Jeffrey J. Tribiano

Jeffrey J. Tribiano
Deputy Commissioner, Operations Support

November 8, 2021
Date

Teresa R. Hunter — Digitally signed by Teresa R. Hunter

Teresa R. Hunter
Chief Financial Officer

November 8, 2021
Date

Financial Statement Overview

The principal financial statements are prepared to report the financial position, financial condition, and results of operations, pursuant to the requirements of 31 U.S.C. Section 3515(b). The statements are prepared from records of federal entities in accordance with Federal generally accepted accounting principles (GAAP) and the formats prescribed by OMB. Reports used to monitor and control budgetary resources are prepared from the same records. Users of the statements are advised that the statements are for a component of the U.S. Government.

The IRS is responsible for the administration of tax laws and the custodial collections of taxes for the U.S. Federal Government. The financial management activities that support the responsibilities of the IRS are divided into two distinct account categories.

Administrative accounts are included as appropriations and offsetting collections in the SBR. These resources are also reflected as assets, liabilities, costs, revenues, and ultimately the net position of the IRS.

Custodial accounts include activity in support of tax collection. The IRS is the custodian for the majority of receipts for the U.S. Federal Government. These receipts are accounted for in designated custodial accounts as presented on the Statement of Custodial Activity (SCA). Custodial accounts are also included as custodial Fund Balance with Treasury (FBWT) prior to distribution as refunds or credits, taxes receivable not yet collected, and taxes payable not yet disbursed on the Balance Sheet.

COVID-19 Legislation

In FY 2021 the IRS received supplemental funding for the ARP for $1,862 million and the CRRSAA for $509 million in budgetary resources totaling $2,371 million for FY 2021. The budgetary resources were appropriated for annual, two-year, and three-year availability. In FY 2021, the IRS distributed a second and third round of EIPs in addition to AdvCTC payments in accordance with legislation. This activity is presented on the SCA under federal tax refund and outlay activities.

Financial statement fluctuations resulting from this activity are discussed in more depth in the applicable financial statement analysis. Note **21** COVID-19 Activity in the Financial Information section of this report also provides information for budgetary resources, obligations incurred, the remaining available budgetary resources and specific note disclosure data for FY 2021 and FY 2020.

Financial Statement Analysis

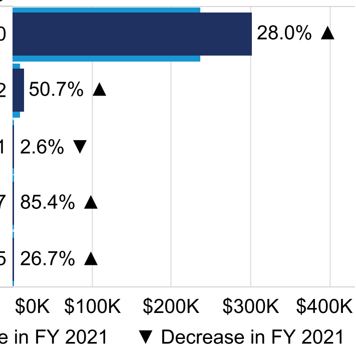
Analysis of the Balance Sheet

The Balance Sheet displays amounts of future economic benefits owned or available for use (assets), amounts owed (liabilities) and the residual amounts (net position) at the end of the fiscal year.

Assets of the IRS are primarily comprised of Federal taxes receivable, intragovernmental balances, FBWT and Due from the General Fund of the U.S. Government, and Internal Use Software classified as General Property and Equipment. Comparative asset balances as of September 30, 2021 and 2020 are presented below.

Assets (in Millions)

Assets	FY 2021	FY 2020	
Federal Taxes Receivable, Net	$302,000	$236,000	28.0% ▲
Intragovernmental	$13,354	$8,862	50.7% ▲
Property and Equipment, Net	$1,822	$1,871	2.6% ▼
Cash and Other Monetary Assets	$1,459	$787	85.4% ▲
Other	$19	$15	26.7% ▲



Asset fluctuations in FY 2021 primarily include increased Federal taxes receivable, net, increased FBWT, increased Due from the General Fund and increased Cash and other monetary assets.

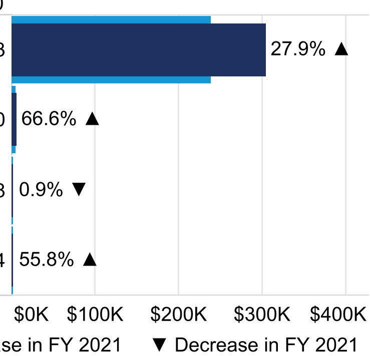
Federal taxes receivable, net, increased $66,446 million in FY 2021 as compared to FY 2020. This increase is primarily due to the two-year deferral on the employer portion of Federal Insurance Contributions Act (FICA) Social Security taxes due to the federal government provided under the CARES Act. These deferrals are discussed in greater detail in Note **5** Federal Taxes Receivable, net of the Financial Information section of this report.

Intragovernmental increases are primarily due to $1,993 million FBWT associated with the supplemental appropriations received for the ARP and CRRSAA and $2,498 million Due From the General Fund as this line items correlates to Federal Tax Refunds Payable, net. Amounts Due From the General Fund represent funds that will be used as a resource to disburse federal tax refunds.

Liabilities include Intragovernmental (payables, Amounts due to the General Fund, and Other Liabilities), Federal Tax Refunds Payable, Federal Employee Benefits, and other liabilities as detailed in Note **8** of the financial information section of this report.

Liabilities (in Millions)

Liabilities	FY 2021	FY 2020	
Intragovernmental	$304,258	$237,803	27.9% ▲
Federal Tax Refunds Payable	$6,248	$3,750	66.6% ▲
Federal Employee Benefits	$1,058	$1,068	0.9% ▼
Other	$2,125	$1,364	55.8% ▲



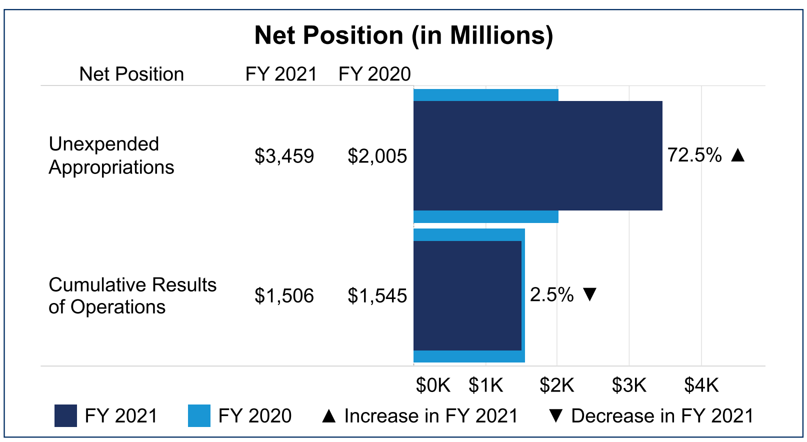
Liability fluctuations in FY 2021 primarily include increased Intragovernmental liabilities and Federal taxes payable.

The increase in Intragovernmental liabilities is primarily attributable to an increase of $66,446 million for the Due to the General Fund balance sheet line item. This line item is representative of funds that will be distributed to the General Fund upon collection and is directly attributable to the increase in Federal taxes receivable, net.

The increase in FY 2021 Federal tax refunds payable of $2,498 million corresponds to an overall increase in disbursements, also associated with COVID-19 relief and increased operations as compared to FY 2020 when we were operating at a reduced capacity.

Net Position consists of Unexpended Appropriations and the Cumulative Results of Operations. Funds made available by Congress are recorded in Unexpended appropriations. Cumulative Results of Operations is the net difference between 1) expenses, losses, and transfers out from the inception of an agency or activity, and 2) financing sources such as appropriations and revenues, and gains from the inception of an agency or activity (whether financed from appropriations, transfer in, revenues, reimbursements, or any combination of the four) to the reporting date of the financial statements.

The Net Position of the IRS increased 72% in FY 2021 due to appropriations received for the implementation of COVID-19 related legislation .



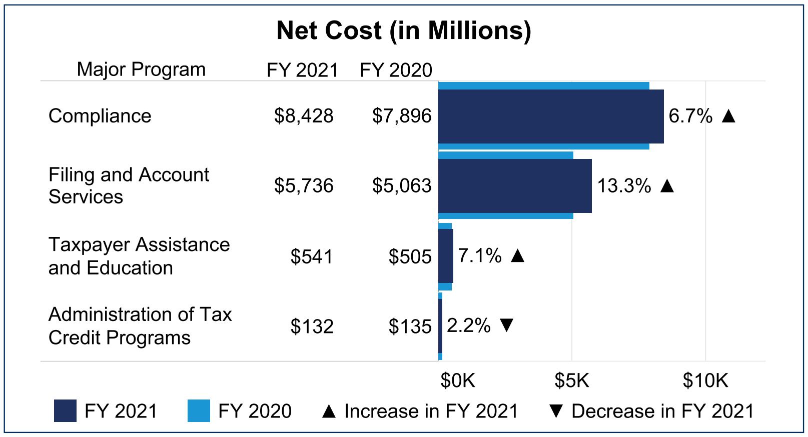
Analysis of the Statement of Net Cost

The Statement of Net Cost (SNC) presents the annual cost of operating the IRS four major programs: Taxpayer Assistance and Education, Filing and Account Services, Compliance, and Administration of Tax Credit Programs. Net cost includes gross costs incurred less exchange revenue earned from user fees and reimbursable agreements.

The Total Net Cost of IRS operations increased $1,238 million or 9% over the prior fiscal year. The SNC reflects a total of $14,837 million for the period ending September 30, 2021 as compared to $13,599 million for the period ending September 30, 2020.

The total gross cost for FY 2021 increased by $1,417 million due to the cost of implementing COVID-19 related legislation including the CRRSAA and ARP. Total earned revenue increased $179 million due to increases in user fees and reimbursable agreements with Treasury and other agencies. In addition, the Private Debt Collection program recognized collections as exchange revenue for the portion of collections that fund IRS payments to the private collection agencies.

Comparative Net Cost of Operations by major program are presented in the table below for the periods ending September 30, 2021 and 2020.



Analysis of the Statement of Budgetary Resources

IRS operations are financed through appropriations, spending authority from offsetting collections, and unobligated balances carried forward.

Appropriations for the Periods Ending September 30, 2021 and 2020 (in Millions)

		2021		2020
Taxpayer Services	$	3,208	$	2,892
Enforcement		5,004		4,993
Operations Support		5,583		4,215
Other:				
Business Systems Modernization		752		195
Private Debt Collection Program		220		152
Miscellaneous Retained Fees		133		261
Total Other		**1,105**		**608**
Total Budgetary Resources	**$**	**14,900**	**$**	**12,708**

Major Budget Account Descriptions

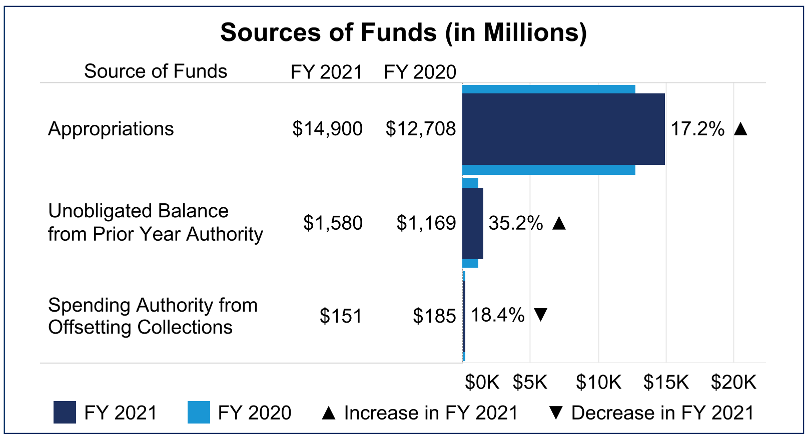
Taxpayer Services funds the necessary expenses of the IRS to provide taxpayer services, including pre-filing assistance and education, filing and account services, taxpayer advocacy services, low-income taxpayer clinic grants, and Community Volunteer Income Tax Assistance Matching Grants for tax return preparation assistance.

Enforcement funds the necessary expenses for tax enforcement activities of the IRS to determine and collect owed taxes, to provide legal and litigation support, to conduct criminal investigations, to enforce criminal statutes related to violations of internal revenue laws and other financial crimes.

Operations Support funds the necessary expenses of the IRS to support taxpayer services and enforcement programs, which includes rent payments, facilities services, printing, postage; physical security, headquarters and other IRS-wide administration activities, research and statistics of income, telecommunications, information technology development, enhancement, operations, maintenance, and security.

Business Systems Modernization funds the necessary expenses of the IRS's business systems modernization program for the capital asset acquisition of information technology systems.

The Private Debt Collection Program funds qualified tax collection contracts to use private collection agencies.

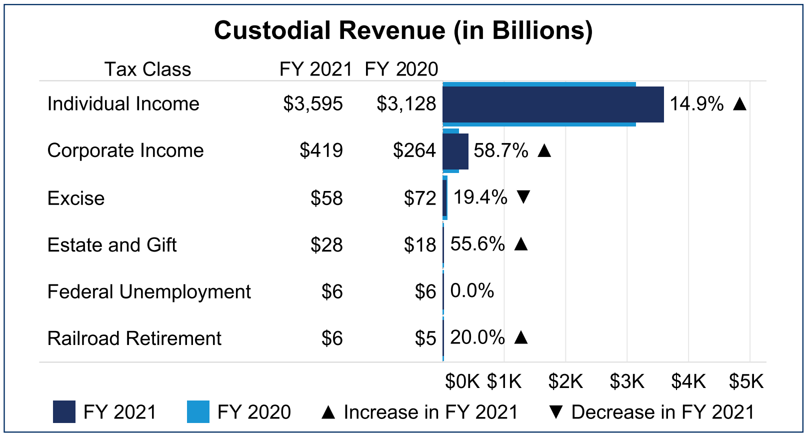


The IRS Total Budgetary Resources increased $2,569 million in FY 2021. This increase was primarily attributable to appropriations received for COVID-19 related legislation including $1,862 million for the ARP and $509 million for the CRRSAA. The Unobligated balance from prior year authority increased $411 million as it includes the Families First Coronavirus Response Act of 2020 (FFCRA) and CARES Act carryover funding. The increased obligations of $1,405 million and outlays of $1,119 million are also tied to expenditures for COVID-19 related legislation.

Analysis of the Statement of Custodial Activity

The SCA is the presentation of custodial revenues, appropriations, and distributions that occur for the current and prior fiscal year. This activity is performed on behalf of the federal government. The custodial appropriations presented on the SCA are not available to the IRS for operational expenditures and are therefore not included in the presentation of the SBR. Additional information relative to the fluctuations discussed below is provided in the Other Information section of this report.

FY 2021 revenue receipts collected by the IRS totaled $4.1 trillion, a $600 billion increase from $3.5 trillion in FY 2020. Federal tax revenues are collected through six major classifications: Individual income (FICA/Self-Employment Contributions Act (SECA) and Other), corporate income taxes, excise taxes, estate and gift taxes, railroad retirement taxes, and federal unemployment taxes.



The SCA also presents refund and outlays made by the IRS on behalf of the federal government. Refund and outlay activities were $1.1 trillion for the period ending September 30, 2021, as compared to $736 billion for the period ending September 30, 2020. This 49% increase in activity was primarily driven by the $570 billion in COVID-19 EIPs paid under the CARES Act, CRRSAA, and the ARP, which included provisions to help stimulate the economy through EIPs and/or RRCs.

Federal tax refunds and outlay activity include refunds of tax overpayments, payments for interest, and disbursements for refundable tax credits such as the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC).

Unpaid Assessments

Under federal accounting standards, federal taxes receivable are unpaid assessments in which the taxpayer or court has agreed to the amount. Unpaid assessments not agreed to by taxpayers or the courts are categorized as compliance assessments; and assessments that have no future collection potential are categorized as write offs. Compliance assessments and write offs are not included on the balance sheet as federal taxes receivable.

Unpaid Assessments
As of September 30, 2021 and September 30, 2020 (in Billions)

		2021		2020
Federal taxes receivable	$	493	$	427
Compliance (Amounts not agreed to by taxpayer or courts)		80		74
Write offs (No future collection potential)		85		95
Total Unpaid Assessments	$	658	$	596

The increase in total unpaid assessments is $62 billion when compared to September 30, 2020. The increase in total unpaid assessments is primarily due to an increase in Social Security Tax Deferral amounts (refer to the Other Information section of this report for additional information).

The total unpaid assessment balance consists of delinquent and non-delinquent balances. These balances are owed by taxpayers who file returns without sufficient payment and/or assessed amounts through the IRS's enforcement programs (refer to financial statements Note **1.E.** and Note **5** or further details). Delinquent balances are past due while non-delinquent balances are due at a future point in time and include IRC Section 965(h) amounts and CARES Act related Social Security Tax Deferral balances.

Federal Taxes Receivable, Gross – Delinquency Status
As of September 30, 2021 and September 30, 2020 (in Billions)

	2021	2020
Nondelinquent 965h Unpaid Assessments	$ 158	$ 178
Nondelinquent Social Security Tax Deferral Unpaid Assessments	106	23
Delinquent Unpaid Assessments	227	224
Delinquent Restitution Based Unpaid Assessments	2	2
Federal Taxes Receivable, Gross	**$ 493**	**$ 427**

Collectability Modeling and Economic Conditions

The economic uncertainty of FY 2021 and FY 2020 related to COVID-19 resulted in new legislation and changes to collectability. Social Security Tax Deferrals increased over $83 billion during FY 2021. IRS treated these deferrals as collectable unless there was specific evidence otherwise, as these amounts are not due until FY 2022 and FY 2023. Indicators of financial health were manually reviewed for publicly traded businesses with large dollar IRC Section 965 amounts due. The analysis determined that large dollar IRC Section 965(h) taxpayers are primarily in a favorable long-term economic position to make the future payments. For delinquent unpaid assessments, collectability reflects existing economic conditions of the taxpayers' ability to pay.

The total Federal taxes receivable, net, excludes the estimated uncollectable amount of $191 billion, as of September 30, 2021 and $191 billion as of September 30, 2020. Examples of uncollectible taxes include taxpayers who agree they owe the tax but are unlikely to pay and businesses with extreme financial hardships. Overall collectability combines separate collectability calculations for delinquent taxes receivable, IRC Section 965(h) amounts, Social Security Tax Deferrals, and restitution-based assessments.

Federal Taxes Receivable As of September 30, 2021 (in Billions)

	Collectability	Gross	Net
Nondelinquent 965h Unpaid Assessments	90.6%	$ 158	$ 143
Nondelinquent Social Security Tax Deferral Unpaid Assessments	99.9%	106	106
Delinquent Unpaid Assessments	23.0%	229	53
Federal Taxes Receivable, Gross		**$ 493**	**$ 302**

Federal Taxes Receivable As of September 30, 2020 (in Billions)

	Collectability	Gross	Net
Nondelinquent 965h Unpaid Assessments	94.3%	$ 178	$ 168
Nondelinquent Social Security Tax Deferral Unpaid Assessments	99.6%	23	23
Delinquent Unpaid Assessments	20.0%	226	45
Federal Taxes Receivable, Gross		**$ 427**	**$ 236**

FINANCIAL INFORMATION

IRS

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I am pleased to present the IRS Financial Report for FY 2021.

This is the first Financial Report to be published on IRS.gov. This report demonstrates the dedication, accountability, and professionalism of the IRS financial management community and provides the American people with a comprehensive view of the IRS's financial activities. I am proud of our continued success in demonstrating stewardship overseeing more than $4.1 trillion in tax revenue, $1.1 trillion in federal tax refunds and other outlays and $658 billion in unpaid assessments, as well as the resources that support the mission of the IRS.

In FY 2021, Congress and both administrations entrusted the IRS with $2.4 billion in supplemental funding to support our nation's recovery from the COVID-19 pandemic. We overcame significant barriers to implement legislative requirements resulting in the expedient roll out of Economic Impact Payments, Consolidated Omnibus Budget Reconciliation Act, Premium Tax Credit changes and the Advanced Child Tax Credits.

The IRS continued our tradition of fiscal integrity and commitment to ensuring strong financial management as we received our 22nd consecutive unmodified opinion on our financial statements in FY 2021. We continue to be diligent in our efforts to resolve two significant deficiencies affecting internal controls over unpaid assessments and financial reporting systems.

Looking ahead in FY 2022, I am focused on providing even more accountability and management of our resources with innovation and dedication. We will continue to work with Treasury, OMB and Congress to address funding shortages to enhance the IRS's ability to modernize IT systems and capture additional information reporting on financial transactions to transform the service delivery we provide to taxpayers.

I am proud of the hard work and dedication of the entire financial management community as we strive for excellence in reporting and continue to ensure taxpayer dollars are managed with integrity and accuracy. We will continue to work together to better manage resources, provide timely, reliable financial information to support critical decision making, and promote resilient, agile, and sound financial management operations while embracing innovative practices.

Sincerely,

Teresa R. Hunter
Chief Financial Officer

INDEPENDENT AUDITOR'S REPORT

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
A Century of Non-Partisan Fact-Based Work

441 G St. N.W.
Washington, DC 20548

Independent Auditor's Report

To the Commissioner of Internal Revenue

In our audits of the fiscal years 2021 and 2020 financial statements of the Internal Revenue Service (IRS), we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2021, and 2020, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- although internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2021; and
- no reportable noncompliance for fiscal year 2021 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes required supplementary information (RSI)[1] and other information included with the financial statements;[2] (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments.

Report on the Financial Statements and on Internal Control over Financial Reporting

In accordance with the authority conferred by the Chief Financial Officers Act of 1990 (CFO Act), as amended by the Government Management Reform Act of 1994, we have audited IRS's financial statements because of the significance of IRS's tax collections to the consolidated financial statements of the U.S. government, which GAO is required to audit.[3] IRS's financial statements comprise the balance sheets as of September 30, 2021, and 2020; the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended; and the related notes to the financial statements. We also have audited IRS's internal control over financial reporting as of September 30, 2021, based on

[1]The RSI consists of Management's Discussion and Analysis and the Required Supplementary Information section, which are included with the financial statements.

[2]Other information consists of information included with the financial statements, other than the RSI and the auditor's report.

[3]31 U.S.C. § 331(e)(2). See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), codified, in relevant part, as amended, at 31 U.S.C. § 3515(c). Pursuant to the authority of 31 U.S.C. § 3515, the Office of Management and Budget requires IRS to issue annual audited financial statements that are separate from those of the Department of the Treasury (Treasury) or that are presented separately in the department's audited, consolidated financial statements.

criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility

IRS management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of September 30, 2021, included in the accompanying Management's Report on Internal Control over Financial Reporting on page 24.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on IRS's internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[4] The procedures selected depend on the

[4]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered IRS's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion on Financial Statements

In our opinion, IRS's financial statements present fairly, in all material respects, IRS's financial position as of September 30, 2021, and 2020, and its net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

In accordance with federal accounting standards, IRS's financial statements do not include an estimate of the dollar amount of taxes that are owed to the federal government but that taxpayers have not reported or that IRS has not identified through its enforcement programs, often referred to as the tax gap,[5] nor do they include information on tax expenditures.[6] Further detail on the tax gap and tax expenditures, as well as the associated dollar amounts, is provided in the other information included with the financial statements.

Opinion on Internal Control over Financial Reporting

In our opinion, although certain internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2021, based on criteria established under FMFIA.

Our fiscal year 2021 audit continued to identify significant deficiencies in internal control over financial reporting concerning IRS's unpaid assessments and financial reporting systems.[7] We considered these significant deficiencies in determining the nature, timing, and extent of our audit procedures on IRS's fiscal year 2021 financial statements.

Although the significant deficiencies in internal control did not affect our opinion on IRS's fiscal year 2021 financial statements, misstatements may occur in unaudited financial information reported internally and externally by IRS because of these significant deficiencies.

In addition, because of the significant deficiencies in internal controls over unpaid assessments and financial reporting systems that existed during fiscal year 2021, IRS's financial management systems did not comply substantially with federal financial management systems requirements as required by the Federal Financial Management Improvement Act of 1996.[8]

We will be reporting additional details concerning the significant deficiency in internal control over financial reporting systems separately to IRS management, along with recommendations

[5]The tax gap arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting), (2) pay taxes due from filed returns (underpayment), or (3) file required tax returns altogether or on time (nonfiling). Based on its most recent study, which relied on 2011–2013 data, IRS estimated the average annual tax gap to be about $441 billion.

[6]Tax expenditures are provisions of the Internal Revenue Code (Title 26, U.S. Code) that reduce taxpayers' tax liability and therefore the amount of tax revenue paid to the government. Examples include tax credits, deductions, exclusions, exemptions, deferrals, and preferential tax rates.

[7]An unpaid assessment is an enforceable claim against a taxpayer for which specific amounts are due, have been determined, and the person(s) or entities from which a tax is due have been identified. See implementing guidance in Internal Revenue Manual § 1.34.4.1.6 (1) p, *Terms/Definitions* (Aug. 25, 2015). A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

[8]Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA), which is reprinted in 31 U.S.C. § 3512 note, requires that CFO Act agencies implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Government Standard General Ledger* at the transaction level. IRS's financial management systems did not comply substantially with federal financial management systems requirements because of the financial management system–related internal control deficiencies discussed in this report. However, IRS's financial management systems did comply substantially with federal accounting standards and the *U.S. Government Standard General Ledger* at the transaction level. FFMIA applies directly to Treasury, which is a CFO Act agency. As a Treasury component, IRS is not required to be assessed separately; however, it is included in Treasury's agency-wide FFMIA assessment. Since IRS is a significant component of Treasury, we conducted this assessment to support the audit of the Treasury agency-wide financial statements. *See* app. D of Office of Management and Budget, *Compliance with the Federal Financial Management Improvement Act of 1996*, OMB Circular No. A-123, § 4.A (Sept. 20, 2013).

for corrective actions. In addition to the significant deficiencies in internal control over unpaid assessments and financial reporting systems, we also identified other deficiencies in IRS's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant IRS management's attention. We have communicated these matters to IRS management and, where appropriate, will report on them separately along with related recommendations for corrective actions.

Significant Deficiency in Internal Control over Unpaid Assessments

During fiscal year 2021, the systems IRS uses to account for federal taxes receivable and other unpaid assessment balances continued to have limitations, as well as other control deficiencies that led to errors in taxpayer accounts. Because of these deficiencies, IRS's systems were unable to provide the timely, reliable, and complete transaction-level financial information necessary to enable IRS to appropriately classify and report unpaid assessment balances.[9]

As in prior years,[10] IRS used a manually driven statistical estimation process to compensate for the effects of its system limitations and other deficiencies on a material portion of its federal taxes receivable balance to help ensure that this balance was free of material misstatement.[11] During fiscal year 2021, IRS recorded adjustments totaling about $18 billion to correct the effects of continued errors in its underlying data that it identified during its estimation process. While using this process to determine a material portion of taxes receivable has enabled IRS to produce reliable related balances for year-end reporting, it does not provide IRS management with readily available, reliable unpaid assessment information on a daily basis throughout the year for effectively managing unpaid assessment balances. Further, errors in taxpayer accounts create a burden for those taxpayers whose accounts were affected.

While not collectively considered a material weakness, IRS's ongoing control deficiencies related to unpaid assessments are important enough to merit attention by those charged with governance of IRS. Therefore, these issues collectively represent a significant deficiency in IRS's internal control over financial reporting as of September 30, 2021. Continued management commitment and sustained efforts are necessary to build on the progress made to

[9]Federal accounting standards classify unpaid assessments into one of the following three categories for reporting purposes: federal taxes receivable, compliance assessments, and write-offs. Federal taxes receivable are taxes due from taxpayers for which IRS can support through the existence of a taxpayer agreement such as filing of a tax return without sufficient payment, or a court ruling in favor of IRS. Compliance assessments are proposed tax assessments where neither the taxpayer (when the right to disagree or object exists) nor a court has affirmed that the amounts are owed. Write-offs represent unpaid assessments for which IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency. Federal accounting standards require only federal taxes receivable, net of an allowance for uncollectible taxes receivable, to be reported on the financial statements. See Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (May 10, 1996). See also implementing guidance in Internal Revenue Manual, § 1.34.4, *Unpaid Assessments* (March 3, 2021).

[10]See GAO, *Financial Audit: IRS's FY 2020 and FY 2019 Financial Statements*, GAO-21-162 (Washington, D.C.: Nov. 10, 2020).

[11]In fiscal year 2021, IRS's reported federal taxes receivable consisted of a combination of three distinct types of taxes receivable with different internal control and accounting processes in place: amounts derived from (1) IRS's unpaid assessments estimation process; (2) the Section 965(h) repatriation of foreign earnings provision of the Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 14103, 131 Stat. 2054, 2195 (Dec. 22, 2017), which is codified at 26 U.S.C § 965; and (3) taxpayer deferral of the employer's share of Social Security taxes and certain self-employment taxes permitted by the CARES Act, Pub. L. No. 116-136, div. A, tit. II, § 2302, 134 Stat. 281, 351-52 (Mar. 27, 2020), which is reprinted in 26 U.S.C. § 3111 note.

date and to fully address IRS's remaining unresolved issues concerning the management and reporting of unpaid assessments.

Significant Deficiency in Internal Control over Financial Reporting Systems

During our fiscal year 2021 audit, we determined that unresolved information system security control deficiencies from prior audits, along with new information system control deficiencies, collectively represent a significant deficiency in IRS's internal control over financial reporting. These control deficiencies relate to business process application controls[12] and general controls.[13]

IRS mitigated the potential effect of continuing and newly identified control deficiencies primarily through compensating controls that management has designed to detect potential misstatements on the financial statements. Nevertheless, these business process application and general control deficiencies increase the risk of unauthorized access to, modification of, or disclosure of sensitive financial and taxpayer data and disruption of critical operations and are therefore important enough to merit the attention of those charged with governance of IRS.

While this significant deficiency in internal control over financial reporting continued to exist as of September 30, 2021, IRS made progress in addressing certain information system security control deficiencies. For example, IRS addressed deficiencies in (1) security management, (2) patch management, and (3) boundary protection.[14] However, unresolved and newly identified control deficiencies continue to exist. For example, deficiencies exist in the business process application and general controls concerning (1) improper configuration of security settings, (2) inadequate implementation of access controls, and (3) inadequate enforcement of encryption mechanisms to protect systems and data. Continued and consistent management commitment and attention are essential to addressing existing system deficiencies and continually improving IRS's information system security controls.

[12]Business process application controls (input, processing, output, interface, and data management system controls) help to provide reasonable assurance about the completeness, accuracy, validity, confidentiality, and availability of transactions and data during application processing.

[13]General controls help to provide reasonable assurance that access to data is appropriately restricted, physical access to sensitive computing resources and facilities is restricted, systems are securely configured to avoid exposure to known vulnerabilities, and incompatible duties are segregated among individuals. In addition, controls should ensure that backup and recovery plans are adequate and tested to ensure the continuity of essential operations and that security is managed entity-wide under a framework that provides a continuing cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures.

[14]Security management establishes a framework and continuous cycle of activity for assessing risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Patch management is an important element in mitigating the risks associated with known vulnerabilities. A patch, which is a piece of software code, is inserted into a program to address a vulnerability. Software vendors develop and release patches when vulnerabilities are discovered. Boundary protection controls the logical connectivity into and out of networks and controls connectivity to and from devices attached to the network.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

IRS's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on IRS's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

In connection with our audits of IRS's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

IRS management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to IRS.

Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to IRS that have a direct effect on the determination of material amounts and disclosures in IRS's financial statements, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to IRS.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2021 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to IRS. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Agency Comments

In commenting on a draft of this report, IRS stated that it was pleased to receive an unmodified opinion on its financial statements and commented on its progress toward resolving prior year recommendations related to information systems. IRS also noted its intention to continue working to improve its internal controls. The complete text of IRS's response is reproduced in the enclosure.

Dawn Simpson

Dawn B. Simpson
Director
Financial Management and Assurance

November 8, 2021

ENCLOSURE: IRS RESPONSE TO THE INDEPENDENT AUDITOR'S REPORT

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

COMMISSIONER

November 4, 2021

Ms. Dawn B. Simpson
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Simpson:

Thank you for the opportunity to comment on the draft report titled, Financial Audit: IRS's Fiscal Years 2021 and 2020 Financial Statements. We are pleased the IRS received an unmodified opinion on its combined financial statements. The unmodified opinion demonstrates the IRS accurately accounts for tax revenue receipts, tax refunds and IRS appropriated funds.

We appreciate the GAO recognizing our successful efforts to implement the Coronavirus Response and Relief Supplemental Appropriations Act, 2021 and the American Rescue Plan Act of 2021. Those efforts resulted in the IRS processing over $600 billion in economic impact payments and advanced child tax credits, as well as accounting for over $100 billion in deferred payroll taxes in Fiscal Year 2021. By prioritizing activities based on the greatest effect on the financial statements, we also made significant progress toward resolving prior year recommendations related to information systems.

The IRS's ability to produce accurate and reliable financial statements each year is due to the efforts of our outstanding management team and staff. We are dedicated to promoting the highest standard of financial management, and we look forward to working with the GAO to continue providing high-quality reporting and improving our internal controls.

Sincerely,

Charles P. Rettig

PRINCIPAL FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the IRS, pursuant to the requirements of the Chief Financial Officers Act of 1990 (Public Law 101-576), the Government Management Reform Act of 1994, and the OMB Circular No. A-136, Financial Reporting Requirements. The responsibility for the integrity of the financial information included in these statements is with the management of the IRS. The audit of the IRS principal financial statements was performed by the GAO.

The IRS principal financial statements for FY 2021 and FY 2020 are:

- The **Balance Sheet** presents the assets, liabilities, and net position.
- The **Statement of Net Cost** presents the net cost of operations by program. It includes the gross costs less any exchange revenue earned from activities.
- The **Statement of Changes in Net Position (SCNP)** presents the change in net position resulting from the net cost of operations, budgetary financing sources other than exchange revenues, and other financing sources.
- The **Statement of Budgetary Resources** presents the budgetary resources; the status of those resources; and the agency outlays, net. Additional detail by major budget accounts is available in the Required Supplementary Information section.
- The **Statement of Custodial Activity** presents the sources of non-exchange federal tax revenues collected, and disposition of refunds and outlays disbursed.

Balance Sheet
As of September 30, 2021 and 2020
(in Millions)

	2021	2020
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Note **2**)	$ 7,062	$ 5,069
Accounts Receivable, Net	34	43
Advances and Prepayments	10	-
Other Assets		
Due From General Fund of the U.S. Government (Note **3**)	6,248	3,750
Total Intragovernmental	**13,354**	**8,862**
With the Public		
Cash and Other Monetary Assets (Note **3**, **4**)	1,459	787
Accounts Receivable, Net		
Federal Taxes Receivable, Net (Notes **3**, **5**, **7**)	302,000	236,000
Other Receivables, Net	9	5
General Property and Equipment, Net (Note **6**)	1,822	1,871
Advances and Prepayments	9	10
Inventory and Related Property, Net	1	-
Total with the Public	305,300	238,673
Total Assets	**$ 318,654**	**$ 247,535**
LIABILITIES		
Intragovernmental		
Accounts Payable	$ 6	$ 6
Other Liabilities		
Due To General Fund of the U.S. Government (Note **7**)	304,058	237,612
Other Liabilities (Note **8**)	194	185
Total Intragovernmental	**304,258**	**237,803**
With the Public		
Accounts Payable		
Federal Tax Refunds Payable	6,248	3,750
Other Payables	3	13
Federal Employee Benefits (Note **9**)	1,058	1,068
Other Liabilities (Note **8**)	2,122	1,351
Total with the Public	9,431	6,182
Total Liabilities	**313,689**	**243,985**
Commitments and Contingencies (Note **12**)		
Net Position		
Unexpended Appropriations		
Funds From Other Than Dedicated Collections	3,459	2,005
Cumulative Results of Operations		
Funds From Dedicated Collections (Note **13**)	206	126
Funds From Other Than Dedicated Collections	1,300	1,419
Total Cumulative Results of Operations	**1,506**	**1,545**
Total Net Position	**4,965**	**3,550**
Total Liabilities and Net Position	**$ 318,654**	**$ 247,535**

The accompanying notes are an integral part of these statements.

Statement of Net Cost
For the Years Ended September 30, 2021 and 2020
(in Millions)

	2021	2020
PROGRAM COSTS		
Taxpayer Assistance and Education		
Gross Cost	$ 542	$ 507
Earned Revenue	(1)	(2)
Net Cost of Program	**541**	**505**
Filing and Account Services		
Gross Cost	5,882	5,224
Earned Revenue	(146)	(161)
Net Cost of Program	**5,736**	**5,063**
Compliance		
Gross Cost	8,914	8,187
Earned Revenue	(486)	(291)
Net Cost of Program	**8,428**	**7,896**
Administration of Tax Credit Programs		
Gross Cost	132	135
Earned Revenue	-	-
Net Cost of Program	**132**	**135**
Net Cost of Operations	**$ 14,837**	**$ 13,599**

The accompanying notes are an integral part of these statements.

Statement of Changes in Net Position
For the Years Ended September 30, 2021
(in Millions)

	2021		
	Funds From Dedicated Collections	**Funds From Other Than Dedicated Collections**	**Total**
Unexpended Appropriations			
Beginning Balances	$ -	$ 2,005	$ 2,005
Appropriations Received	-	14,290	14,290
Other Adjustments	-	(63)	(63)
Appropriations Used	-	(12,773)	(12,773)
Net Change	-	1,454	1,454
Total Unexpended Appropriations, Ending Balances	-	3,459	3,459
Cumulative Results of Operations			
Beginning Balances	126	1,419	1,545
Appropriations Used	-	12,773	12,773
Special Compliance Personnel Program	110	-	110
Transfers In/Out Without Reimbursement	-	31	31
Imputed Financing (Note **14**)	3	1,885	1,888
Transfers To General Fund of the U.S. Government	-	(4)	(4)
Net Cost of Operations	(33)	(14,804)	(14,837)
Net Change	80	(119)	(39)
Total Cumulative Results of Operations, Ending Balances	206	1,300	1,506
Net Position	$ 206	$ 4,759	$ 4,965

The accompanying notes are an integral part of these statements.

Statement of Changes in Net Position
For the Years Ended September 30, 2020
(in Millions)

	2020		
	Funds From Dedicated Collections	**Funds From Other Than Dedicated Collections**	**Total**
Unexpended Appropriations			
Beginning Balances	$ -	$ 1,506	$ 1,506
Appropriations Received	-	12,276	12,276
Other Adjustments	-	(47)	(47)
Appropriations Used	-	(11,730)	(11,730)
Net Change	-	499	499
Total Unexpended Appropriations, Ending Balances	-	2,005	2,005
Cumulative Results of Operations			
Beginning Balances	69	1,686	1,755
Appropriations Used	-	11,730	11,730
Non-exchange Revenues	153	-	153
Transfers In/Out Without Reimbursement	-	6	6
Imputed Financing (Note **14**)	-	1,504	1,504
Transfers To General Fund of the U.S. Government	-	(4)	(4)
Net Cost of Operations	(96)	(13,503)	(13,599)
Net Change	57	(267)	(210)
Total Cumulative Results of Operations, Ending Balances	126	1,419	1,545
Net Position	$ 126	$ 3,424	$ 3,550

The accompanying notes are an integral part of these statements

Statement of Budgetary Resources
For the Years Ended September 30, 2021 and 2020
(in Millions)

	2021	2020
Budgetary Resources		
Unobligated Balance Brought Forward, October 1	$ 1,396	$ 1,026
Recoveries of Prior Year Unpaid Obligations	165	150
Other Changes in Unobligated Balance	19	(7)
Unobligated Balance From Prior Year Budget Authority, Net	1,580	1,169
Appropriations (Discretionary and Mandatory)	14,900	12,708
Spending Authority From Offsetting Collections (Discretionary and Mandatory)	151	185
Total Budgetary Resources	**$ 16,631**	**$ 14,062**
Status of Budgetary Resources		
New Obligations and Upward Adjustments (Total)	$ 14,071	$ 12,666
Unobligated Balance, End of Year		
Apportioned, Unexpired Accounts	2,296	1,078
Exempt From Apportionment, Unexpired Accounts	7	7
Unapportioned, Unexpired Accounts	3	70
Unexpired Unobligated Balance, End of Year	2,306	1,155
Expired Unobligated Balance, End of Year	254	241
Unobligated Balance, End of Year (Total)	2,560	1,396
Total Budgetary Resources	**$ 16,631**	**$ 14,062**
Outlays, Net		
Outlays, Net (Total) (Discretionary and Mandatory)	$ 13,293	$ 12,172
Distributed Offsetting Receipts	(370)	(275)
Agency Outlays, Net (Discretionary and Mandatory)	**$ 12,923**	**$ 11,897**

The accompanying notes are an integral part of these statements.

Statement of Custodial Activity
For the Years Ended September 30, 2021 and 2020
(in Billions)

	2021	2020
Revenue Activity		
Collections of Federal Tax Revenue (Note **17**)		
Individual Income, FICA/SECA, and Other	$ 3,595	$ 3,128
Corporate Income	419	264
Excise	58	72
Estate and Gift	28	18
Railroad Retirement	6	5
Federal Unemployment	6	6
Total Collections of Federal Tax Revenue	**4,112**	**3,493**
Increase in Federal Taxes Receivable, Net	66	92
Total Federal Tax Revenue	**$ 4,178**	**$ 3,585**
Distribution of Federal Tax Revenue Due To General Fund of the U.S. Government	$ 4,112	$ 3,493
Increase in Amount Due	66	92
Total Disposition of Federal Tax Revenue	**4,178**	**3,585**
Net Federal Revenue Activity	**$ -**	**$ -**
Federal Tax Refund and Outlay Activities		
Total Refunds of Federal Taxes and Outlays (Note **18**)	$ 1,138	$ 736
Appropriations Used For Refund of Federal Taxes and Outlays	(1,138)	(736)
Net Federal Tax Refund and Outlay Activities	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

NOTES TO THE FINANCIAL STATEMENTS

For the Years Ended September 30, 2021 and 2020

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The IRS is a bureau of the Department of the Treasury. The IRS originated in 1862, when Congress established the Office of the Commissioner of the Internal Revenue. The IRS administers the nation's tax laws and annually collects approximately 95% of the revenues funding the federal government. The organizational divisions and programs within the IRS contribute to this achievement.

B. Basis of Accounting and Presentation

The financial statements have been prepared from the accounting records of the IRS in conformity with U.S. GAAP and in accordance with OMB Circular No. A-136, Financial Reporting Requirements. Accounting principles for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, which is the official body for setting accounting standards of the federal government.

These comparative financial statements and related notes consist of the Balance Sheet, SNC, SCNP, SBR, and SCA.

The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The SCA is presented on the modified cash basis of accounting. Under this method, cash collections and transfers to the General Fund of the U.S. Government are reported on a cash basis. The collections and transfers are adjusted on the face of the SCA for the net change in taxes receivable, producing modified cash basis balances.

Certain assets, liabilities, earned revenues, and costs have been classified as intragovernmental in the financial statements and notes. Intragovernmental is defined as transactions made between two reporting entities within the federal government.

C. Fund Balance with Treasury

The FBWT is an asset of a reporting entity and a liability of the General Fund of the U.S. Government. The amounts represent commitments by the federal government to provide resources for certain programs; but do not represent net assets to the federal government as a whole.

When the IRS seeks to use the FBWT to liquidate budgetary obligations, Treasury will finance the disbursements in the same way it finances all other disbursements, using some combination of receipts, other inflows and borrowing from the public (if there is a budget deficit).

D. Accounts Receivable, net

Accounts receivable, net, are due to the IRS from the public and from federal agencies. The reimbursable receivables are recorded, and revenues are recognized as services are performed and costs are incurred. The allowance for uncollectible accounts is based on an annual review of groups of accounts by age for accounts receivable balances older than one year. Intragovernmental receivables include an expenditure transfer receivable from the Treasury Forfeiture Fund for the repayment of costs incurred in criminal investigations related to seizure and forfeitures.

E. Federal Taxes Receivable, net

The IRS reduces its taxes receivable amount by an allowance to report the amount of Federal taxes receivable, net, on its Balance Sheet. The allowance reflects an estimate of the portion of total taxes receivable deemed to be uncollectible.

Accruals are made to reflect penalties and interest on taxes receivable through the Balance Sheet date. The majority of the Due to General Fund of the U.S. Government balance is the offsetting liability of Federal taxes receivable, net.

Taxes receivable consist of unpaid assessments (taxes, associated penalties and interest) due from taxpayers. The existence of a receivable is supported by a taxpayer agreement, such as filing of a tax return without sufficient payment, or a court ruling in favor of the IRS. Restitution based assessments are included in the taxes receivable balance. The IRC Section 965(h) requires U.S. shareholders to pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States. IRC Section 965(h) allows taxpayers to elect to pay their IRC Section 965(h) tax on an eight-year installment schedule. The CARES Act, Section 2302, contains a provision which allows employers to defer payment, without penalty, of the entire amount of the employer's share of the Social Security portion of Federal Insurance Contributions Act (FICA). This also includes the employer's and employee representative's share of the Railroad Retirement tax. The deferred amount is due in two installments with 50% due by December 31, 2021 and the remaining amount by December 31, 2022.

Other Unpaid Assessments

Compliance assessments are unpaid assessments which neither the taxpayer nor a court has affirmed is owed to the federal government. This includes assessments resulting from an IRS audit or examination in which the taxpayer does not agree with the results. Write-off assessments consist of unpaid assessments for which the IRS does not expect further collections due to factors such as taxpayers' bankruptcy, insolvency, or death. Compliance assessments and write-off assessments are not reported on the Balance Sheet. Statutory provisions authorize the IRS to collect on unpaid assessments for a specific statutory timeframe. To pursue collections and account for collection efforts, the IRS maintains unpaid assessment accounts in the financial records until the statute for collection expires.

Tax Assessments

Under IRC Section 6201, the Secretary of the Treasury is authorized and required to make inquiries, determinations, and assessments of all taxes imposed and accrued under any internal revenue law, which have not been duly paid, including interest, additions to the tax, and assessable penalties. The Secretary has delegated this authority to the Commissioner of the IRS. Unpaid assessments result from taxpayers filing returns without sufficient payments and from the enforcement programs of the IRS, such as examination, under-reporter, substitute for return, and combined annual wage reporting.

Abatements

IRC Section 6404 authorizes the Commissioner of the IRS to abate certain paid or unpaid portions of assessed taxes, interest, and penalties. Abatements occur for several reasons and are a standard part of the tax administration process. Abatements may be allowed for qualifying corporations claiming net operating losses that create a credit when carried back and applied against a prior year's tax liability. Additionally, abatements can correct previous assessments from enforcement programs, eliminate taxes discharged in bankruptcy, reduce or eliminate taxes encompassed in offers-in-compromise, eliminate penalty assessments for reasonable cause, eliminate contested assessments caused by mathematical or clerical errors, and eliminate assessments contested after the liability has been satisfied. Abatements may result in claims for refunds or reductions of the unpaid assessed amounts.

F. Cash and Other Monetary Assets

Imprest funds are maintained by headquarters and field offices in commercial bank accounts. Other monetary assets consist primarily of offers-in-compromise, voluntary deposits received from taxpayers pending application of the funds to unpaid tax assessments, and seized monies pending the results of criminal investigations.

G. General Property and Equipment

General property and equipment are recorded at historical cost. They consist of tangible and intangible assets, including software. The IRS depreciates property and equipment on a straight-line basis over its estimated useful life. Depreciation is recorded using the half year convention in the first year and the final year for all property and equipment except for leases meeting the 75% useful life and/or 90% of net present value criteria. The IRS depreciates these leases over the life of the leases. Disposals are recorded annually.

In FY 2021, the IRS changed its capitalization policy to expense acquisitions of Laptop/Desktop, Furniture, and End User Software regardless of the amount. Prior to FY 2021, these categories were capitalized if they met the capitalization threshold of $50 thousand.

IRS Capitalization Policy	
Asset Class	**Capitalization Threshold**
IT equipment (Mainframe, Server & Telecommunication)	Bulk cost of $50 thousand or greater.
Non-IT equipment	Assets with bulk cost of $50 thousand or greater and the individual cost is $5 thousand or greater.
Investigative equipment	Bulk cost of $50 thousand or greater.
Vehicles	No threshold.
Internal use software (IUS)	Projects with an estimated cost of greater than or equal to $10 million per year or greater than or equal to $50 million over the life cycle.
Leasehold improvements (LHI)	Improvements with bulk cost of $50 thousand or greater.
Assets under capital lease	Assets with bulk cost of $50 thousand or greater.

H. Advances and prepayments

Intragovernmental advances and prepayments include postage purchased from the United States Postal Service (USPS) for postage meters, business reply mail, bulk mailing permits, stamps and postage paid envelopes. The USPS requires payment for the postage in advance. Advances and prepayments to the public represent cash outlays for criminal investigations and employee travel.

I. Inventory and Related Property

Forfeited property held for sale is acquired as a result of forfeiture proceedings or foreclosure sales to satisfy a tax liability. The Federal Tax Lien Revolving Fund, established in accordance with Title 26 U.S.C., Section 7810, is used to redeem real property foreclosed upon by a holder of a lien. The IRS may sell the property, reimburse the revolving fund in an amount equal to the redemption, and apply any net proceeds to the outstanding tax obligation.

J. Due to General Fund of the U.S. Government

Due to General Fund of the U.S. Government is comprised of two sources, Federal taxes receivable, net, and State Innovation Waiver Program (SIWP). The portion of the liability for Federal taxes receivable is to be distributed to the General Fund of the U.S. Government upon collection. The portion of the liability for the SIWP are awards by the Centers for Medicare and Medicaid Services (CMS), under Section 1332 of the Patient Protection & Affordable Care Act of 2010 (PPACA), where the grantees participating in the program have not drawn down the funds per the term of the grant. The program is also referred to as a State Relief and Empowerment Waiver.

K. Federal Tax Refunds Payable and Due from General Fund of the U.S. Government

Federal tax refunds payable is comprised of measurable and legally payable amounts due to taxpayers under established refund processes of the IRS. It is a fully funded liability offset by a corresponding asset, Due from General Fund of the U.S. Government. The IRS records an amount Due from General Fund of the U.S. Government to designate approved funding to pay year-end tax refund liabilities to taxpayers.

L. Financing Sources and Revenues

Appropriations Received

The IRS receives most of its funding through annual, multi-year, and no-year appropriations available for use within statutory limits for operating and capital expenditures. Appropriations are presented as a budgetary financing source on the SCNP.

Exchange Revenue

Exchange revenue is recognized when earned and is derived from transactions where both the government and the other party receive value. The IRS exchange revenue represents reimbursements, user fees and collections of outstanding inactive tax receivables. Reimbursements are recognized as the result of costs incurred for services performed for federal agencies or the public under reimbursable agreements. User fees are from transactions with the public and are generally recognized when earned. The Private Collection Agencies program has the authority to procure qualified tax collection contracts for private collection contractors to perform the collection of outstanding inactive tax receivables from the public. A portion of the collections are retained for cost of services performed through the contracts.

Non-exchange Revenue

Non-exchange revenue results from the government's power to demand payments from the public. The Special Compliance Personnel Program has a specifically, identifiable, legally enforceable claim to a portion of the collections from outstanding inactive tax receivables to fund the administration of the program.

Imputed Financing Source

The IRS receives goods and services from other federal entities at no cost or at less than the full cost to the providing entity. When costs are identifiable to the IRS, these amounts are recognized as imputed costs in the SNC and as an imputed financing source on the SCNP. Imputed financing sources include Fiscal Service costs of processing tax payments and collections, employee benefits administered by OPM and claims to be settled by the Treasury Judgement Fund.

M. Program Costs

Taxpayer Assistance and Education provides services to assist taxpayers with tax return preparation. Primary activities include tax law interpretations, developing and disseminating tax forms and publications, researching customer needs and establishing partnerships with stakeholder groups, and taxpayer advocacy. In addition, these programs continue to emphasize taxpayer education, outreach, and enhancing pre-filing taxpayer support through electronic media. Earned revenues include reimbursable revenues for services provided.

Filing and Account Services provides resources and support services to taxpayers with filing returns or paying taxes, and for the issuance of refunds and maintenance of taxpayer accounts. Program activities include assistance, education, and compliance services to taxpayers through telephone, correspondence, and electronic means to resolve account and notice inquiries. Earned revenues include reimbursable revenues for services provided and user fees for several services performed including photocopies, U.S. residency certifications, and Income Verification Express Service disclosures.

Compliance administers compliance activities after a return is filed to identify and correct possible errors or underpayments. This program includes examination and collection programs, which ensure proper payment and tax reporting; criminal investigation programs to uncover violations of internal revenue tax laws and other financial crimes; the development and printing of published IRS guidance materials; and support of taxpayers for pre-filing agreements, determination letters, and advance pricing agreements. It also includes specialty program examinations, international collections, and international examinations. Earned revenues are primarily from user fees for installment agreements, letter rulings and determinations, offers in compromise, enrolled agent and actuary programs, return preparer registrations, advance pricing agreements, and for services provided from reimbursable revenues and the Private Collection Agencies program.

Administration of Tax Credit Programs primarily administers the EITC program, which works closely with internal and external stakeholders through expanded customer service and public outreach, enforcement, and research efforts to increase the number of eligible taxpayers who claim the EITC and to reduce the number of EITC claims paid in error. EITC payments refunded to individuals or credited against tax liabilities are not included in program costs.

N. Custodial Activity

Revenues

The IRS collects custodial non-exchange revenues for taxes levied against taxpayers for: individual and corporate income, FICA, SECA, excise, estate, gift, railroad retirement, and federal unemployment taxes. These collections are not available to the IRS for obligation or expenditure and are recognized as custodial revenues when collected. The sources of federal tax revenue and their distribution to the General Fund of the U.S. Government are reported on the SCA.

Appropriations

The IRS was granted permanent and indefinite budgetary authority through legislation to disburse tax refund principal and related interest as they become due. The permanent and indefinite appropriations are not subject to budgetary ceilings set by Congress during the annual appropriation process.

Refunds due to taxpayers are reported as Federal tax refunds payable on the Balance Sheet. The IRS records an offsetting asset, Due from General Fund of the U.S. Government, to reflect the year-end budget authority to pay this liability.

Disbursements for tax refunds, refundable tax credits and other outlays, reported on the SCA, are offset by appropriations used for refunds. Disbursements for refunds are not a cost to the IRS, but rather a cost to the federal government as a whole.

O. Funds from Dedicated Collections

Funds from Dedicated Collections are specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the federal government's general revenues.

P. Allocation Transfers

The IRS is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one federal entity of its authority to obligate budget authority and outlay funds to another federal entity. A separate fund account (allocation account) is created in Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Financial activity related to these allocation transfers is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The IRS allocates funds, as the parent entity, to the Department of Health and Human Services (HHS). Also, the IRS receives allocation transfers, as the child entity, from the Department of Transportation's Federal Highway Administration and HHS.

Q. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest the federal government must uphold.

The IRS fiduciary activities include the net collections for a taxable year from U.S. military and federal employees working in the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa. These fiduciary assets are not assets of the IRS.

R. Employee Compensation and Benefits

Accrued Annual, Sick, and Other Leave

Annual and compensatory leave is accrued and expensed as earned and used. Each year, the IRS adjusts the balance in the accrued annual leave liability account to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual and compensatory leave earned but not taken, funding is obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as used.

Federal Employees' Compensation Act

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection and other death benefits to beneficiaries for federal civilian employees with proper coverage who are injured on the job, have incurred work-related occupational diseases, and whose deaths were attributed to job-related injuries or occupational diseases. The FECA program is administered by the Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement for claims paid. Accrued FECA liability represents amounts due to the DOL for claims paid on behalf of the IRS. Actuarial FECA liability represents the liability for future workers' compensation benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. The DOL estimates the liability for future payments as a result of past events.

Employee Health and Life Insurance Benefits

Employees are eligible to participate in the Federal Employees Health Benefit Program (FEHB) and Federal Employees' Group Life Insurance Program (FEGLI). The FEHB offers a wide variety of group plans and coverage. The coverage is available to employees, retirees, and their eligible family members. The cost for each plan varies and is shared between the IRS and the employee. An employee participating in the FEGLI program can obtain basic term life insurance, with the employee paying two-thirds of the cost and the IRS paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may continue into retirement if certain requirements are met. The IRS recognizes the full cost of providing these benefits.

Employee Pension Benefits

The IRS recognizes the full costs of its employees' pension benefits. The liabilities associated with these costs are reported by the OPM, who administers the plans. Eligibility of employees to participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) is based on their hire date with the federal government, and the IRS contributes a percentage of an employee's basic pay toward the retirement plan.

Employees covered by either CSRS or FERS are also eligible to contribute to the Thrift Savings Plan (TSP), a defined contribution plan. The IRS is required to contribute to TSP a minimum of 1% per year of the basic pay of employees covered by this system, match voluntary employee contributions up to 3% of the employee's basic pay, and match one-half of contributions between 3% and 5% of the employee's basic pay. No TSP matching contributions are made to the CSRS.

Employee Pension Benefit Contribution Rates

	Category	Employee	Agency
CSRS Rates	Regular	7.0%	7.0%
	Law Enforcement Officers	7.5%	7.5%
FERS Rates Hired Prior to January 1, 2013	Regular	0.8%	17.3%
	Law Enforcement Officers	1.3%	35.8%
FERS – Revised Annuity Rate Hired January 1, 2013 - December 31, 2013	Regular	3.1%	15.5%
	Law Enforcement Officers	3.6%	34.0%
FERS – Further Revised Annuity Rate Hired January 1, 2014 or Later	Regular	4.4%	15.5%
	Law Enforcement Officers	4.9%	34.0%

S. Use of Estimates

The preparation of financial statements in conformity with GAAP in the United States of America requires management to make certain estimates and assumptions related to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities. Actual results could differ from these estimates.

T. Classified Activities

Statement of Federal Financial Accounting Standards (SFFAS) No. 56, Classified Activities, states Accounting Standards allow certain presentations and disclosures to be modified, if needed, to prevent the disclosure of classified information.

U. Reclassifications

Certain FY 2020 balances have been reclassified to conform to the FY 2021 OMB A-136 presentation of the Balance Sheet, SCNP, and accompanying disclosures in the current year.

Note 2. Fund Balance with Treasury

(In Millions)	2021	2020
Unobligated Balances		
Available	$ 2,303	$ 1,085
Unavailable	257	311
Obligated Balance Not Yet Disbursed	2,434	2,054
Non-Budgetary and Other FBWT	2,068	1,619
Status of Fund Balance with Treasury	**$ 7,062**	**$ 5,069**

Non-budgetary and other FBWT includes Section 1332 SIWP funds. As of September 30, 2021, the grantee has not drawn down the funds per the terms of the grant. In FY 2021 and FY 2020, the SIWP funds were $2,058, and $1,612 million, respectively.

The status of FBWT includes obligated and unobligated balances. The obligated balances not yet disbursed represent the unpaid funds with budgetary obligations. Unobligated balances, available represent amounts in unexpired appropriations as of the end of the current fiscal year. Unobligated balances become available when apportioned by the OMB. Unobligated balances, unavailable represent amounts in expired appropriations and amounts not apportioned for obligation as of the end of the current fiscal year.

Note 3. Non-entity Assets

	2021		2020	
(In Millions)	Intra-governmental	With the Public	Intra-governmental	With the Public
Due From General Fund of the U.S. Government	$ 6,248	$ -	$ 3,750	$ -
Federal Taxes Receivable, Net	-	302,000	-	236,000
Other Monetary Assets	-	1,455	-	785
Non-Entity Assets	**$ 6,248**	**$ 303,455**	**$ 3,750**	**$ 236,785**

Non-entity assets are not available for use by the IRS. Federal taxes receivable, net are collected for the U.S. Government, but the IRS does not have the authority to spend them.

Note 4. Cash and Other Monetary Assets

(In Millions)	2021	2020
With the Public		
Imprest Fund	$ 4	$ 2
Other Monetary Assets	1,455	785
Cash and Other Monetary Assets	**$ 1,459**	**$ 787**

Note 5. Federal Taxes Receivable, Net

(In Billions)		2021		2020
With the Public				
Federal Taxes Receivable	$	493	$	427
Allowance For Uncollectible Taxes Receivable		(191)		(191)
Federal Taxes Receivable, Net	**$**	**302**	**$**	**236**

Federal taxes receivable are taxes due from taxpayers for which the IRS can support the existence of a receivable through either a taxpayer agreement or a court ruling determining an assessment. Federal taxes receivable, net is the portion of Federal taxes receivable estimated to be collectible and the corresponding liability is Due to General Fund of the U.S. Government which is to be transferred when collected. The taxes receivable consists primarily of two categories:

- Delinquent tax assessments, penalties, and interest not paid or abated, which were agreed to by the taxpayer and the IRS or upheld by the courts. As of September 30, 2021, the net Federal taxes receivable for this category was $53 billion, an increase of $8 billion over the $45 billion reported for FY 2020. The majority of the increase was driven by higher estimated collectability.

- Non-delinquent assessments are detailed in Note **1.E.** As of September 30, 2021, the net Federal taxes receivable for this category was $249 billion. These non-delinquent assessments consist of two categories:

  - IRC Section 965(h) which allowed taxpayers to elect to pay this tax on an eight-year installment schedule. As of September 30, 2021, net Federal taxes receivable for IRC Section 965(h) consist of $143 billion, a decrease of $25 billion from $168 billion reported for FY 2020, due to receiving scheduled tax payments.

  - The CARES Act, Section 2302 which contained a provision for employers to defer payment of the employer's share of the Social Security portion of FICA, and their portion and the employee representative's share of the Railroad Retirement tax. The net Federal taxes receivable for Section 2302 deferrals consists of $106 billion, an increase of $83 billion over the $23 billion reported for FY 2020. The increase was due to additional employer tax deferrals.

For taxes receivable, specific collectability methods were applied to each of the categories mentioned above to determine allowance for uncollected taxes receivable:

- **Delinquent tax assessments**. In FY 2021, to derive the estimated collectability rate applied to delinquent gross Federal taxes receivable, the IRS utilized the FY 2021 sample collectible point estimate of $57 billion (+/- $10.0 billion). The IRS averaged three years of collectability rates (FY 2019-2021) to normalize the effect of year-to-year fluctuations. In FY 2020, the $45 billion in taxes receivable, net, was derived from a three-year average including the FY 2020 collectible point estimate of $40 billion (+/- $8.6 billion).

- **IRC Section 965(h) elections**. In FY 2021, the IRS used an updated econometric methodology to derive its collectability estimate. This methodology considered indicators of financial health of the largest business modules (more than 90% of the remaining unpaid deferral balance) along with industry specific data in determining the degree to which IRC Section 965(h) taxpayers are considered to be at-risk of non-payment. IRC Section 965(h) taxes receivable estimated collectability was 90.6% overall due to the high collectability from large businesses outweighing the remaining smaller businesses and individuals who are at-risk due to global uncertainties. The FY 2020 overall collectability estimate for IRC Section 965(h) was 94.3%.

- **Social Security Tax Deferral**. For FY 2021, the legislation authorizing Social Security Tax Deferrals resulted in $83 billion in new non-delinquent unpaid assessments to be paid over two-yearly installments. Businesses determined to be at-risk for non-payment of an IRC Section 965(h) election were considered at-risk for non-payment of Social Security Tax Deferral. The IRS considered businesses not at-risk to be fully collectible. This resulted in an estimated 99.9% collectability for Social Security Tax Deferrals in FY 2021. In FY 2020, there were $23 billion in new non-delinquent unpaid assessments, and an overall 99.6% estimated collectability for Social Security Tax Deferrals.

Note 6. General Property and Equipment, Net

(In Millions)	Useful Life (Years)	Cost	Accumulated Depreciation	2021 Net Book Value	2020 Net Book Value
IT Equipment	3 to 7	$ 1,028	$ (647)	$ 381	$ 434
IUS	2 to 15	3,423	(2,597)	826	882
IUS - In Development	N/A	454	-	454	402
LHI	2 to 10	233	(154)	79	71
Vehicles	5	3	(2)	1	1
Non-IT	8 and 10	103	(66)	37	42
Assets Under Capital Lease	4.5 to 8	27	(18)	9	12
Investigative Equipment	10	5	(3)	2	1
LHI Construction in Progress	N/A	33	-	33	26
Property and Equipment		**$ 5,309**	**$ (3,487)**	**$ 1,822**	**$ 1,871**

The Cost column represents the historical cost of property and equipment, net of disposals. The cost basis for FY 2021 and FY 2020 was $5,309 and $5,379 million, respectively. Accumulated depreciation for FY 2021 and FY 2020 was $3,487 and $3,508 million, respectively.

In FY 2021, the IRS changed the capitalization policy to expense new acquisitions of laptops/desktops, furniture, and end user software. Accordingly, the IRS removed $221 million in cost and accumulated depreciation related to fully depreciated assets in these categories previously capitalized.

Components of the Changes in General Property and Equipment, Net

(In Millions)	2021
Balance Beginning of Year	$ 1,871
Capitalized Acquisitions	345
Dispositions	(8)
Depreciation Expense	(386)
Balance at End of Year	**$ 1,822**

Note 7. Due to General Fund of the U.S. Government

(In Millions)		2021		2020
Intragovernmental				
Federal Taxes Receivable, Net	$	302,000	$	236,000
FBWT		2,058		1,612
Due to General Fund of the U.S. Government	**$**	**304,058**	**$**	**237,612**

Due to General Fund of the U. S. Government reports General Fund assets held and managed on behalf of the U.S. Government. These General Fund assets constitute resources available to meet the operating needs of the U.S. Government. The Federal taxes receivable, net is the portion of gross Federal taxes receivable estimated to be collectible and will be transferred to the General Fund when collected. The FBWT represents funds to administer the SIWP. These funds are not available for use by the IRS.

Note 8. Other Liabilities

(In Millions)		2021		2020
Intragovernmental				
Benefit Program Contributions Payable	$	120	$	105
Unfunded FECA		73		77
Unfunded Unemployment Compensation for Federal Employees (UCFE)		1		3
Other Liabilities	**$**	**194**	**$**	**185**
With the Public				
Accrued Funded Payroll	$	371	$	334
Accrued Expenses		294		230
Deposit Fund and Clearing Accounts		1,456		786
Energy Savings Performance		1		1
Other Liabilities	**$**	**2,122**	**$**	**1,351**

The current liabilities not covered by budgetary resources for FY 2021 are unfunded FECA for $33 million, and unfunded UCFE and energy savings performance for $1 million each. In FY 2020, the current liabilities not covered by budgetary resources for unfunded FECA, unfunded UCFE, and energy savings performance were $36 million, $3 million, and $1 million, respectively.

Note 9. Federal Employee Benefits

(In Millions)		2021		2020
With the Public				
Accrued Annual Leave	$	602	$	607
Actuarial FECA		442		447
Employer Contributions For TSP		14		14
Federal Employee Benefits	**$**	**1,058**	**$**	**1,068**

Accrued annual leave is a current liability not covered by budgetary resources.

Note 10. Liabilities Not Covered by Budgetary Resources

(In Millions)		2021		2020
Intragovernmental				
Unfunded FECA	$	73	$	77
Unfunded UCFE		1		3
Capital Lease Liability		1		1
Intragovernmental	**$**	**75**	**$**	**81**
With the Public				
Accrued Annual Leave	$	602	$	607
Actuarial FECA		442		447
Energy Savings Performance		1		1
With the Public	**$**	**1,045**	**$**	**1,055**
Liabilities Not Covered By Budgetary Resources	$	1,120	$	1,136
Liabilities Covered By Budgetary Resources		9,113		6,063
Liabilities Not Requiring Budgetary Resources		303,456		236,786
Liabilities	**$**	**313,689**	**$**	**243,985**

Liabilities not covered by budgetary resources are from the receipt of goods and services, or occurrence of eligible events in the current or prior periods, for which revenue or other funds to pay the liabilities has not been made available through appropriations of the IRS.

Liabilities covered by budgetary resources are liabilities which Congress has appropriated funds or funding is otherwise available to pay amounts due.

Liabilities not requiring budgetary resources are liabilities that have not in the past required and will not in the future require the use of budgetary resources. This includes liabilities for clearing accounts, non-fiduciary deposit funds, and custodial collections.

Note 11. Leases

Capital Leases

The IRS leases IT telecommunications equipment for toll free call centers, and currently has one two-year lease and two seven-year leases. There are no future payments due for equipment under these active leases.

In FY 2018, the IRS entered into a software license agreement for five years with perpetual use rights to the licenses.

The IRS has leases with the General Services Administration (GSA) for furniture. Furniture is being leased over a period of five years.

In FY 2021, the capital lease liability totals $1 million. These leases are not covered by budgetary resources. The future payments due for FY 2022 through FY 2024 are less than $1 million each year.

Summary of Assets Under Capital Lease:

(In Millions)	2021	2020
Capital Lease Category		
Telecom Equipment	$ 8	$ 8
Software License Agreement	17	17
Furniture	2	2
Accumulated Depreciation	(18)	(16)
Assets Under Capital Lease, Net	**$ 9**	**$ 11**

Operating Leases

The IRS leases office space from GSA under non-cancelable occupancy agreements with lease terms from 1 to 30 years. Future lease payments under non-cancelable leases of office spaces are:

(In Millions)	Intragovernmental
Fiscal Year	
2022	$ 125
2023	85
2024	80
2025	68
2026	68
After 2026	269
Future Lease Payments	**$ 695**

Also, the IRS maintains annual operating leases with both GSA for other office space and commercial entities for equipment and software licenses. These leases may be canceled or renewed on an annual basis by the IRS.

Note 12. Commitments and Contingencies

The IRS is a party to legal actions whose outcome, if unfavorable, could materially affect the financial statements. The IRS has determined it is reasonably possible as of September 30, 2021, one of these proceedings will result in a loss of up to $275 million. This case was disclosed in the September 30, 2020 financial statements. There was no contingent liability as of September 30, 2021 and 2020, respectively.

For some of the legal actions to which the IRS is a party, management and legal counsel cannot determine the likelihood of an unfavorable outcome nor can any related loss be reasonably estimated. The IRS does not accrue for possible losses related to cases where the potential loss cannot be estimated, or the likelihood of an unfavorable outcome is less than probable. As of September 30, 2021, and 2020, there is one case in each year for which the IRS is unable to determine the likelihood of an unfavorable outcome or establish a range of potential losses. Additionally, for some of the legal actions, the IRS determined the likelihood of an unfavorable outcome is remote.

Note 13. Funds from Dedicated Collections

	2021					
(In Millions)	**Private Debt Collection**		**Other Dedicated Collections**		**Combined Funds from Dedicated Collections**	
Balance Sheet						
Assets						
Intragovernmental						
FBWT	$	204	$	7	$	211
Total Intragovernmental		204		7		211
With the Public						
General Property and Equipment, Net		1		-		1
Inventory and Related Property		-		1		1
Total with the Public		1		1		2
Total Assets	**$**	**205**	**$**	**8**	**$**	**213**
Liabilities						
With the Public						
Federal Employee Benefits	$	1	$	-	$	1
Other Liabilities		6		-		6
Total with the Public		7		-		7
Total Liabilities	**$**	**7**	**$**	**-**	**$**	**7**
Net Position						
Cumulative Results of Operations		198		8		206
Total Liabilities and Net Position	**$**	**205**	**$**	**8**	**$**	**213**
Statement of Net Cost						
Gross Costs	$	143	$	-	$	143
Earned Revenue		(110)		-		(110)
Net Costs of Operations	**$**	**33**	**$**	**-**	**$**	**33**
Statement of Changes in Net Position						
Cumulative Results of Operations						
Beginning Balances	$	118	$	8	$	126
Special Compliance Personnel Program		110		-		110
Imputed Financing		3		-		3
Net Costs of Operations		(33)		-		(33)
Net Change		80		-		80
Ending Balances	**$**	**198**	**$**	**8**	**$**	**206**

The IRS administers four Funds from Dedicated Collections and they are presented in accordance with SFFAS No. 27, Identifying and Reporting Earmarked Funds, as amended by SFFAS No. 43, Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27. There are no eliminations between the four funds from dedicated collections.

Private Debt Collection

Established under the American Jobs Creation Act of 2004, the Private Collection Agent Program, Treasury Account Symbol 20X5510, ended in March 2009. The remaining unobligated funds were retained by the IRS. The Fixing America's Surface Transportation Act, Public Law 114-94, enacted in December 2015, amended Title 26 USC, Section 6306, requiring the IRS to enter one or more qualified tax collection contracts for the collection of outstanding inactive tax receivables in the Private Collection Agencies Program. This program has the authority to retain a portion of these collections to use for the costs performed under the contracts. The revenue is recognized as exchange revenue on the SNC.

The Fixing America's Surface Transportation Act amended Title 26, USC, Section 6307, to establish the Special Compliance Personnel Program Account, Treasury Account Symbol 20X5622. The program requires the hiring, training, and employment of special compliance personnel. A portion of the collections from outstanding inactive tax receivables fund the program. The revenue is recognized as non-exchange revenue on the SCNP.

Other Dedicated Collections

The Federal Tax Lien Revolving Fund, Treasury Account Symbol 20X4413, was established pursuant to Section 112(a) of the Federal Tax Lien Act of 1966, to serve as the source of financing for the redemption of real property by the United States. The forfeited property may be sold at auction to reimburse the revolving fund in an amount equal to the redemption. The net proceeds are applied to the outstanding tax obligation. The inventory and related property on the balance sheet is capitalized for purchases and reduced for sales.

The Informant Payments Fund, Treasury Account Symbol 20X5433, was established by the Taxpayer Bill of Rights of 1996 (P.L. 104-168). It provides for payments to individuals from the proceeds of amounts collected by reason of the information provided, and any amount collected shall be available for such payments. The custodial collection activities are reported in the SCA.

Note 14. Inter-Entity Costs

(In Millions)		**2021**		**2020**
Fiscal Service Cost For Tax Collections and Refunds	$	1,177	$	937
Federal Employees Benefit Programs		634		566
Treasury Judgement Fund		77		1
Inter-Entity Costs	**$**	**1,888**	**$**	**1,504**

Imputed financing sources are recognized for goods or services received from other federal agencies without reimbursement from the IRS. This includes pension and other benefit costs administered by the OPM, costs of processing payments and collections by the Fiscal Service, and legal judgments paid by the Treasury Judgment Fund. Unreimbursed costs of goods and services other than those identified above are not included in the IRS financial statements.

Note 15. Undelivered Orders at the End of the Period

(In Millions)	2021 Intragovernmental		2021 With the Public		2021 Total	
Unpaid	$	238	$	1,442	$	1,680
Paid		10		9		19
Undelivered Orders at the End of the Period	**$**	**248**	**$**	**1,451**	**$**	**1,699**

(In Millions)	2020 Intragovernmental		2020 With the Public		2020 Total	
Unpaid	$	241	$	1,179	$	1,420
Paid		-		10		10
Undelivered Orders at the End of the Period	**$**	**241**	**$**	**1,189**	**$**	**1,430**

Undelivered orders are the value of goods and services ordered and obligated, but not yet received. Amounts include any prepaid or advanced orders for which delivery or performance has not yet occurred.

Note 16. Statement of Budgetary Resources

Explanation of Differences Between the FY 2020 Statement of Budgetary Resources and the FY 2022 Budget of the United States Government

(In Millions)	Budgetary Resources	New Obligations and Upward Adjustments	Distributed Offsetting Receipts	Outlays, Net
Statement of Budgetary Resources (SBR)	$ 14,062	$ 12,666	$ 275	$ 12,172
Expired Funds In SBR	(315)	-	-	-
Refundable Tax Credits, Interest Refunds to Taxpayers, and Other Outlays Not In SBR	445,947	445,947	-	436,734
Informant Payments Not In SBR	63	63	-	63
Other	1	5	-	1
Budget of the United States Government	**$ 459,758**	**$ 458,681**	**$ 275**	**$ 448,970**

The FY 2023 Budget of the United States Government presenting the actual amounts for the year ended September 30, 2021 has not been published as of the issue date of these financial statements and will be available at a future date. A reconciliation of the FY 2020 SBR and the FY 2020 actual amounts in the FY 2022 Appendix, Budget of the United States Government for budgetary resources, new obligations and upward adjustments, distributed offsetting receipts, and outlays, net is presented above. The Budget of the United States Government can be found at www.whitehouse.gov/omb/budget.

Refundable tax credits, interest refunds, other outlays, and informant payments total $446 billion in appropriations. These appropriations are primarily EIP, EITC, Premium Tax Credit (PTC), and CTC reported with refunds as custodial activities on the SCA and are not reported as budgetary resources on the SBR.

Note 17. Collections of Federal Tax Revenue

(In Billions)	Tax Year 2021	Tax Year 2020	Tax Year 2019	Tax Year Prior Years	Collections Received FY 2021	Collections Received FY 2020
Individual Income, FICA/ SECA, and Other	$ 2,284*	$ 1,232	$ 44	$ 35	$ 3,595	$ 3,128
Corporate Income	255**	131	4	29	419	264
Excise	44	14	-	-	58	72
Estate and Gift	1	21	3	3	28	18
Railroad Retirement	4	1	-	1	6	5
Federal Unemployment	4	2	-	-	6	6
Collections of Federal Tax Revenue	**$ 2,592**	**$ 1,401**	**$ 51**	**$ 68**	**$ 4,112**	**$ 3,493**

*Includes other collections of $640 million.

**Includes TY 2022 corporate income tax receipts of $11 billion.

Note 18. Federal Tax Refund and Outlay Activities

(In Billions)	Tax Year 2021	Tax Year 2020	Tax Year 2019	Tax Year Prior Years	Refunds and Outlays FY 2021	Refunds and Outlays FY 2020
Individual Income, FICA/SECA, and Other	$ 534	$ 497	$ 38	$ 13	$ 1,082	$ 674
Corporate Income	4	6	14	29	53	60
Excise	-	2	-	-	2	2
Estate and Gift	-	-	1	-	1	-
Federal Tax Refund and Outlay Activities	**$ 538**	**$ 505**	**$ 53**	**$ 42**	**$ 1,138**	**$ 736**

Federal tax refunds and outlays include overpayments from taxpayers; payments for the various refundable credits, including EITC and the PTC; and other payments, Basic Health Program (BHP), and the SIWP under the PPACA. The CARES Act, CRRSAA, and the ARP included provisions to help stimulate the economy through EIPs and/or recovery rebate credits for those eligible taxpayers who did not receive the full amount of the EIP. In FY 2021, the IRS disbursed $570 billion of payments to eligible taxpayers based upon the criteria in each Act. In FY 2020, the IRS disbursed payments of $275 billion to eligible taxpayers of up to $1,200 for individuals and $2,400 for individuals filing a joint tax return, with up to an additional $500 for each eligible child. The CARES Act authorized an EIP for eligible taxpayers of up to $1,200 for individuals and $2,400 for individuals filing a joint tax return, with up to an additional $500 for each eligible child added. The CRRSAA created an additional EIP of up to $600 for individuals and $1,200 for individuals filing a joint tax return, with up to an additional $600 for each eligible child. Additionally, the ARP created an additional EIP of up to $1,400 for individuals, and $2,800 for individuals filing a joint tax return, with up to an additional $1,400 for each qualifying dependent.

Note 19. Fiduciary Activities

(In Millions) 2021	20X6737	20X6738	20X6740	20X6741	Total
Fiduciary Net Assets, Beginning of Year	$ -	$ 17	$ -	$ -	$ 17
Contributions	168	207	4,866	140	5,381
Disbursements To and On Behalf of Beneficiaries	(168)	(196)	(4,866)	(140)	(5,370)
Decrease In Fiduciary Net Assets	-	11	-	-	11
Fiduciary Net Assets, End of Year	**$ -**	**$ 28**	**$ -**	**$ -**	**$ 28**

(In Millions) 2020	20X6737	20X6738	20X6740	20X6741	Total
Fiduciary Net Assets, Beginning of Year	$ -	$ 19	$ -	$ 1	$ 20
Contributions	63	96	4,523	47	4,729
Disbursements To and On Behalf of Beneficiaries	(63)	(98)	(4,523)	(48)	(4,732)
Decrease In Fiduciary Net Assets	-	(2)	-	(1)	(3)
Fiduciary Net Assets, End of Year	**$ -**	**$ 17**	**$ -**	**$ -**	**$ 17**

In fiduciary fund 20X6738, the fiduciary net assets, end of year balances are pending a tax matter resolution.

In accordance with the SFFAS No. 31, Accounting for Fiduciary Activities, fiduciary cash and other assets are not assets of the federal government. The IRS has four fiduciary funds not reported on the Balance Sheet:

Internal Revenue Collections for Northern Mariana Islands	20X6737
Coverover Withholdings – U.S. Virgin Islands	20X6738
Coverover Withholdings – Guam	20X6740
Coverover Withholdings – American Samoa	20X6741

IRC Section 7654 governs the tax coordination between the governments of the United States and the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa.

The collections of federal income taxes withheld from U.S. military and federal employees working in these U.S. territories are maintained in fiduciary funds of the IRS. The disbursements of these collections to these U.S. territory governments represent the transfer of the individual tax liability for a taxable year.

Note 20. Budget and Accrual Reconciliation

	2021		
(In Millions)	Intra-governmental	With the Public	Total
Net Cost of Operations	$ 5,523	$ 9,314	$ 14,837
Components of Net Cost That Are Not Part of Net Outlays:			
Property and Equipment Depreciation	-	(386)	(386)
Property and Equipment Disposal and Reevaluation	-	(8)	(8)
Private Collection Agencies Revenue Not In Actual Offsetting Collections	110	-	110
Other	(2)	286	284
Increase/Decrease in Assets:			
Accounts Receivable	(9)	4	(5)
Advances, Prepayments and Inventory	10	-	10
Increase/Decrease in Liabilities			
Accounts Payable	-	10	10
Federal Employee Benefits	-	10	10
Other Liabilities	(9)	(101)	(110)
Other Financing Sources			
Federal Costs Imputed to the Agency	(1,888)	-	(1,888)
Transfers Out(In) Without Reimbursement	(31)	-	(31)
Total Components of Net Cost Not Part of the Net Outlays	(1,819)	(185)	(2,004)
Components of the Net Outlays That Are Not Part of Net Cost			
Acquisition of Capital Assets	3	87	90
Total Components of the Net Outlays That Are Not Part of Net Cost	3	87	90
Net Outlays	$ 3,707	$ 9,216	$ 12,923

(In Millions)	2020 Intra-governmental	2020 With the Public	2020 Total
Net Cost of Operations	$ 4,712	$ 8,887	$ 13,599
Components of Net Cost That Are Not Part of Net Outlays:			
Property and Equipment Depreciation	-	(391)	(391)
Property and Equipment Disposal and Reevaluation	-	(7)	(7)
Other	-	249	249
Increase/Decrease in Assets:			
Accounts Receivable	30	-	30
Other Assets		1	1
Increase/Decrease in Liabilities			
Accounts Payable	-	4	4
Salaries and Benefits	(27)	(75)	(102)
Other Liabilities	-	(110)	(110)
Other Financing Sources			
Federal Costs Imputed to the Agency	(1,504)	-	(1,504)
Transfers Out(In) Without Reimbursement	(6)	-	(6)
Total Components of Net Cost Not Part of the Net Outlays	**(1,507)**	**(329)**	**(1,836)**
Components of the Net Outlays That Are Not Part of Net Cost			
Acquisition of Capital Assets	1	133	134
Total Components of the Net Outlays That Are Not Part of Net Cost	**1**	**133**	**134**
Net Outlays	$ 3,206	$ 8,691	$ 11,897

In accordance with the SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, amended and SFFAS No. 53, Budget and Accrual Reconciliation, the IRS's relationship between the net cost of the programs and operations presented on an accrual basis must be reconciled to the net outlays presented on the budgetary basis during the reporting period. The accrual basis of accounting reports the net cost of resources used. Budgetary accounting reports the outlays of financial resources to acquire or provide goods and services.

Note 21. COVID-19 Activity

The IRS received COVID-19 supplemental funding for the ARP for $1,862 million and the CRRSAA for $509 million in budgetary resources totaling $2,371 million for FY 2021. The budgetary resources were appropriated for annual, two-year, and three-year availability. Programs supported for COVID-19 funding include the IRS administration of two EIPs and an expanded, refundable CTC. The funding also accelerates the IRS efforts to integrate, modernize, and secure the IRS information technology systems. The CRRSAA extended the COVID-19 related Relief Act to address COVID-19 related tax administration issues.

In FY 2020, COVID-19 funding included the CARES Act for $751 million and the FFCRA for $15 million totaling $766 million in budgetary resources. The budgetary resources were appropriated for two-year and three-year availability. This funding supports the IRS costs associated with the implementation of COVID-19 legislation.

Budgetary Activities Related to COVID-19 Response

(In Millions)		2021		2020
Budgetary Resources	$	2,736	$	766
Obligations Incurred	$	1,321	$	439
Remaining Available Budgetary Resources	$	1,415	$	327

Note Disclosures with COVID-19 Program Administration Support

(In Millions)		2021		2020
FBWT	$	1,793	$	482
General Property and Equipment	$	29	$	9
Other Liabilities, With the Public	$	42	$	14
Undelivered Orders at the End of the Period	$	195	$	141

Additionally, the IRS received appropriated funding, which is included in the SCA Federal tax refund and outlay activities section, to execute COVID-19 related refundable tax credits and EIPs as noted in further detail in the Other Information, Refundable Tax Credit and Other Outlays section (See Note **18**).

REQUIRED SUPPLEMENTARY INFORMATION

Unaudited, See Accompanying Auditor's Report

Schedule of Budgetary Resources by Major Budget Account

(In Millions)	2021 Taxpayer Services	2021 Enforcement	2021 Operations Support	2021 Other	2021 Total
Budgetary Resources					
Unobligated Balance Brought Forward, October 1	$ 215	$ 333	$ 304	$ 544	$ 1,396
Recoveries of Prior Year Unpaid Obligations	47	26	86	6	165
Other Changes in Unobligated Balance	109	(10)	164	(244)	19
Unobligated Balance From Prior Year Budget Authority, Net	371	349	554	306	1,580
Appropriations (Discretionary & Mandatory)	3,208	5,004	5,583	1,105	14,900
Spending Authority From Offsetting Collections (Discretionary & Mandatory)	35	67	49	-	151
Total Budgetary Resources	**$ 3,614**	**$ 5,420**	**$ 6,186**	**$ 1,411**	**$ 16,631**
Status of Budgetary Resources					
New Obligations and Upward Adjustments (Total)	$ 3,290	$ 5,099	$ 5,191	$ 491	$ 14,071
Unobligated Balance, End of Year					
Apportioned, Unexpired Accounts	281	259	849	907	2,296
Exempt From Apportionment, Unexpired Accounts	-	-	-	7	7
Unapportioned, Unexpired Accounts	-	3	-	-	3
Unexpired Unobligated Balance, End of Year	281	262	849	914	2,306
Expired Unobligated Balance, End of Year	43	59	146	6	254
Unobligated Balance, End of Year (Total)	324	321	995	920	2,560
Total Budgetary Resources	**$ 3,614**	**$ 5,420**	**$ 6,186**	**$ 1,411**	**$ 16,631**
Outlays, Net					
Outlays, Net (Total) (Discretionary & Mandatory)	$ 3,154	$ 4,915	$ 4,778	$ 446	$ 13,293
Distributed Offsetting Receipts	-	-	-	(370)	(370)
Agency Outlays, Net (Discretionary & Mandatory)	**$ 3,154**	**$ 4,915**	**$ 4,778**	**$ 76**	**$ 12,923**

(In Millions)	2020 Taxpayer Services	Enforcement	Operations Support	Other	Total
Budgetary Resources					
Unobligated Balance Brought Forward, October 1	$ 42	$ 125	$ 176	$ 683	$ 1,026
Recoveries of Prior Year Unpaid Obligations	16	17	103	14	150
Other Changes in Unobligated Balance	4	11	343	(365)	(7)
Unobligated Balance From Prior Year Budget Authority, Net	62	153	622	332	1,169
Appropriations (Discretionary & Mandatory)	2,892	4,993	4,215	608	12,708
Spending Authority From Offsetting Collections (Discretionary & Mandatory)	73	47	65	-	185
Total Budgetary Resources	**$ 3,027**	**$ 5,193**	**$ 4,902**	**$ 940**	**$ 14,062**
Status of Budgetary Resources					
New Obligations and Upward Adjustments (Total)	$ 2,812	$ 4,860	$ 4,598	$ 396	$ 12,666
Unobligated Balance, End of Year					
Apportioned, Unexpired Accounts	178	277	163	460	1,078
Exempt From Apportionment, Unexpired Accounts	-	-	-	7	7
Unapportioned, Unexpired Accounts	-	-	-	70	70
Unexpired Unobligated Balance, End of Year	178	277	163	537	1,155
Expired Unobligated Balance, End of Year	37	56	141	7	241
Unobligated Balance, End of Year (Total)	215	333	304	544	1,396
Total Budgetary Resources	**$ 3,027**	**$ 5,193**	**$ 4,902**	**$ 940**	**$ 14,062**
Outlays, Net					
Outlays, Net (Total) (Discretionary & Mandatory)	$ 2,618	$ 4,705	$ 4,460	$ 389	$ 12,172
Distributed Offsetting Receipts	-	-	-	(275)	(275)
Agency Outlays, Net (Discretionary & Mandatory)	**$ 2,618**	**$ 4,705**	**$ 4,460**	**$ 114**	**$ 11,897**

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents the amount (principal and interest) which may be paid for claims pending judicial review by the federal courts or internally by Appeals. In FY 2021, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $1.5 billion and by Appeals is $1.0 billion. In FY 2020, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts was $1.6 billion and by Appeals was $1.7 billion. To the extent judgments against the government in these cases prompt other similarly situated taxpayers to file similar refund claims, these amounts could become significantly greater.

Federal Taxes Receivable, Net

In accordance with the SFFAS No. 7, some unpaid assessments do not meet the criteria for financial statement recognition as discussed in Note **1.E.**, Federal Taxes Receivable, Net and Note **1.J.**, Due to General Fund of the U.S. Government. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the IRS acting on behalf of the federal government. There is, however, a significant difference in the collection potential of these categories.

The components of the total unpaid assessments and derivation of net Federal taxes receivable were as follows:

(In Billions)		**2021**		**2020**
Total unpaid assessments	$	658	$	596
Compliance assessments		(80)		(74)
Write-offs		(85)		(95)
Gross federal taxes receivables		493		427
Allowance for uncollectible taxes receivable		(191)		(191)
Federal taxes receivable, net	**$**	**302**	**$**	**236**

The total unpaid assessments as of September 30, 2021, increased $62 billion since September 30, 2020, due primarily to the net effect of the increase in Social Security Tax Deferral and decrease in IRC Section 965(h). Total unpaid assessments include $249 billion of non delinquent taxes receivable, including $143 billion in IRC Section 965(h) tax, which is collectible based on the type of taxpayer and the financial help of large dollar businesses. The nondelinquent IRC Section 965(h) component refers to taxpayers who elected to pay their IRC Section 965(h) tax on an eight-year installment schedule. The remaining balance is Social Security Tax Deferral. The Social Security Tax Deferral is from the CARES Act, Section 2302 which contains a provision for employers to defer the employer's share of the Social Security portion of FICA, and the employer's and employee representative's share of the Railroad Retirement tax (See Note **1.E.**). The deferred amount is due by December 31, 2022 (See Note **5**). The $62 billion increase in total unpaid assessments comes from the $66 billion increase in gross taxes receivables, offset by a net decrease in write-offs and compliance assessments. The $66 billion increase in net taxes receivables is largely due to the net result of an $83 billion increase in Social Security Tax Deferral and a $25 billion reduction in IRC Section 965(h), from receipt of scheduled tax payments.

To eliminate double counting, the compliance assessments reported above exclude duplicated trust fund recovery penalties assessed against officers and directors of businesses involved in the non-remittance of federal taxes withheld from their employees. These penalties totaled approximately $1.2 and $1.4 billion as of September 30, 2021 and 2020, respectively. The related unpaid assessments of those businesses are reported as taxes receivable or write-offs, but the IRS may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom a trust fund recovery penalty is assessed.

In FY 2021, the IRS cannot reasonably estimate the allowance for uncollectible amounts pertaining to the value of pre-assessment work in process. The IRS was not able to incorporate new pandemic economic conditions into its econometric model to determine the net realizable value of compliance assessments. In accordance with standards, this does not include the compliance assessments amount in its taxes receivable.

OTHER INFORMATION

IRS

SECTION A: REFUNDABLE TAX CREDITS AND OTHER OUTLAYS

Unaudited, See Accompanying Auditor's Report

Refundable Tax Credits

To offer tax relief to targeted individuals and businesses, Congress has provided assistance in the form of tax credits. For the majority of tax credits, the economic benefit is limited to the taxpayer's tax liability. Credits limited in this manner are termed non-refundable credits. Refundable credits, in contrast, are fully payable to the taxpayer, even if the credit exceeds the tax liability. These types of credits provide greater economic benefits because the taxpayer realizes the full amount of the credit, regardless of the underlying tax liability.

The following overview summarizes the refundable credits the IRS administers and pays. This overview describes refundable credits in existence for many years, and those created more recently by Congress, including those enacted as part of the American Recovery and Reinvestment Act of 2009 (ARRA), PPACA, CARES Act, FFCRA, CRRSAA, and ARP.

Additional Child Tax Credit

ACTC is a special credit for taxpayers who work, have earnings below an established ceiling, and have a qualifying child. The CTC is limited to the taxpayer's tax liability and is a nonrefundable tax credit. Certain individuals who receive less than the full amount of the CTC may qualify for the "Additional" CTC. Under this credit, subject to additional criteria, the taxpayer may receive the full credit amount even if such amount exceeds the taxpayer's tax liability. Consequently, the ACTC is categorized as a refundable tax credit. Under ARP, the AdvCTC provision increases the child tax credit from $2,000 to $3,000 only for the 2021 tax year. In the case of a qualifying child who has not attained the age of six as of the close of the calendar year, the credit is increased to $3,600. In addition, the term "qualifying child" was broadened to include a qualifying child who had not attained the age of 18.

Earned Income Tax Credit

The EITC is a refundable tax credit for low to moderate income working individuals and families. Congress originally approved the tax credit legislation in 1975, in part, to offset the burden of social security taxes and to provide an incentive to work. To qualify, taxpayers must meet certain requirements and file a tax return, even if they did not have sufficient income to meet regular tax return filing requirements.

Premium Tax Credit

Starting January 1, 2014, persons who purchase health insurance coverage through the Health Insurance Marketplace may be eligible for the PTC. In general, a person is eligible for the credit if they (a) buy health insurance through the Marketplace, (b) are ineligible for coverage through an employer or government plan, (c) are within certain income limits, (d) do not file a Married Filing Separately tax return (unless they meet specific criteria that allow certain victims of domestic abuse to claim the PTC using the Married Filing Separately filing status), and (e) cannot be claimed as a dependent by another person.

Eligible individuals may elect to have some, or all of their estimated credit paid in advance directly to their insurance company to lower the amount they must pay out-of-pocket for their monthly premiums or they may elect to receive all of the credit when they file their tax return. Each person who receives the benefit of a credit advance or who wishes to claim the credit must file an income tax return.

Sick & Paid Family Leave, Employee Retention Tax Credit, and Consolidated Omnibus Budget Reconciliation Act

Sick and Paid Family Leave credit was created by the FFCRA Section 7001-7004, CRRSAA and ARP. The credit allows employers a payroll credit on the qualified sick leave and family leave wages paid in the calendar quarter, limited to ten sick days and $200 leave wages per day. In addition, the family leave wages paid is limited to $10,000. The credit is available to employers with fewer than 500 employees. Sick and Paid Family Leave was extended by CRRSAA until March 31, 2021. The ARP tax credits extended to eligible employers sick and family leave pay from April 1, 2021 through September 30, 2021. The tax credit for paid sick leave wages is equal to the sick leave wages paid for COVID-19 related reasons for up to two weeks (80 hours), limited to $511 per day and $5,110 in the aggregate, at 100% of the employee's regular rate of pay. The tax credit for paid family leave wages is equal to the family leave wages paid for up to 12 weeks, limited to $200 per day and $12,000 in the aggregate, at two thirds of the employee's regular rate of pay.

ERC was created by CARES Act, Section 2301, CRRSAA and ARP. The provision provides a refundable payroll tax credit for 50% of wages (up to $10,000) paid by employers to employees during the COVID-19 pandemic. The credit is available to employers whose (1) operations were fully or partially suspended due to a COVID-19 related shut-down order or (2) gross receipts declined by more than 50% when compared to the same quarter in the prior year. CRRSAA extended through the first two quarters of 2021 with the credit increased to 70% of wages limited to $10,000 paid in any calendar quarter and a maximum to $7,000 paid per quarter to any employee. Under ARP, it was extended through the fourth quarter of 2021, and the credit continues to be capped at $7,000 per quarter for wages paid. However, the ARP adds a separate $50,000 maximum aggregate credit per quarter for Recovery Startup Business.

ARP, Section 9501, requires certain employers to offer free Consolidated Omnibus Reconciliation Act (COBRA) coverage to qualified individuals between April 1, 2021 and September 30, 2021. Also, ARP provides tax credits to employers to offset the cost of the COBRA coverage. The right to free COBRA coverage extends to some individuals whose right to COBRA coverage previously ended. The bill subsidizes 100% of COBRA premiums for six months for individuals who lost employment or had reduced hours.

Corporate Alternative Minimum Tax Credit

IRC Section 168(k)(4) allows a taxpayer to elect to claim a refundable credit for certain unused research credits in lieu of the special depreciation allowance for eligible property.

American Opportunity Tax Credit

The American Opportunity Tax Credit replaces the Hope Credit. The credit was made permanent by the Protecting Americans Against Tax Hikes Act of 2015. This tax credit makes the Hope Credit available to a broader range of taxpayers, including many with higher incomes and those who owe no tax. Additionally, it adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four post-secondary education years instead of two. Many of those eligible will qualify for the maximum annual credit of $2,500 per student.

Build America and Recovery Zone Bonds

Build America Bonds (BABs) are a financing tool for state and local governments. The bonds, which allow a new direct federal payment subsidy, are taxable bonds issued by state and local governments to give them access to the conventional corporate debt markets. At the election of the state and local governments, Treasury will make a direct payment to the state or local governmental issuer in an amount equal to 35% of the interest payment on the BABs. This federal subsidy payment provides state and local governments lower net borrowing costs and allows them to reach more sources of borrowing than they can with more traditional tax-exempt or tax credit bonds.

Created by the ARRA, Recovery Zone Bonds are targeted to areas particularly affected by job losses and help local governments obtain financing for much needed economic development projects, such as public infrastructure development.

Qualified Zone Academy Bonds and Qualified School Construction Bonds

Congress created Qualified Zone Academy Bonds and Qualified School Construction Bonds to help schools raise funds to renovate and repair buildings, invest in equipment and current technology, develop more challenging curricula, and train teachers. The tax credit portion of these bonds depends on the issuance date of the bonds, the number of bonds outstanding, and the time remaining until their redemption.

Qualified Energy Conservation Bonds and New Clean Renewable Energy Bonds

Qualified Energy Conservation Bonds (QECB) may be issued by state, local, and tribal governments to finance qualified energy conservation projects. A minimum of 70% of a state's allocation must be used for governmental purposes, and the remainder may be used to finance private activity projects. QECBs were originally structured as tax credit bonds. However, the March 2010 Hiring Incentives to Restore Employment (HIRE) Act (H.R. 2847 (Section 301)) changed QECB from tax credit bonds to direct subsidy bonds similar to BABs. The QECB issuer pays the investor a taxable coupon and receives a rebate from Treasury.

New Clean Renewable Energy Bonds (CREBs) may be issued by public power utilities, electric cooperatives, government entities (states, cities, counties, territories, Indian tribal governments), and certain lenders to finance renewable energy projects. CREBs were originally structured as tax credit bonds. The HIRE Act changed CREBs from tax credit bonds to direct subsidy bonds similar to BABs. The issuer pays the investor a taxable coupon and receives a rebate from Treasury.

Health Coverage Tax Credit

The federal Health Coverage Tax Credit (HCTC) was created by the Trade Act of 2002 to help certain displaced workers and certain retirees pay for health insurance. Those eligible to claim the credit fall into one of two categories: 1) trade-impacted workers who have lost their jobs because of increased imports or a shift in production to another country and are classified as Trade Adjustment Assistance or Alternative Trade Adjustment Assistance and, 2) individuals whose pensions are being paid by the Pension Benefit Guaranty Corporation (PBGC), are at least 55 years of age and not entitled to Medicare.

The HCTC, authorized in the Trade Adjustment Assistance Reform Act of 2002, first became effective for coverage months beginning after August 6, 2002. The tax credit later expired for coverage months after 2013. The Trade Adjustment Assistance Reauthorization Act of 2015 restored the HCTC retroactively for 2014 coverage, erasing the hiatus in its duration, and extended it for coverage through the end of 2019. On December 20, 2019, Congress passed H.R. 1865, Further Consolidated Appropriations Act of 2020, which included an extension of the HCTC program through December 31, 2020. HCTC legislation was extended again, through December 31, 2021, under the Relief Act of 2020, Section 134.

Eligible participants are responsible for paying 27.5% of their insurance premium while the IRS is responsible for paying the remaining 72.5%.

The HCTC Monthly Program is only available to individuals who are determined eligible by the DOL or PBGC, enrolled in qualified health coverage, and have an approved HCTC monthly vendor. These vendors are Health Plan Administrators or Third-Party Administrators who are willing to provide direct deposit information in order to accept health insurance premiums on their member’s behalf.

Payments for Disaster Related Tax Relief

On September 29, 2017, the President of the United States of America signed into law H.R. 3823, known as the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (the Act), which provides a series of relief measures for zones and areas affected by hurricanes Harvey, Irma, and Maria, among other matters. Pursuant to Section 504(d)(1) of the Act, the Secretary of the Treasury shall pay to Virgin Islands and Puerto Rico amounts estimated by the Secretary of the Treasury as being equal to the aggregate benefits that would have been provided to residents of Virgin Islands and Puerto Rico by reason of the provisions of Title V of the Act if a mirror code tax system had been in effect in Virgin Islands and Puerto Rico.

Other Outlays

Economic Impact Payments and Recovery Rebate

CARES Act, CRRSAA and ARP included provisions to help stimulate the economy through EIPs and/or recovery rebate credits. The CARES Act created an economic impact payment that allowed for individuals with adjusted gross income (AGI) up to $75,000 ($150,000 joint return), who are not a dependent of another taxpayer and have a work eligible social security number, are eligible for a $1,200 ($2,400 joint return) rebate. In addition, they are eligible for up to an additional $500 per eligible child. For filers with income above those amounts, the payment amount is reduced by 5% of the amount that their AGI exceeds the $75,000/$150,000 thresholds. CRRSAA created a second EIP of up to $600 for individuals and $1,200 for individuals filing a joint tax return, with up to an additional $600 for each eligible child. The payment amount is reduced by 5% of the amount their AGI exceeds the $75,000 (single file)/$150,000 (joint return) thresholds. Additionally, ARP created a third EIP of up to $1,400 for individuals and $2,800 for individuals filing a joint tax return, with up to an additional $1,400 for each qualifying dependent. The payment amount is phased out where their AGI exceeds the $75,000 (single filer)/$150,000 (joint return) thresholds. Taxpayers will not receive a third payment if their AGI exceeds

$80,000 (single filer)/$160,000 (joint return). Social Security recipients and railroad retirees who are otherwise not required to file a tax return are also eligible and will not be required to file a return.

Pursuant to CARES Act and CRRSAA, the IRS used its permanent and indefinite authority to pay recovery rebates for individuals, referred to as EIPs. These Acts authorized the IRS to allow for a tax credit (or rebate) to individuals against their 2020 income taxes.

Basic Health Program

Section 1331 of the PPACA gives states the option of creating a health benefits coverage program for low-income residents who would otherwise be eligible to purchase coverage through the Health Insurance Marketplace. The BHP gives states the ability to provide more affordable coverage for these low-income residents and improve continuity of care for people whose income fluctuates above and below Medicaid and Children's Health Insurance Program levels. These subsidies, which are federal government outlays, are not tax credits and are not reported on the recipient's income tax return. In addition, the Cost Sharing Reduction (CSR) portion of the BHP was terminated, and no further quarterly payments were disbursed in FY 2018.

Interest on Tax Refunds

The IRS pays interest on refunds sent later than 45 days from the original filing deadline (April 15, 2021) of the return. Additionally, interest is generally paid on amended returns that result in a refund. Returns that have been examined and show an overpayment also result in the payment of interest. The interest rate on overpayments is adjusted quarterly.

State Innovation Waiver Program

Starting January 1, 2017, the states can apply for a waiver under Section 1332 of the PPACA. The waivers will enable the states to implement innovative ways for providing access to quality health care to their residents. The coverage must be at least as comprehensive and affordable as would be provided absent the waiver. In addition, the states must extend coverage to a comparable number of residents as would be provided coverage absent a waiver and must not increase the federal deficit. Pass through funding is the foundation of the waivers, which will grant the states the equivalent of the forgone financial assistance they otherwise would receive absent the waiver, such as the PTC (IRC Section 36B), and the Small Business Health Tax Credit (IRC Section 45R).

Cost Sharing Reduction

In addition to the premium tax credit, individuals who purchased a qualified health care plan through the Marketplace could qualify for CSR based on their family income. This lowered the amount they had to pay for out-of-pocket costs such as deductibles, coinsurance, and copayments. In FY 2018, based upon an Attorney General legal opinion, HHS discontinued the CSR program. The IRS activity only reflects the recovery amounts from insurance companies CMS has collected.

Payments of refundable tax credits in excess of tax liabilities and other outlays in FY 2021 and FY 2020 are shown below.

(In Millions)	2021	2020
Economic Impact Payments and Recovery Rebate	$ 569,508	$ 274,654
Additional Child Tax Credit	78,959	27,779
Earned Income Tax Credit	60,757	57,577
Premium Tax Credit*	56,428	44,554
Sick & Paid Family Leave, Employee Retention Tax Credit, and Consolidated Omnibus Budget Reconciliation Act	10,143	714
Corporate Alternative Minimum Tax Credit	9,160	16,104
Basic Health Program	6,928	6,303
American Opportunity Tax Credit	3,967	2,787
Interest On Tax Refunds	3,033	2,957
Build America and Recovery Zone Bonds	3,012	2,075
State Innovation Waiver Program	1,296	605
Qualified School Construction Bonds	797	462
New Clean Renewable Energy Bonds	57	31
Qualified Zone Academy Bonds	54	34
Qualified Energy Conservation Bonds	43	27
Health Care Tax Credit	23	13
Payments For Disaster Related Tax Relief	-	61
Cost Sharing Reduction**	(19)	(3)
Refundable Tax Credits and Other Outlays	**$ 804,146**	**$ 436,734**

*Includes advanced amounts for the PTC. Beginning in FY 2015, preliminary outlay amounts are adjusted upward or downward based on information from tax returns. In FY 2021 and FY 2020, total PTC advances disbursed by the Center for Medicare and Medicaid Services totaled $58,160 and $52,516, respectively. The FY 2021 and FY 2020 advanced amounts were adjusted downward based on tax return information.
**Negative amount represents funds CMS recovered from insurance companies.

Social Security and Medicare Taxes

The FICA provides for a federal system of old-age, survivors, disability, and hospital insurance benefits. Payments to trust funds established for these programs are financed by payroll taxes on employee wages and tips, employers' matching payments, and a tax on self-employment income.

A portion of FICA benefits involves old-age, survivors, and disability payments. These benefits are funded by the social security tax, which is 12.4% for calendar year 2021. Employees currently pay 6.2% on wages and tips up to $142,800, and an employer matching amount of 6.2%. In calendar year 2020, the rate was 12.4%, but on wages and tips up to $137,700. These benefits are also funded by a self-employment tax of 12.4% on self-employment income up to $142,800 and $137,700, for calendar years 2021 and 2020, respectively. Remaining benefits under FICA pertain to hospital benefits (referred to as Medicare) and are funded by a separate 1.45% tax on all wages and tips (there is no wage limit) and the employer matching contribution of 1.45%, for a total of 2.9%. Self-employed individuals pay a Medicare tax of 2.9% on all self-employment income. Beginning in 2013, an additional Medicare tax of 0.9% was collected on earned individual income of more than $200,000 and $250,000 for married couples filing jointly. Social security taxes collected by the IRS were approximately $964 and $973 billion in FY 2021 and FY 2020, respectively. Medicare taxes collected by the IRS were approximately $296 and $294 billion in FY 2021 and FY 2020, respectively. Social security taxes and Medicare taxes are included in the Individual income, FICA/SECA, and other financial statement line on the SCA. Additionally, the CARES Act deferred the employer's share of the Social Security portion of FICA. (See Note **1.E.** and Note **5**.)

Tax Expenditures

The *Congressional Budget and Impoundment Control Act of 1974* (Public Law 93-344) defines tax expenditures as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Tax expenditures are the foregone federal revenue resulting from deductions and credits provided in the IRC. Since tax expenditures directly affect funds available for government operations, decisions to forego federal revenue are as important as decisions to spend federal revenue.

While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly approved and authorized by Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

In accordance with SFFAS 52, Tax Expenditures, narrative disclosures and information regarding tax expenditures are reported in the consolidated Financial Report of the U.S. Government. Such disclosures do not apply to the financial statements of component reporting entities such as the IRS. Tax expenditures also do not affect the reporting in the Budget of the U.S. Government or any other special purpose report.

Tax Gap and Tax Burden

Tax Gap

The gross tax gap is the amount of true tax liability for a given tax year not paid voluntarily and/or timely. The IRS develops tax gap estimates on a periodic basis. In September 2019, the IRS issued tax gap estimates for the TY 2011-2013 timeframe. Like the TY 2008-2010 tax gap estimates, these estimates reflect an average compliance rate and average annual tax gap for a timeframe of three years. This approach was selected as it provides more reliable tax gap estimates by category and source of noncompliance. The estimated average annual gross tax gap for the TY 2011-2013 timeframe is $441 billion.

There are three primary sources of noncompliance:

1. Nonfiling tax gap (the tax not paid on time by those who do not file required returns on time).
2. Underreporting tax gap (the net understatement of tax on timely filed returns).
3. Underpayment tax gap (the amount of tax reported on timely filed returns not paid on time).

The estimated gross tax gap of each of these components is $39 billion for nonfiling, $352 billion for underreporting, and $50 billion for underpayments. Additionally, the gross tax gap can be grouped by type of tax, as follows:

- $314 billion for individual income tax.
- $42 billion for corporation income tax.
- $81 billion for employment tax.
- $3 billion for combined estate and excise tax.

(The estimates of the component breakouts do not add to the $441 billion total due to rounding.)

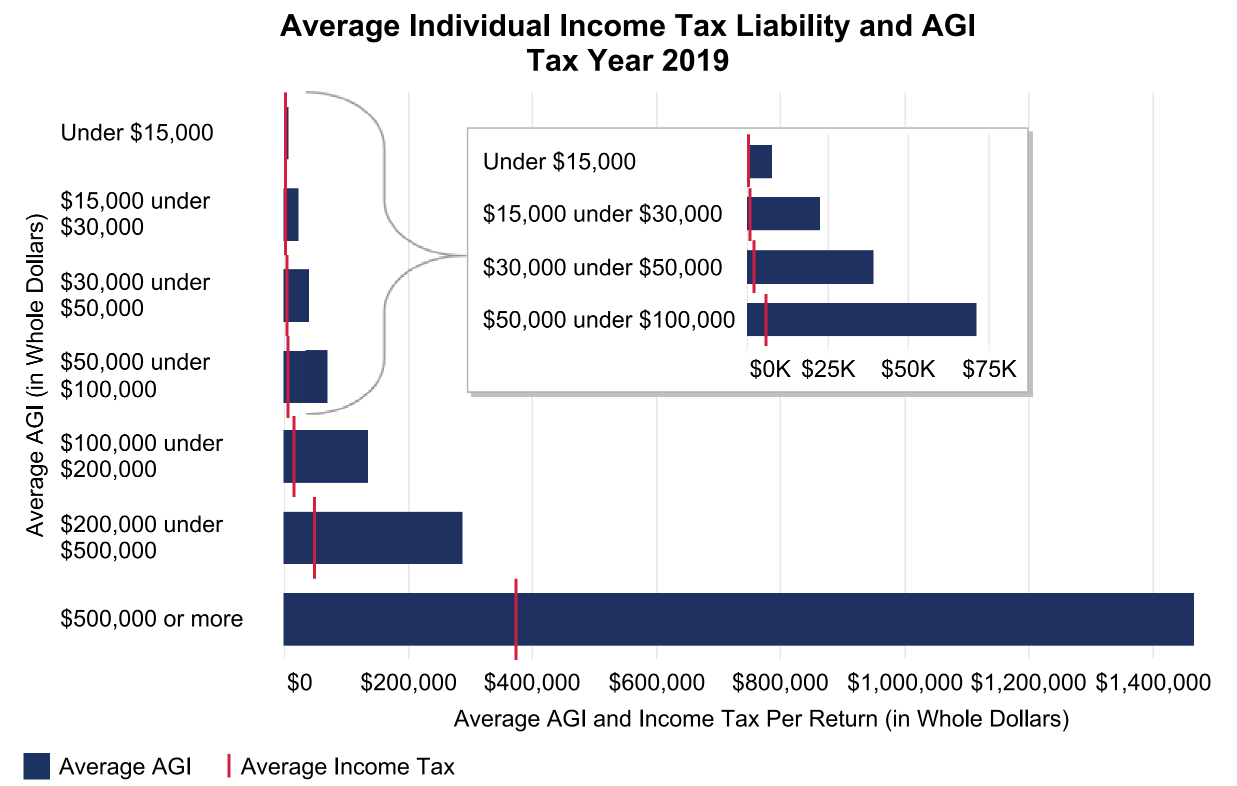
The net tax gap is the gross tax gap less tax subsequently paid either voluntarily paid late or collected through IRS administrative and enforcement activities. As a result, the net tax gap is the portion of the gross tax gap that will not be paid. The portion of gross tax gap that is estimated to be eventually collected is $60 billion, resulting in a net tax gap of $381 billion. The estimated net tax gap by type of tax is:

- $271 billion for individual income tax.
- $32 billion for corporation income tax.
- $77 billion for employment tax.
- $1 billion for combined estate and excise tax.

Tax Burden

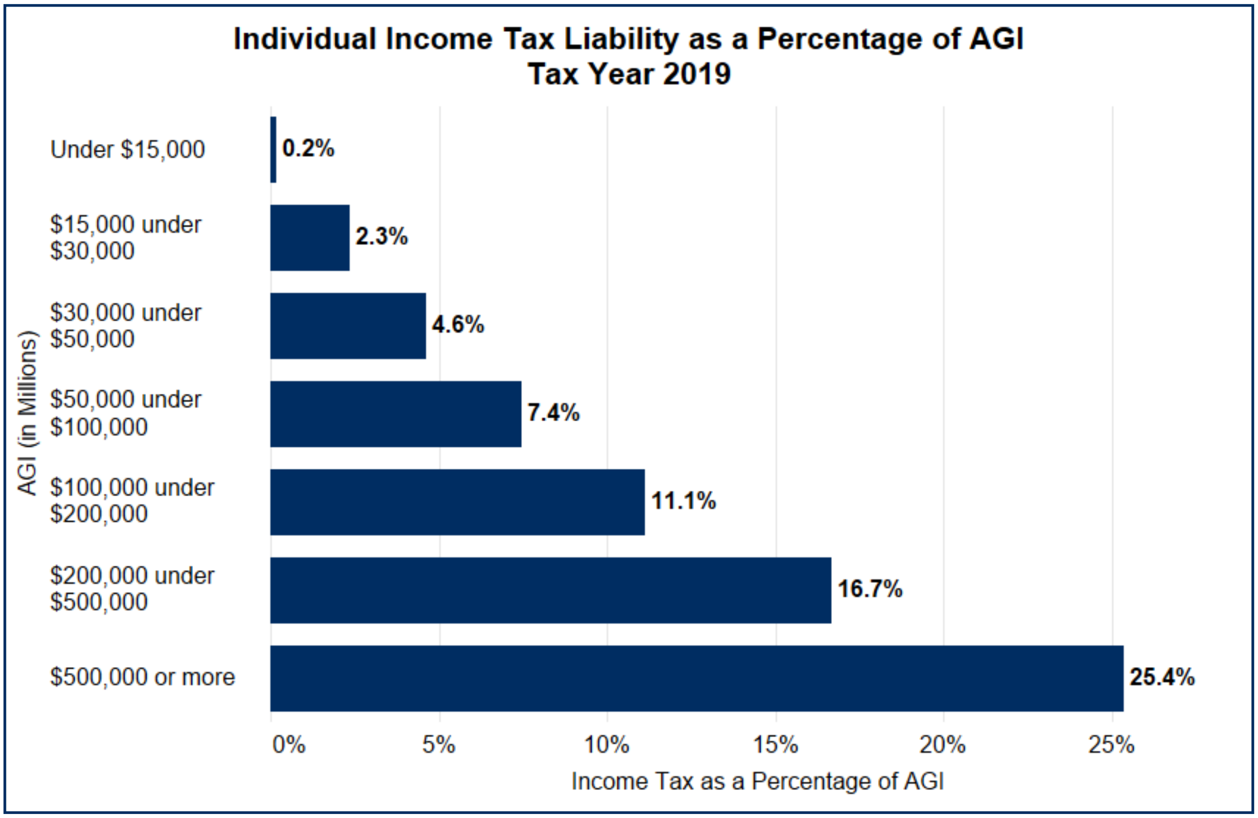
The IRC provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The following pages present in both graph and table format various income levels and tax liability levels reported by individuals and corporations (that is, these amounts do not account for tax burdens that taxpayers do not report on their returns). This information is the most recent available for individuals (tax year 2019) and corporations (tax year 2018). The graphs and charts are representative of more detailed data and analyses available from the IRS Statistics of Income Office.

For individuals, the information illustrates, in both percentage and dollar terms, the tax burden that taxpayers bear by varying levels of AGI. The corporate information illustrates, for varying corporate asset categories, the tax burden borne by these entities as a percentage of taxable income.

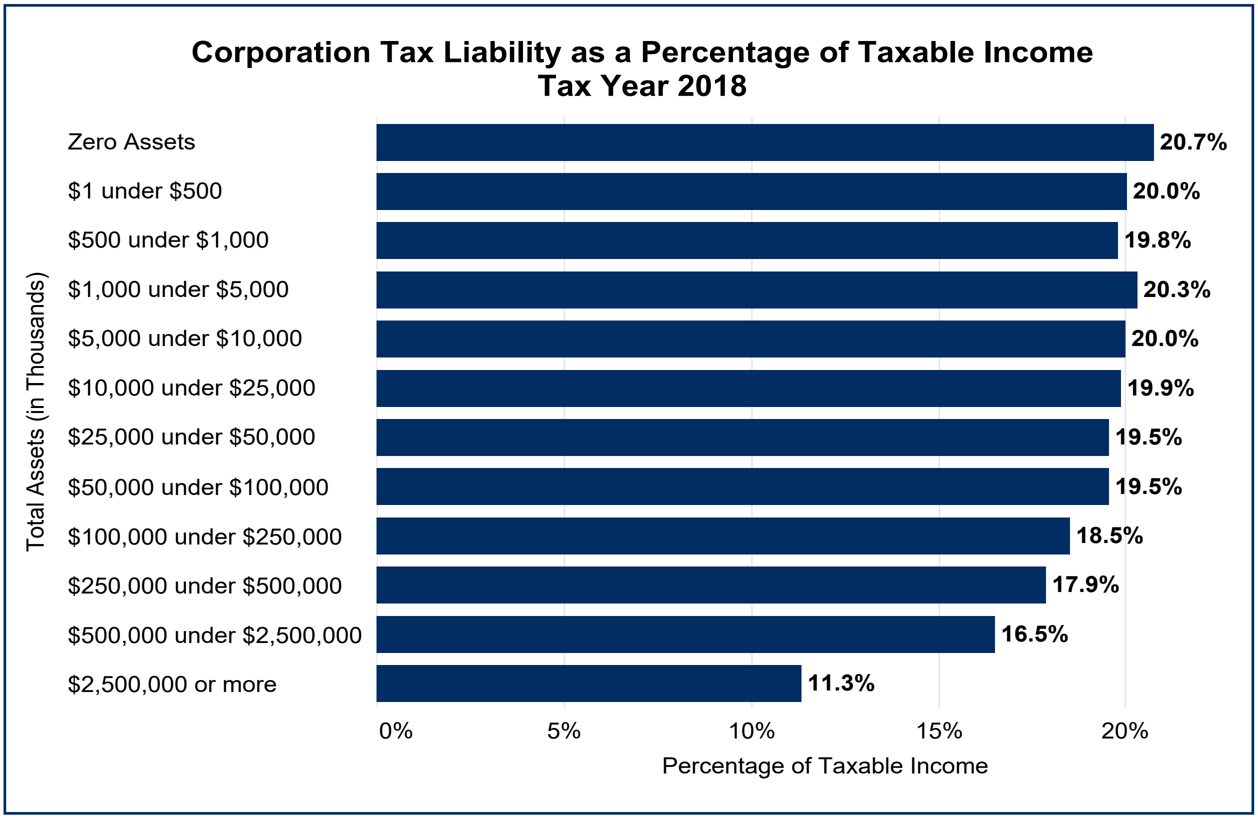


AGI	Number of Taxable Returns (In Thousands)	AGI (In Millions)	Total Income Tax (In Millions	Average AGI Per Return (In Whole Dollars)	Average Income Tax Per Return (In Whole Dollars)	Income Tax as a Percentage of AGI
Under $15,000	30,881	$ 237,255	$ 391	$ 7,683	$ 13	0.2%
$15,000 under $30,000	28,823	643,794	15,069	22,336	523	2.3%
$30,000 under $50,000	28,594	1,120,332	51,692	39,181	1,808	4.6%
$50,000 under $100,000	36,357	2,589,840	192,888	71,234	5,305	7.4%
$100,000 under $200,000	21,998	3,004,364	333,838	136,574	15,176	11.1%
$200,000 under $500,000	7,298	2,090,809	348,843	286,491	47,800	16.7%
$500,000 or more	1,719	2,517,544	638,389	1,464,540	371,372	25.4%
Totals	**155,670**	**$12,203,938**	**$1,581,110**			

(All figures are estimates and based on sampling provided by the IRS Statistics of Income Office. All negative AGI under $15,000 are treated as zero-dollar amounts.)



(All figures are estimates and based on sampling provided by the IRS Statistics of Income Office. All negative AGI under $15,000 are treated as zero-dollar amount.)



Total Assets (In Thousands)	Income Subject To Tax (In Millions)	Total Income Tax After Credits (In Millions)	Percentage of Income Tax After Credits To Taxable Income
Zero Assets	$ 55,884	$ 11,595	20.7%
$1 under $500	7,829	1,569	20.0%
$500 under $1,000	4,829	956	19.8%
$1,000 under $5,000	17,223	3,496	20.3%
$5,000 under $10,000	10,086	2,016	20.0%
$10,000 under $25,000	19,143	3,805	19.9%
$25,000 under $50,000	14,385	2,812	19.5%
$50,000 under $100,000	16,854	3,294	19.5%
$100,000 under $250,000	25,808	4,773	18.5%
$250,000 under $500,000	26,192	4,679	17.9%
$500,000 under $2,500,000	126,275	20,836	16.5%
$2,500,000 or more	1,632,171	184,856	11.3%
Totals	**$ 1,956,679**	**$ 244,687**	

(All figures are estimates and based on sampling provided by the IRS Statistics of Income Office.)

SECTION B: MANAGEMENT CHALLENGES AND IRS RESPONSE

Treasury Inspector General for Tax Administration Memorandum on Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2022.

INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20005

October 14, 2021

MEMORANDUM FOR SECRETARY YELLEN

FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2022

The Reports Consolidation Act of 2000[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the annual *Department of the Treasury Agency Financial Report*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the most vulnerable areas in the Nation's tax system. For Fiscal Year (FY) 2022, the IRS's top management and performance challenges, in order of priority, are:

1. Administration of Tax Law Changes and Pandemic Relief Benefits;
2. Enhancing Security of Taxpayer Data and Protection of IRS Resources;
3. Improving Tax Reporting and Payment Compliance to Reduce the Tax Gap;
4. Modernizing IRS Operations;
5. Improving Customer Service and the Taxpayer Experience;
6. Addressing Emerging Threats to Tax Administration;
7. Reducing Fraudulent Claims and Improper Payments;
8. Increasing International Tax Compliance;
9. Protecting Taxpayer Rights; and
10. Human Capital.

The following information detailing the management and performance challenges is being provided to promote the economy, efficiency, and effectiveness of the IRS's administration of the Nation's tax laws.

[1] 31 U.S.C. § 3516(d) (2006).

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ADMINISTRATION OF TAX LAW CHANGES AND PANDEMIC RELIEF BENEFITS

The IRS's operations were significantly impacted by the Coronavirus Disease 2019 (COVID-19) pandemic. Although the Tax Processing Centers were open for the 2021 Filing Season, the IRS was not always able to operate at full capacity due to social distancing requirements. As such, the IRS was unable to perform many of its essential functions. The backlog of individual tax returns and other types of taxpayer account work nearly doubled when compared to the 2020 Filing Season. For example, as of August 16, 2021, the IRS reported having approximately 11 million paper tax returns waiting to be processed and approximately 9.6 million cases in other key tax processing functions that still needed to be addressed. At about the same time in 2020, the IRS reported having more than 4.8 million tax returns waiting to be processed and about 5.4 million cases in other key tax processing functions that still needed to be addressed. The backlog of returns, correspondence, and other types of work has, and will continue to have, a significant impact on the associated taxpayers.

The pandemic also resulted in numerous legislative changes that impacted tax administration. Most recently, the American Rescue Plan Act of 2021 (ARP),[2] enacted on March 11, 2021, includes approximately $1.9 trillion in economic relief and stimulus to address the continuing impact of the COVID-19 pandemic on the economy, public health, State and local governments, individuals, and businesses. It also contains numerous tax-related provisions intended to provide relief to individuals and businesses. This legislation creates a third Recovery Rebate Credit (RRC) of up to $1,400 per eligible individual to be applied toward income earned during Tax Year (TY) 2021. The legislation directs the IRS to make advance payments of the RRC as soon as possible, but not later than December 31, 2021. The IRS began issuing the RRC payments on March 11, 2021, the same day the ARP Act was enacted. As of June 3, 2021, the IRS reports issuing more than 163 million advance payments totaling nearly $390 billion for the third round of the RRC.

Another key provision in the ARP Act is the expanded Child Tax Credit. Determining eligibility for, and the amount of, the Child Tax Credit is a complex process. Available tax data may reflect children who qualify for the credit in prior tax years but do not qualify in the current tax year. The IRS will have to continually adjust the Child Tax Credit advance payments as updated information is obtained from taxpayers.

A number of the provisions contained in pandemic legislation required the IRS to take steps to implement such legislation while in the midst of its 2020 and 2021 annual tax filing seasons. The tax filing season is a critical time for the IRS because this is when most individuals file their income tax returns and contact the IRS if they have questions about specific tax laws or filing procedures. The extensive actions the IRS must undertake to implement tax legislation will continue to be challenging when tax law changes are enacted close to, or after, the start of the annual filing season. Additional legislative developments related to tax reform and tax policy will continue to present challenges for the IRS.

[2] Pub. L. No. 117-2, 135 Stat. 4.

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ENHANCING SECURITY OF TAXPAYER DATA AND PROTECTION OF IRS RESOURCES

The IRS is responsible for safeguarding a vast amount of sensitive financial and personal data. IRS systems withstand approximately 1.4 billion cyberattacks annually (including denial-of-service attacks, unsuccessful intrusion attempts, probes or scans, and other unauthorized connectivity attempts). Many of these attempts are sophisticated in nature or represent advanced, persistent threats.[3]

On July 1, 2019, Congress enacted the Taxpayer First Act[4] and amended the Internal Revenue Code to give the IRS the authority to disclose certain return information for the purpose of cybersecurity and the prevention of identity theft tax refund fraud. The IRS decided to leverage the Security Summit[5] to disclose return information related to refund fraud schemes to State tax agencies and industry partners. However, TIGTA reported that additional policies, procedures, and actions are needed to improve the effectiveness of security over the sharing and storing of the data.[6] In addition, opportunities exist to enhance controls and ensure consistency in applying policies for accessing the shared data.

Further, the Taxpayer First Act contained provisions to modernize the IRS's Income Verification Express Service (IVES) program[7] and increase taxpayer protections. However, TIGTA found that some key processes are not operating as intended to ensure that taxpayers authorize the release of their tax transcripts.[8] IVES program management did not conduct compliance reviews in FY 2019 to ensure that participants completed the required client certifications. These certifications are important because they validate the identity of clients that ultimately receive the transcripts. The IRS also did not conduct sufficient suitability checks on 577 IVES participants that were "grandfathered" into the program in February 2016 when management implemented the suitability checks.

Additionally, the IRS continues to digitize many of the previously paper processes, which generates targets of opportunity for malicious actors around the globe. Each new system created, while potentially improving the experience of the taxpayer, also enables new ways to subvert, misuse, manipulate, and disrupt the IRS's ability to administer the Federal tax system. Numerous Government agencies also rely on tax information to

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[3] Written testimony of Charles Rettig, Commissioner, Internal Revenue Service, *On the IRS Budget and Current Operations,* Senate Appropriations Committee, Subcommittee on Financial Services and General Government (May 15, 2019).
[4] Pub. L. No. 116-25, 133 Stat. 981 (2019).
[5] The IRS formed the Security Summit with representatives from State Departments of Revenue, the Chief Executive Officers of leading tax preparation firms, software developers, and payroll and tax financial product processors. The Security Summit's primary mission is to assist in the fight against the filing of fraudulent tax returns and protect taxpayers from identity theft tax refund fraud.
[6] TIGTA, Report No. 2021-25-025, *Taxpayer First Act: Data Security in the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center* (May 2021).
[7] Once accepted in the IVES Program, participants such as banks and financial institutions can submit requests, on behalf of their clients, to obtain tax transcripts for individuals and businesses.
[8] TIGTA, Report No. 2021-45-017, *Additional Security Processes Are Needed to Prevent Unauthorized Release of Tax Information Through the Income Verification Express Service Program* (Feb. 2021).

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administer public benefits, which sets the stage for downstream effects on other Government benefit programs when IRS systems are successfully exploited.

In June 2021, Pro Publica released data it claimed to be from the tax returns of thousands of individuals, covering more than 15 years. The protection of taxpayer data will continue to be a top priority for the IRS as it tries to leverage technology to be responsive to taxpayers' needs for its services, while minimizing the risks from cyberattacks and insider threats.

IMPROVING TAX REPORTING AND PAYMENT COMPLIANCE TO REDUCE THE TAX GAP

One of the IRS's key responsibilities is to ensure that taxpayers comply with the tax law. Sustaining and improving taxpayer compliance is important because small declines in compliance cost the Nation billions of dollars in lost revenue and shift the tax burden away from those who do not pay their taxes onto those who pay their taxes on time every year.

According to the IRS, high-income nonfilers, although fewer in number, contribute to the majority of the nonfiler Tax Gap. High-income taxpayers generally have more opportunities to engage in planning to avoid taxes. In March 2021, TIGTA reported that the IRS could more effectively prioritize high-income taxpayers who owe delinquent taxes.[9] Specifically, TIGTA identified approximately 685,000 taxpayers with adjusted gross income of $200,000 or more that owed a combined total of $38.5 billion as of May 14, 2019. TIGTA also found that revenue officer staffing does not always align with locations where the greatest number of high-income cases are located. While TIGTA recognizes that resources are limited, hiring or reallocating resources to work high-income cases in these areas could lead to higher collection potential and increased revenue.

Prior to FY 2018, the IRS had a High Income High Wealth strategy focusing on high-income taxpayers whose total positive income was at least $200,000 on Form 1040, *U.S. Individual Income Tax Return*.[10] However, TIGTA reported that the majority (73 percent) of the individual returns closed using the strategy for FYs 2015 through 2017 had total positive income of less than $200,000.[11] After disbanding the High Income High Wealth strategy, the IRS focused instead on using the less productive Discriminant Function strategy[12] resulting in $121.5 million in potential lost assessments for FYs 2018 and 2019.

TIGTA also reported that for TY 2017 numerous business and individual nonfiler taxpayers with Form 1099-K, *Payment Card and Third Party Network Transactions*,

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[9] TIGTA, Report No. 2021-30-015, *High-Income Taxpayers Who Owe Delinquent Taxes Could Be More Effectively Prioritized* (Mar. 2021).

[10] Total positive income is the sum of all positive incomes shown for the various sources of income reported on the individual income tax return and, therefore, excludes losses.

[11] TIGTA, Report No. 2021-30-041, *The IRS Continued Compliance Efforts for High-Income Taxpayers After Disbanding the High Income High Wealth Strategy, but With Less Effective Outcomes* (July 2021).

[12] The Discriminant Function examination strategy contains returns selected based on algorithms. The results of the IRS's National Research Program strategy examinations are used to update the algorithms.

income were not identified and cases were not created by the IRS's nonfiler programs, and in other cases, they were identified but not worked by the IRS.[13] Specifically, TIGTA identified 314,586 business taxpayers with $335.5 billion in Form 1099-K income that appeared to have a filing obligation, but were not identified as nonfilers by the IRS.

Further, the growth of peer-to-peer payment applications has greatly enhanced the flow and transfer of funds between users on virtual platforms, making it easier and cheaper to send payments from one person to another. However, the technology presents additional tax compliance challenges in that the payments are not always reported to the IRS and can be hard to detect during an IRS examination.[14]

MODERNIZING IRS OPERATIONS

The IRS relies extensively on computerized systems to support its financial and mission-related operations. The IRS requested $305 million for the modernization effort in its FY 2022 budget request, an increase of $82 million or approximately 37 percent from the FY 2021 enacted budget. Successful modernization of systems and the development and implementation of new information technology applications are critical to meeting the IRS's evolving business needs and enhancing services provided to taxpayers. The reliance on legacy systems and its use of outdated programming languages pose significant risks to the IRS's ability to deliver its mission. Modernizing the IRS's computer systems has been a persistent challenge for many years and will likely remain a challenge for the foreseeable future.[15]

For example, the IRS uses more than 60 different legacy case management systems that widely vary in complexity, size, and customization to support tax administration. In January 2015, the IRS formally established the Enterprise Case Management (ECM) program to provide an enterprise solution to perform case management functions utilizing a Department of the Treasury Cloud platform, thus reducing long-term costs and increasing operational efficiency, innovation, and security. However, TIGTA reported that the ECM program has not finalized its agile development methodology.[16] The program is implementing a mixture of two different agile configurations and trying to strike a balance between implementing the recommended roles while minimizing unnecessary overhead. In addition, the benefits of the ECM program are defined in broad terms and will make it difficult for leadership to manage continuous implementation of processes over a long period of time, identify tradeoffs in competing priorities, and evaluate success.[17]

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[13] TIGTA, Report No. 2021-30-002, *Billions in Potential Taxes Went Unaddressed From Unfiled Returns and Underreported Income by Taxpayers That Received Form 1099-K Income* (Dec. 2020).
[14] TIGTA, Report No. 2021-30-022, *The Internal Revenue Service Faces Challenges in Addressing the Growth of Peer-to-Peer Payment Application Use* (Apr. 2021).
[15] TIGTA, Report No. 2021-20-001, *Annual Assessment of the Internal Revenue Service's Information Technology Program for Fiscal Year 2020* (Oct. 2020).
[16] IRS guidance characterizes agile development as having iterative product development and delivery. Regular testing intervals, customer involvement, and continuous product delivery allow for feedback throughout the development process.
[17] TIGTA, Report No. 2021-20-059, *Enterprise Case Management Deployed Its Initial Release, but Process Improvements Are Needed for Future Releases* (Sept. 2021).

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Ineffective security controls to protect IRS systems and data could have a significant effect on a broad array of Government operations and assets. Without effective security controls, computer systems are vulnerable to human errors or actions committed with malicious intent. Server virtualization[18] is now an established standard for enterprise information technology infrastructure in data centers and cloud services as it provides better utilization of hardware resources, reduces physical space required, and reduces power consumption and administrative overhead. As a result, the IRS concluded that its diverse and widely deployed server infrastructure would benefit from a consolidation and virtualization project. TIGTA reported that the IRS is performing security scans of the virtual host infrastructure platform.[19] However, the IRS inventory system does not accurately reflect all of the virtual host infrastructure platform servers. For example, virtual host servers were uncategorized and incorrectly recorded. Protecting critical assets and infrastructure helps reduce the risk of internal and external attacks on IRS assets that could potentially expose taxpayer data and information.

IMPROVING CUSTOMER SERVICE AND THE TAXPAYER EXPERIENCE

The 2021 Filing Season began later than normal, on February 12, 2021. The later start was needed to update the IRS's processing systems. On March 17, 2021, the Department of the Treasury extended the income tax filing due date to May 17, 2021. Backlogs of unprocessed tax returns and other types of tax account work that affected the previous filing season now continue into the 2021 Filing Season. The inability to timely address these backlogs will continue to have a significant impact on the associated taxpayers.

Contributing to the IRS's inability to address backlogs is the significant shortfall in its hiring of personnel needed for their Submission Processing functions as well as the closure of its Tax Processing Site in Fresno, California. The IRS also continues to take steps to protect the health and safety of its employees working in its Tax Processing Centers; as a result, it was not always able to operate at full capacity due to social distancing requirements. These requirements include limiting close contact with other employees and maintaining a physical distance of at least six feet in an effort to reduce the spread of COVID-19. Finally, while much of the IRS's workforce continues to telework, the work performed at the IRS's Tax Processing Centers is not conducive to a remote telework environment. This work includes receiving, sorting, and distributing of mail and processing of paper tax returns, which requires manually inputting information from tax returns into IRS systems, correcting errors, and corresponding with the taxpayer, when needed.

In an effort to restore customer service options to taxpayers the IRS accelerated the implementation of several new initiatives it had been testing and expanded the use of

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[18] Virtualization is the simulation of the software and hardware upon which other software runs. This simulated environment is called a virtual machine.
[19] TIGTA, Report No. 2021-20-024, *Improvements Are Needed for the Virtual Host Infrastructure Platform* (June 2021).

existing technologies and capabilities.[20] However, while the majority of customer service assistance options are now available to taxpayers, the previous closures are a contributing factor to increased demand on the IRS and its inability to provide quality customer service. For example, the IRS reported 321.4 million visits to IRS.gov for the 2020 Filing Season as of March 6, 2020. In comparison, as of March 5, 2021, the IRS reported 555.7 million visits to IRS.gov this filing season, which is an increase of 72.9 percent. However, as of March 5, 2021, the IRS only provided a 27.3 percent Level of Service on its toll-free customer service lines. In comparison to the same timeframe in March 2020, the IRS reported a 68 percent Level of Service.

The Taxpayer First Act included provisions for the IRS to develop a comprehensive customer service strategy to better serve taxpayers. In response, the IRS developed the taxpayer experience strategy. According to the Commissioner of Internal Revenue, the taxpayer experience strategy is designed to improve a taxpayer's experience with the IRS through expanded digital services, increased multilingual services, and an increased presence in hard-to-reach, historically underserved communities.[21] This law also requires the IRS to develop an organizational redesign strategy that prioritizes the taxpayer experience to ensure that taxpayers can easily and readily receive the help they need.

ADDRESSING EMERGING THREATS TO TAX ADMINISTRATION

Identity theft tax refund fraud involves the use of another person's name and Taxpayer Identification Number[22] to file a fraudulent tax return reporting false income and withholding in an effort to receive a fraudulent tax refund. The IRS recognized that the Economic Impact Payments (EIP) created a new risk for tax-related identity theft. In response, the IRS developed specific filters to identify potentially fraudulent filings. Once a return was identified as potentially fraudulent, it was sent to an IRS team for review. As of December 31, 2020, the IRS identified 528,388 questionable tax returns associated with the EIP for review and determined that 46,111 tax returns were fraudulent.

Illicit actors may also file false individual international tax returns in order to obtain refunds. TIGTA evaluated IRS processes to identify and prevent potentially fraudulent individual international tax returns and identified areas for improvement.[23] Specifically, the IRS does not have sufficient processes in place to identify potentially fraudulent individual international tax returns at the time these returns are filed. TIGTA's review of

[20] TIGTA, Report No. 2021-46-029, *Assessment of the Effects of the Coronavirus Pandemic on Customer Service Operations* (Apr. 2021).
[21] Written testimony of Charles Rettig, Commissioner, Internal Revenue Service, *The IRS's Fiscal Year 2022 Budget,* Senate Finance Committee (June 8, 2021).
[22] A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.
[23] TIGTA, Report No. 2021-40-057, *Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing* (Sept. 2021).

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TY 2018 tax returns identified 8,332 international tax returns with potentially erroneous or fraudulent refunds totaling nearly $20.6 million that were not identified by the IRS.

Identity theft not only affects individuals, it can also affect businesses. The IRS defines business identity theft as creating, using, or attempting to use businesses' information without authority to obtain tax benefits. The IRS continues to take actions to improve its detection of business identity theft, including expanding the number of identity theft filters from 35 in Processing Year 2018 to 84 in Processing Year 2020. However, continued expansion of detection capabilities, to include other business return types, is needed. For example, TIGTA found that 36 business return types with refunds issued totaling $10.5 billion in Processing Year 2019 were not evaluated for potential identity theft.[24]

Preventing refund fraud associated with prisoners' Social Security Numbers is also a challenge for tax administration. The IRS implemented corrective actions in response to concerns raised in a TIGTA report issued in July 2017.[25] However, in April 2021, TIGTA reported that the IRS could take additional actions to expand its participation in the Blue Bag Program, a program in which the IRS partners with the Federal Bureau of Prisons and State Departments of Corrections to identify potentially fraudulent tax returns and refunds.[26]

TIGTA works closely with the IRS to identify, investigate, and combat threats to tax administration. After passage of the Coronavirus Aid, Relief, and Economic Security Act (CARES),[27] TIGTA observed an increase in related illicit scams and schemes with various objectives, such as manipulation of IRS online applications, theft of EIPs, and efforts to steal sensitive taxpayer information. Because the IRS used the same distribution methodology for ARP Act payments as it did for CARES Act payments, TIGTA estimates that a similar amount of theft will occur.

TIGTA plays a key role in protecting IRS employees. Threats and assaults directed at IRS employees, facilities, and infrastructure impede the effective and safe administration of the Federal tax system and the IRS's ability to collect tax revenue. In the last several years, threats directed at the IRS have remained the second largest component of TIGTA's Office of Investigations' work. Recent incidents involving taxpayers who threatened or assaulted IRS employees underscore the dangers that these employees face.

REDUCING FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

The Office of Management and Budget describes an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an

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[24] TIGTA, Report No. 2021-40-004, *Refinement and Expansion of Filters to Include Additional Business Returns Will Continue to Improve Business Identity Theft Detection Efforts* (Oct. 2020).
[25] TIGTA, Report No. 2017-40-041, *Actions Need to Be Taken to Ensure Compliance With Prisoner Reporting Requirements and Improve Identification of Prisoner Returns* (July 2017).
[26] TIGTA, Report No. 2021-40-027, *Actions Were Taken to Improve the Identification of Prisoner Tax Returns* (Apr. 2021).
[27] Pub. L. No. 116-136, 134 Stat. 281 (2020).

ineligible recipient. The Improper Payments Information Act of 2002[28] requires Federal agencies, including the IRS, to estimate the amount of improper payments and report to Congress annually on the causes of, and the steps taken to, reduce improper payments. The Earned Income Tax Credit (EITC) has been identified as a high-risk program; therefore, the IRS must include the rate and amount of improper payments for the EITC program in the Department of the Treasury's annual Agency Financial Report.

In FY 2020, the Office of Management and Budget determined that the EITC, Additional Child Tax Credit (ACTC), and American Opportunity Tax Credit are also high-priority programs that are susceptible to significant improper payments.[29] The IRS estimates it issued approximately $22.8 billion in potentially improper EITC, ACTC, and American Opportunity Tax Credit in FY 2020. This represents a significant loss to both the Federal Government and taxpayers.

The IRS did not calculate the dollar amount and percentage rate of improper payments for another high-risk program – the Net Premium Tax Credit.[30] IRS management stopped working on this calculation, citing delays stemming from significant demands placed on the Department of the Treasury and the IRS in connection with the COVID-19 pandemic as well as delays working with the Department of Health and Human Services and the Centers for Medicare and Medicaid Services to develop a joint methodology for assessing improper payment risk for the Premium Tax Credit.

Further, the passage of the ARP Act temporarily expands the Child and Dependent Care Credit. Beginning on January 1, 2021, the credit is fully refundable and the amount of the credit and the income phase-out limits have significantly increased. The unintended consequence of refundable credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals. TIGTA is planning to conduct several audits evaluating the IRS's implementation of this credit.

INCREASING INTERNATIONAL TAX COMPLIANCE

Complexity and change in the international tax environment require that the IRS collaborate with tax administrations of foreign countries to enforce compliance. The IRS has not developed a reliable estimate of the international tax gap. The Tax Gap is estimated using statistics from the IRS's National Research Program data that does not measure international noncompliance.[31] The IRS must continue to focus significant efforts on global tax cooperation and tax administration practices that can prevent and resolve disputes among countries to increase certainty for taxpayers. International

[28] Pub. L. No. 107-300, 116 Stat. 2350 (2018).
[29] TIGTA, Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* (May 2021).
[30] Eligible taxpayers can choose to receive the Advanced Premium Tax Credit (APTC), which helps cover the cost of their health insurance premiums. When taxpayers prepare their tax return, they must reconcile the APTC with the amount of the Premium Tax Credit that they are allowed to claim. Taxpayers whose Premium Tax Credit exceeds their APTC have a Net Premium Tax Credit, which reduces their tax liability and, if more than the tax liability, results in a refundable tax credit.
[31] TIGTA, Report No. 2009-IE-R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Jan. 2009).

agreements and tax law changes are important, but the Department of the Treasury and the IRS should follow through to ensure that these efforts achieve their intended results.

The Foreign Account Tax Compliance Act (FATCA) was designed to establish reporting requirements for U.S. citizens with foreign accounts, with significant penalties if foreign accounts were not reported.[32] It was estimated that revenue from the FATCA would be $8.7 billion from FYs 2010 to 2020. While initial enforcement-related complications involved data reliability issues, more recent problems are related to the fact that the Department of the Treasury and the IRS have delayed the requirement for Foreign Financial Intermediaries (FFI) to require that U.S. citizens provide Social Security Numbers when establishing accounts and the FFIs to provide that information to the United States so the IRS can match compliance information it has with information that the FFIs have.

With the rising number of taxpayers giving up or abandoning their U.S. citizenship or resident status, it is important that the IRS has controls in place to enforce the tax provisions applicable to expatriates. Since enactment of the Heroes Earnings Assistance and Relief Tax Act of 2008,[33] the number of taxpayers expatriating increased significantly from Calendar Year 2008 to Calendar Year 2018 (from a total of 312 in 2008 to 3,974 in 2018). During the same period, TIGTA found that the IRS did not have a centralized compliance effort aimed at enforcing the expatriate rules.[34]

In addition, TIGTA reported that the IRS currently has no processes and procedures in place to ensure the legitimacy of certain international tax returns at the time returns are filed.[35] Specifically, TIGTA identified 130,448 international tax returns in which individuals reduced or eliminated the Federal income tax paid on nearly $2 billion in income.

PROTECTING TAXPAYER RIGHTS

The IRS must balance tax compliance activities to enforce the tax code while at the same time upholding taxpayer rights. The IRS continues to dedicate significant resources and attention to complying with the taxpayer rights provisions of the IRS Restructuring and Reform Act of 1998.[36]

The IRS Restructuring and Reform Act of 1998 requires TIGTA to audit certain taxpayer rights provisions and report whether the IRS complied with those provisions. While overall compliance has improved, TIGTA continues to identify areas in which the IRS can improve. For example, TIGTA evaluated whether the IRS followed the joint return

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[32] Pub. L. No. 111-147, Subtitle A, 124 Stat 97 (codified in scattered sections of 26 U.S.C.). TIGTA, Report No. 2018-30-040, *Despite Spending Nearly $380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance With the Foreign Account Tax Compliance Act* (July 2018).
[33] Pub. L. No. 110-245 (2008).
[34] TIGTA, Report No. 2020-30-071, *More Enforcement and a Centralized Compliance Effort Are Required for Expatriation Provisions* (Sept. 2020).
[35] TIGTA, Report No. 2021-40-057, *Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing* (Sept. 2021).
[36] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2, 5, 16, 19, 22, 23, 26, 31, 38, and 49 U.S.C.).

disclosure requirements on collection information requests and determined that disclosure requirements were not followed in 26 of 124 Accounts Management customer service representatives' history files and three of 20 Field Assistance individual taxpayer advisory specialists' history files in the Wage and Investment Division.[37] Also, during the review of the IRS's compliance with the prohibition against designating taxpayers as Illegal Tax Protesters or similar designations, TIGTA found that IRS employees used these designations on some taxpayer accounts.[38]

TIGTA also evaluated the IRS's compliance with provisions of the law that restrict the direct contact of taxpayers who are represented. TIGTA found that in 18 of the 75 cases reviewed, taxpayer rights were potentially infringed upon because the IRS did not send notices and letters to authorized representatives as required.[39] Of the 75 cases reviewed, a power of attorney was authorized to receive notices in 50 of these cases. When projected to the overall population of 4,349 examinations in which taxpayers had an authorized representative, the IRS potentially negatively impacted taxpayer rights for 1,043 taxpayer accounts in regards to representative notice and letter requirements.

Additionally, Collection Due Process hearing provisions are designed to give taxpayers an opportunity for an independent review to ensure that the levy action that has been proposed or the Notice of Federal Tax Lien that has been filed is warranted and appropriate. Similar to prior audits, TIGTA identified processing errors in 16 of 81 sampled taxpayer cases.[40] Processing errors related to proper classification of hearing requests and incorrect Collection Statute Expiration Dates on the taxpayer's accounts. For example, taxpayer accounts had errors due to incorrectly input Collection Statute Expiration Date suspension start and stop dates. In some cases, the IRS incorrectly extended the time period, allowing the IRS additional time to collect delinquent taxes.

HUMAN CAPITAL

Human capital is the Federal Government's most critical asset. At a time when the IRS is taking on such new challenges as the implementation of pandemic relief for taxpayers, the recruitment of new employees and retention of existing employees are critical to ensuring the maintenance of a quality workforce capable of meeting the needs of the American public.

Between FY 2010 and FY 2020, the IRS lost more than 33,000 full-time personnel, which included nearly 13,400 key enforcement personnel.[41] In addition, TIGTA reported that the IRS continues to experience challenges hiring and retaining an adequate

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[37] TIGTA, Report No. 2021-30-050, *Fiscal Year 2021 Statutory Review of Disclosure of Collection Activity With Respect to Joint Returns* (Aug. 2021).
[38] TIGTA, Report No. 2021-30-048, *Fiscal Year 2021 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations* (Aug. 2021).
[39] TIGTA, Report No. 2021-30-054, *Fiscal Year 2021 Statutory Review of Restrictions on Directly Contacting Represented Taxpayers* (Aug. 2021).
[40] TIGTA, Report No. 2021-10-049, *Review of the Independent Office of Appeals Collection Due Process Program* (Aug. 2021).
[41] IRS, *Management's Discussion and Analysis*, *Fiscal Year 2020*.

workforce to meet its workload demands at Tax Processing Centers.[42] For example, the IRS's Submission Processing function was only able to reach 59 percent of its hiring goals during the 2021 Filing Season. Although the IRS has several initiatives underway to help address its hiring shortages, these initiatives may not successfully mitigate the hiring challenges as anticipated. We remain concerned about the IRS's continued challenges in hiring sufficient staff needed to work backlog inventory and process tax returns at the same time. The inability of the IRS to hire sufficient staff could further affect taxpayers awaiting refunds and additional Recovery Rebate Credits claimed on TY 2020 returns.

The IRS's FY 2022 budget request includes a net staffing increase of approximately 12 percent, or 8,493 direct Full-Time Equivalents, as compared to FY 2021.[43] Although increased funding would assist the IRS in replacing employees lost through attrition, on-boarding, training, and assimilating large numbers of employees will create its own challenges for the IRS.

In addition, the IRS was faced with unprecedented human capital-related challenges due to the COVID-19 pandemic. In March 2020, the IRS directed all employees, except those performing mission-critical functions that could not be performed remotely, to vacate IRS worksites and work from home or an alternate location. The IRS initially placed nearly 35,000 employees on paid Weather and Safety Leave because the employees could not work in an IRS facility or telework.[44] In response to the pandemic, the IRS steadily increased telework participation, and in July 2020 reopened IRS facilities to some employees. Between March 2020 and September 2020, the IRS distributed nearly 19,000 laptops to employees to allow them to perform their jobs remotely. By September 2020, over 60,000 employees teleworked at least a portion of their work schedule, while approximately 25,000 employees worked at least a portion of their time from an IRS facility.

As the IRS reopened its facilities to mission essential functions and non-portable work, it faced additional challenges.[45] As of June 30, 2021, nearly 4,200 IRS employees reported having tested positive for COVID-19. IRS data show that approximately 47 percent of these employees reported to an IRS facility during the 14 days preceding a positive test result.

In March 2021, TIGTA completed unannounced site visits to eight IRS campuses. Overall, TIGTA found that the IRS had implemented its COVID-19 guidance; however, we observed instances of noncompliance with health and safety guidance at all eight facilities, including guidance pertaining to mask and social distancing requirements.

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[42] TIGTA, Report No. 2021-40-038, *Interim Results of the 2021 Filing Season* (May 2021).
[43] Full-Time Equivalents are a measure of labor hours in which one Full-Time Equivalent is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.
[44] Weather and Safety Leave is a form of administrative leave permitted when an agency determines that safety-related conditions prevent employees from safely traveling to or safely performing work at an approved location or telework site.
[45] TIGTA, Report No. 2021-16-073, *Steps Were Taken to Protect Employee Health and Safety, but Additional Efforts Are Needed to Ensure Compliance With Federal Guidelines During Pandemics* (Sept. 2021).

The IRS will continue to face challenges as it balances the completion of its mission with the health and safety of its employees.

CONCLUSION

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in FY 2022. TIGTA's *Fiscal Year 2022 Annual Audit Plan* and *Fiscal Year 2022 Inspections and Evaluations Program Plan* contain our proposed reviews. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary of the Treasury
Acting Assistant Secretary for Management
Deputy Chief Financial Officer
Commissioner of Internal Revenue

IRS Response to TIGTA Management and Performance Challenges

1. Administration of Tax Law Changes and Pandemic Relief Benefits

The COVID-19 pandemic resulted in numerous legislative changes that impacted tax administration. Several of the provisions contained in pandemic legislation required the IRS to take steps to implement such legislation during its 2020 and 2021 annual tax filing seasons.

The CRRSAA, signed into law on December 27, 2020, authorized a second round of Economic Impact Payments (EIP 2). This legislation required that the second round of payments be issued by January 15, 2021. The IRS was prepared for and delivered the majority of EIP 2 in just two days following the enactment.

The Relief Act made several changes to the employee retention tax credits previously made available under the CARES Act, including changing and extending the ERC for six months through June 30, 2021. Several of the changes apply only to TY 2021 while others apply to both TYs 2020 and 2021.

The ARP signed into law on March 11, 2021, authorized an EIP 3. The IRS began issuing these payments on March 12, 2021. In FY 2021, the IRS, in coordination with Fiscal Service, issued EIP 2 and 3 payments worth over $800 billion.

2. Enhancing Security of Taxpayer Data and Protection of IRS Resources

In FY 2021, the IRS enhanced security of taxpayer data and protect IRS resources. The IRS updated and remediated the critical and high-risk vulnerabilities identified on the servers that store federal tax information (FTI) and backup servers used to transmit FTI to the Trusted Third Parties (TTP) by installing appropriate updates.

Once accepted into the Income Verification Express Service (IVES) Program, participants, such as banks and financial institutions, can submit requests to obtain tax transcripts on behalf of their clients. To mitigate the risk of releasing taxpayers' information to unauthorized individuals, the IRS revised Form 4506-C, Request for Transcript of Tax Return, to update cautionary language for instructing taxpayers to complete third-party information before signing, to include a clear indication of electronically signed forms and to include a line for client information if a client is requesting a transcript on behalf of an IVES participant.

The IRS updated the research instructions contained in Internal Revenue Manual (IRM) 3.5.20, Processing Requests for Tax Return/Return Information, to clarify the intended programming of the Integrated Automation Technologies (IAT) tool. The IRS also updated the IAT tool programming to reflect IRM processing instructions to alert the IVES program employee to reject transcript requests with identity theft (IDT) markers. The IRS reviewed the IRM to ensure clarity of instructions to identify all IDT markers on taxpayers' accounts and when to properly reject them. Lastly, the IRS revised IRM 3.5.20.4.2.3.4, Identification and Validation of IVES Requests, to add IVES research instructions for requests with no account on the Masterfile.

The IRS will complete their certifications and determine who is eligible to use e-signatures within the IVES program. The IRS is developing Enterprise File Storage software to include a listing of authorized e-signature users that the IRS will maintain and review on an annual basis to ensure program compliance. Clear guidance will be issued to IVES participants to articulate the requirements of the annual independent audit report for electronic signature usage. The IRS is also developing an online system to process IVES Participants' Forms 4506-T, which will comply with the requirements in the Taxpayer First Act, Section 2201. In FY 2022, the IRS will finalize the IVES online system project schedule and costing estimates, making any adjustments to the user fee as necessary. The IRS will identify and allocate sufficient resources to the IVES Program to timely complete the annual compliance reviews, summarizing the results of the compliance reviews after each fiscal year. The IRS will continue to perform tax compliance checks on IVES participants and investigate an automated solution for performing continuous tax compliance. The IRS will perform suitability checks on the 319 IVES Participants identified by TIGTA.

3. Improving Tax Reporting and Payment Compliance to Reduce the Tax Gap

The IRS's primary objective in selecting returns for examination is to promote the highest degree of compliance. When taxpayers do not report their correct income and pay what they owe, it contributes to the tax gap. The gross tax gap is the estimated difference between the amount of the tax that taxpayers should pay, and the amount paid voluntarily and on time. High-income nonfilers contribute to the majority of the nonfiler tax gap.

To address the nonfiler Tax Gap, an Executive Steering Committee (ESC) provides oversight of Nonfiler program performance and strategic planning, which also ensures coordination across multiple business functions. Additional steps to strengthen the ESC by adding the director of the Fraud Enforcement Office as well as revision to the charter is ongoing.

The IRS remains committed to ensuring its enforcement efforts are fair. Compliant taxpayers deserve to know that noncompliant taxpayers are at risk of audit or other enforcement actions. Over the last few years, the IRS shifted resources to focus on Abusive Transactions and Technical Issues projects, which involve high-income individuals. This includes areas of greater noncompliance such as syndicated conservation easements, micro-captive insurance transactions, research and experimentation credits, and virtual currency. IRS examiners are conducting audits of high-income and high-wealth taxpayers at a rate far higher than any other category of individual filers. As reported in the most recently published IRS Data Book (2020), Tax Year 2015 audit rates for taxpayers with income of at least $10 million or more was 8%, while rates for individuals with income under $200,000 is less than 0.6%. In addition, the IRS initiated a Compliance Initiative Project to ensure that the IRS continues to maintain a high rate of audit coverage of taxpayers at the highest income categories.

The IRS received approval to update the Business Masterfile (BMF) Start Date criteria rules for business nonfilers. This will ensure identification of all potential nonfiler forms and returns are made available for further examination or assessment. The updated BMF Start Date criteria rules are to be delivered in FY 2022. In addition, the IRS is creating a definition of high-income business nonfilers as well as a compliance strategy to work unfiled returns and underreported Form 1099-K, Merchant Card and Third-Party Network Payments, income. The IRS has initiated a research project in FY 2022 to determine if a High-Income Nonfiler (HINF) definition can be applied to BMF nonfilers by identifying similarities or patterns with potential nonfiler cases and prior nonfiler audit results.

The IRS prioritizes high-income nonfilers in our Individual Masterfile case creation nonfiler identification process. The IRS has issued instructions to Collection's Nonfiler Inventory and Analysis staff to ensure that 100% of HINF cases are included in the return delinquency program case starts, which places these cases into the work stream. The IRS also updated the Collection automated substitute for return program to prioritize high liability cases. The IRS's Collection case management program continues to place a high priority on high-income nonfilers when selecting case inventory for revenue officers. Field Collection managers assign high priority HINF cases to revenue officers from an inventory (queue) of cases selected for potential compliance action. IRS revenue officers are highly trained civil enforcement officers, adept at investigating the most complex collection cases, including HINF. Revenue officers are also assigned other Collection case priorities, including pyramiding employment tax cases, and high-dollar balance due cases.

Currently, the IRS has less than 2,000 revenue officers, the lowest number of field collection personnel since the 1970's, and over 100,000 collection cases in active inventory. Furthermore, the IRS has classified roughly 85% of the inventory as high priority cases, many of which involve delinquent business employment taxes. In addition, the IRS has over 1.5 million collection cases awaiting assignment, 500,000 of which are considered high priority. Additional resources would better enable Collection to assign the highest priority HINF cases to revenue officers to address these taxpayers' noncompliance.

The Peer-to-Peer (P2P) payment application has created some challenges for the IRS particularly because the use has grown exponentially over the years in replacement of traditional mobile banking applications. The largest challenge is attributable to the lack of compliance with the filing requirement of the Form 1099-K, Payment Card and Third-Party Network Transactions and P2P applications. The ARP changed the threshold for reporting significantly. The ARP requires reporting by third party settlement organizations of a gross amount of $600 or more paid to a single payee in a calendar year, effective for calendar years beginning after December 31, 2021. As a result of the new legislation, the IRS will receive Form 1099-K for a majority of the individuals receiving payment via P2P applications. This will allow the IRS to identify areas of noncompliance either through our Automated Underreporter program or during an examination. The IRS is actively developing guidance for examiners to reinforce the requirement to complete the minimum income probe for all examinations which includes addressing the taxpayer's internet use and e-commerce income activity.

4. Modernizing IRS Operations

The IRS relies extensively on computerized systems to support its financial and mission-related operations. Weaknesses within the IRS's computer operations could adversely affect its ability to meet its mission of helping taxpayers comply with their tax responsibilities and enforcing the tax laws with integrity and fairness to all.

The IRS has several process improvements planned for future Enterprise Case Management (ECM) releases. First, the IRS is implementing a combination of two Scaled Agile Environment (SAFe) configurations to strike a balance between implementing the recommended roles and configurations while minimizing unnecessary overhead. The IRS will document its current SAFe implementation and perform a SAFe competency assessment for the associated core competencies. Additionally, the IRS will establish an initial set of quantifiable metrics to enable traceability of progress from planning through decommissioning, recognizing that quantifiable metrics are not static, and updates are necessary throughout ECM implementation. Finally, to improve 508 compliance, the IRS has already taken actions to significantly reduce the number of Section 508 compliance defects in the current ECM release and is developing activities for subsequent releases. The IRS is providing style guides, checklists, and other tools to aid developers and avoid the creation of Section 508 defects. The IRS is also standing up an

Accessibility Advocate function to work with the existing IT Information Resources Accessibility Program (IRAP) to reduce the number of Section 508 defects in future releases and improve the user experience.

Server virtualization is a standard for enterprise information technology infrastructure in data centers and cloud services as it provides better utilization of hardware resources, reduces physical space required, and reduces power consumption and administrative overhead. Protecting critical assets and infrastructure helps reduce the risk of internal and external attacks on IRS assets that could potentially expose taxpayer data and information.

The IRS has identified several improvements for the virtual host infrastructure platform. First, the IRS will remediate critical and high-risk vulnerabilities in the virtual host infrastructure platform by priority and within the required IRM timeframes. Additionally, the IRS will ensure remediation of configuration issues for Windows and Linux platform servers using the new Continuous Diagnostics and Mitigation (CDM) tool and correct defects in that tool. The IRS will identify and implement a tool to perform automated configuration scanning of the VMware ESXi platform in accordance with CDM guidance and will ensure remediation of configuration issues for Windows and Linux platform servers using the new CDM tool by VMWare once the new tools are in place. The IRS will also finalize, approve, and implement a Platform Audit Plan for the virtual host infrastructure platform, implement automated audit logging and monitoring, and establish a review process for VMware servers in the virtual host infrastructure platform. Finally, the IRS will ensure use of its established asset management process for inventory revision and will ensure the IRS follows standard operating procedures for properly decommissioning virtual host infrastructure platform servers.

5. Improving Customer Service and the Taxpayer Experience

The IRS took unprecedented actions in response to the COVID-19 pandemic to protect the health and safety of its employees and taxpayers during the 2020 filing season. To restore services to taxpayers as quickly as possible, the IRS accelerated the implementation of several customer service options it had been testing and expanded the use of existing technologies and capabilities.

The IRS provided resources and guidance to ensure Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites were equipped with the necessary tools to prepare accurate current and prior year returns.

The IRS developed and timely delivered outreach messages to inform taxpayers about traditional VITA, TCE, Facilitated Self Assistance, Virtual VITA, and the Free File program to partners, in addition to a postcard initiative. The IRS mailed postcards with helpful links to Free File and assistance with finding VITA locations to 2.5 million taxpayers.

In addition, the IRS developed Publication 5450, 2021 VITA/TCE Site Operations to provide outreach and additional guidance to partners about tax return preparation alternatives. Additionally, the IRS identified outreach priorities for delivery to partners with a focus on topics that are determined critical and beneficial.

The IRS completed its Web Service Delivery pilot in May 2021, which only included a limited testing of services normally available in TACs. Therefore, the IRS could not make a full assessment of taxpayers' demand for virtual face-to-face services throughout the IRS.

6. Addressing Emerging Threats to Tax Administration

The IRS continues efforts to protect tax revenue by implementing processes to identify and prevent prisoner tax fraud by prisoners and individuals who use prisoners' Social Security Numbers (SSN) to file fraudulent tax returns.

In FY 2021, the IRS took additional actions to expand its participation in the Blue Bag Program partnering with the Federal Bureau of Prisons and state Departments of Corrections to identify potentially fraudulent tax returns and refunds.

The IRS revised IRM 25.25.12.14, General Agreement on Tariffs and Trade Procedures to include revised procedures that facilitate the timely identification of questionable tax returns, where refunds are appropriately frozen, and the returns are referred for treatment.

The IRS also reviewed two questionable tax returns filed by a prisoner who was incarcerated for the entire tax year and found they were filed by a taxpayer working and residing in Puerto Rico. The SSN appears to have been fraudulently used by another individual who is incarcerated and was included in the prisoner information reported to the IRS. In addition, the IRS reviewed international returns identified by TIGTA, which reported that the IRS potentially issued fraudulent refunds of estimated tax payments. The IRS concluded that there were no refunds that needed to be recovered.

The IRS efforts to protect tax revenue continues into FY 2022 and beyond. Some of the actions planned include:

- Studying various tax forms in which the income and withholding reported on the return is not supported by third-party income documents and taking appropriate actions to strengthen system filters and procedures.

- Studying the feasibility of sampling claims of the AdvCTC on international tax returns in which the address on the return is not in Canada, India, Mexico, South Korea, or a U.S. territory and taking appropriate actions based on the result of the study and available resources.

- Providing training for tax examiners in the Error Resolution function to emphasize the proper procedures for resolving AdvCTC claims on international tax returns in which the taxpayer's TIN or spouse's TIN was not issued prior to the due date of the tax return and in which the taxpayer does not meet the qualifying child requirements.

- Reviewing 36,373 identified returns that potentially received the American Opportunity Tax Credit (AOTC) in error and taking appropriate actions on a sample of the returns based on available resources.

- Studying the feasibility of sampling potentially erroneous tax returns filed by international taxpayers filing incorrect tax forms to receive refundable credits, including returns filed by nonresidents claiming the AOTC, which they are not eligible to receive. The IRS will take appropriate actions based on the result of the study and available resources.

The IRS acknowledges erroneously processing seven returns that received the AdvCTC and will take steps to have the improperly allowed AdvCTC corrected. The IRS is in the process of reviewing other questionable returns to determine whether the AdvCTC was properly allowed and, when possible and within the constraints, of the assessment statute of limitations date, take steps to have any returns that improperly allowed AdvCTC corrected.

Additionally, the IRS created 34 business IDT filters to evaluate employment tax returns for potential identity theft. These additional filters resulted in a monetary benefit (funds put to better use) of more than $248 million. The IRS completed an analysis on the effectiveness of incorporating withholding discrepancies as a BMF IDT filter characteristic and concluded that due to the increasing complexity of the withholding match feature, and the low return on investment for efforts to improve the matching rate, the use of withholding discrepancy is not a reliable element to include in the BMF IDT filters.

The IRS completed an analysis of 1,966 identified returns and found that most of the filter selections were false positives that did not meet Frivolous Return Program selection criteria. The IRS held meetings to discuss and provided feedback on timing issues and reminded analysts to perform screening in a timely manner, following IRM 25.25.10.5(1) procedures.

The IRS will conduct an analysis to determine the effectiveness of using estimated payments that post to the taxpayer's account in the filtering process for the Form 1041 business IDT filters.

7. Reducing Fraudulent Claims and Improper Payments

OMB defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. In Fiscal Year 2020, using OMB guidelines, the Earned Income Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit are high-priority programs that are susceptible to significant improper payments. Although error rates for each of these credits remain high, the IRS attributes these refundable tax credit overclaims to their statutory design and the complexity taxpayers face when self-certifying eligibility for the refundable tax credits and not to internal control weaknesses, financial management deficiencies, or reporting failures.

The IRS identified barriers to reducing refundable tax credit improper payments: complexity and lack of data to verify statutory eligibility requirements, lack of correctable error authority, high turnover of eligible taxpayers, unscrupulous and/or incompetent tax return preparers, and fraud.

8. Increasing International Tax Compliance

The U.S. Congress intended the Foreign Account Tax Compliance Act (FATCA) to improve U.S. taxpayer compliance with reporting foreign financial assets and offshore accounts. Under FATCA, individual taxpayers with specified foreign financial assets that meet a certain dollar threshold should report this information to the IRS, beginning with Tax Year 2011, by filing Form 8938, Statement of Specified Foreign Financial Assets, with their income tax return.

Efforts to combat underreporting related to U.S. holders of foreign accounts and to Foreign Financial Institutions are ongoing, where Form 8966 and Form 8938 data will be systemically matched to identify non-filers. The development of a data product to automate risk assessments across the FATCA filing population has been initiated. The compliance initiative to address error notices and unresolved record-level errors, including follow-up procedures, will improve the accuracy of data in FATCA reports.

Complexity and change in the international tax environment require that the IRS collaborate with tax administrations of foreign countries to enforce compliance. The IRS continues to focus significant efforts on global tax cooperation and tax administration practices that can prevent and resolve disputes among countries to increase certainty for taxpayers.

The IRS held a conference call on December 15, 2020 with the Department of State's Office of Consular Affairs and discussed adding a SSN to Form DS-4083, Certificate of Loss of Nationality (CLN) and explore the feasibility of obtaining the CLN electronically as related to the IRS's Expatriation Program. The Expatriation Campaign is the process established to compile information on all expatriates, whether they filed Form 8854, Initial and Annual Expatriation Statement, with their Form 1040-NR or filed Form 8854 with the Low-Income Housing Credit unit.

The IRS plans to complete the following actions in FY 2022 and beyond:

- Update letters 2399C and 4135C to include the requirements of I.R.C. § 877A and remove any language no longer applicable under the Heroes Earnings Assistance and Relief Tax Act of 2008. The IRS will also develop IRM or other procedures on how, and when appropriate, to obtain Form 8854 when receiving a Certificate of Loss of Nationality but no Form 8854, taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

- Evaluate the information reported on Form 8854 and determine what data fields should be added to the expatriate database to best evaluate the tax compliance of taxpayers that expatriate, taking into consideration an initial assessment of Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

- Develop IRM or other procedures for inputting and correcting certain Form 8854 data when information as filed by expatriates is missing or incomplete and prepare an analysis as needed to determine if the expatriate is a covered expatriate and subject to tax under I.R.C. § 877A, following the initial assessment of the Expatriation Campaign results, compliance risks, resource availability, and organizational priorities.

9. Protecting Taxpayer Rights

Congress enacted the prohibition against the use of the term “Illegal Tax Protester” and similar designations due to a concern that some taxpayers were being permanently labeled as Illegal Tax Protesters even though they had subsequently become compliant with the tax laws.

To more clearly direct employees to the appropriate guidance on what collection activities may and may not be disclosed to taxpayers who jointly filed returns, the IRS will update IRMs 21.3.4.13 and 21.3.4.23, Disclosure, to reference and link to IRM 5.19.5.4.13, ACS and Disclosure, where the disclosure criteria is found. Linking to the source information, rather than duplicating it across multiple IRM sections complies with IRM standards and ensures consistency in published guidance.

The IRS will update the applicable IRMs to directly reference and link to the scenarios provided in IRM 5.19.5.4.13, ACS and Disclosure.

In addition, the IRS will provide disclosure training in the FY 2022 Critical Filing Season Readiness Training.

10. Human Capital

The IRS is executing the actions in its Pandemic Incident Management Plan for the protection of the health and safety of its employees during the Coronavirus Disease 2019 (COVID-19) pandemic. The COVID-19 pandemic continues to affect the IRS’s ability to perform its responsibilities of processing tax returns. The pandemic also threatens the health and safety of IRS employees. As such, the IRS has had to continue to balance the achievement of its mission with the health and safety of its employees.

The IRS updated existing guidance clarifying the leave options, reminded employees of the current mask wearing requirements, and updated (or replaced) signage where needed. The IRS updated its Pandemic Incident Management Plan to encourage leaders to implement measures, such as spot checks, to help ensure that employees are following the policies and guidance issued by the federal government and the IRS in response to emergency conditions.

SECTION C: SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

The following table summarizes the results of the IRS's FY 2021 financial statement audit, as well as management's assurances regarding conformance with the FMFIA and the FFMIA.

Summary of Financial Statement Audit

Audit Opinion: Unmodified

Restatement: No

Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weakness	0	0	0	0	0

Summary of Management Assurances

Effectiveness of Internal Control Over Financial Reporting (FMFIA Section 2)

Statement of Assurance: Unmodified

Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weakness	0	0	0	0	0

Effectiveness of Internal Control Over Operations (FMFIA Section 2)

Statement of Assurance: Unmodified

Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Total Material Weakness	0	0	0	0	0

Conformance With FMFIA Section 4

Statement of Assurance: Federal systems conform, except instances of non-conformance, to financial management system requirements

Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reasssessed	Ending Balance
Unpaid Tax Assessments***	1	0	0	0	0	1
Financial Reporting Systems (Information Security)	1	0	0	0	0	1
Total Non-Conformances	2	0	0	0	0	2

***Refer to Independent Auditors' Report in Part 2 of this report.

Conformance With FMFIA Section 803(A)

Non-Conformances	Agency	Auditor
1. Federal Financial Management System Requirements	Lack of Compliance Noted	Lack of Compliance Noted
2. Applicable Federal Accounting Standards	No Lack of Compliance Noted	No Lack of Compliance Noted
3. U.S. Standard General Ledger (USSGL) at Transaction Level	No Lack of Compliance Noted	No Lack of Compliance Noted

FMFIA and FFMIA Requirements

The FMFIA requires agencies to establish and maintain internal control to ensure that federal programs operate efficiently, effectively, and in compliance with laws and regulations. In support of the Secretary of the Treasury's Assurance Statement, the Commissioner must evaluate and report annually on (a) whether there is reasonable assurance that the IRS's controls are achieving their intended objectives, and (b) material weaknesses in the IRS's controls (FMFIA Section 2). Additionally, the Commissioner must evaluate and report separately on whether the IRS's financial management systems comply with government-wide requirements (FMFIA Section 4). The FFMIA requires agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements. The requirements of the FMFIA serve as an umbrella under which other reviews, evaluations, and audits should be coordinated and considered to support management's assertion about the effectiveness of internal controls over operations, reporting, and compliance with laws and regulations.

As of September 30, 2021, we had no material weaknesses under Section 2 or Section 4 of the FMFIA. However, we have two instances of non-conformance with the federal financial management systems requirements of Section 4 of the FMFIA. These non-conformances also constitute a lack of compliance with the federal financial management system requirements, as reported above under FFMIA Section 803(a). Refer to the section in Part 1 entitled Systems, Controls, and Legal Compliance and the section in Part 2 entitled Independent Auditor's Report for additional information on the non-conformances.

SECTION D: ACRONYM LIST

ACS	Automated Collection System
ACTC	Additional Child Tax Credit
AdvCTC	Advance Child Tax Credit
AGI	Adjusted Gross Income
AOTC	American Opportunity Tax Credit
APTC	Advance Premium Tax Credit
ARP	American Rescue Plan
BABs	Build America Bonds
BHP	Basic Health Program
BMF	Business Master File
BSA	Bank Secrecy Act
CARES Act	Coronavirus Aid, Relief, and Economic Security Act
CLN	Certificate of Loss of Nationality
CDM	Continuous Diagnostics and Mitigation
CMS	Centers for Medicare and Medicaid Services
COBRA	Consolidated Omnibus Budget Reconciliation Act
Compliance Framework	Federal Financial Management Improvement Act Compliance Determination Framework
COVID-19	Coronavirus 2019
CREBs	New Clean Renewable Energy Bonds
CRRSAA	Coronavirus Response and Relief Supplemental Appropriations Act of 2021
CSR	Customer Service Representative
CSRS	Civil Service Retirement System

CTC	Child Tax Credit
CTCUP	Child Tax Credit Update Portal
CY	Calendar Year
DOL	Department of Labor
DUT	Documentation Upload Tool
e-File	Electronically Filed
ECM	Enterprise Case Management
EIP	Economic Impact Payment
EIP 2	Second Round of Economic Impact Payments
EIP 3	Third Round of Economic Impact Payments
EITC	Earned Income Tax Credit
ERC	Employee Retention Credit
ESAPR	Enterprise Self-Assistance Participation Rate
ESC	Executive Steering Committee
FATCA	Foreign Account Tax Compliance Act
FBWT	Fund Balance with Treasury
FECA	Federal Employees' Compensation Act
FEHB	Federal Employees Health Benefit Program
FEGLI	Federal Employees' Group Life Insurance Program
FERS	Federal Employees Retirement System
FFCRA	Families First Coronavirus Response Act of 2020
FFMIA	Federal Managers' Financial Integrity Act
FICA	Federal Insurance Contributions Act
FinCEN	Financial Crimes Enforcement Network

Fiscal Service	Bureau of the Fiscal Service
FMFIA	Federal Financial Managers' Financial Integrity Act
FTI	Federal Tax Information
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GSA	General Services Administration
HCTC	Health Coverage Tax Credit
HINF	High Income Nonfiler
HHS	Department of Health and Human Services
HIRE	Hiring Incentives to Restore Employment
IAT	Integrated Automation Technologies
IDT	Identity Theft
IP PIN	Identity Protection Personal Identification Number
IRAP	Information Resources Accessibility Program
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
IRS-CI	IRS Criminal Investigation
ISAC	Information Sharing and Analysis Center
IT	Information Technology
ITIN	Individual Taxpayer Identification Numbers
IVES	Income Verification Express Service
LOS	Level of Service

NIST	National Institute of Standards and Technology
OECD	Organization of Economic Cooperation and Development
OLA	Online Account
OMB	Office of Management and Budget
OPM	Office of Personnel and Management
P2P	Peer-to-Peer
PATH	Protecting Americans Against Tax Hikes
PBGC	Pension Benefit Guaranty Corporation
PPACA	Patient Protection & Affortable Care Act of 2010
PTC	Premium Tax Credit
QECB	Qualified Energy Conservation Bonds
QRP	Questionable Refund Program
Relief Act	Taxpayer Certainty and Disaster Tax Relief Act of 2020
RRC	Recovery Rebate Credit
SADI	Secure Access Digital Identity
SAfe	Scaled Agile Environment
SBR	Statement of Budgetary Resources
SCA	Statement of Custodial Activity
SCNP	Statement of Changes in Net Position
SECA	Self-Employment Contributions Act
SIWP	State Innovation Waiver Program
SNC	Statement of Net Cost
SSA	Social Security Administration
SSN	Social Security Number

TAC	Taxpayer Assistance Center
TCE	Tax Counseling for the Elderly
TDC-ON	Taxpayer Digital Communication – Outbound Notifications
TFA	Taxpayer First Act
TIGTA	Treasury Inspector General for Tax Administration
TPRA	Transfer Pricing Risk Assessment
Treasury	Department of the Treasury
TSP	Thrift Savings Plan
TTP	Trusted Third Parties
TY	Tax Year
UCFE	Unemployment Compensation for Federal Employees
U.S.C.	United States Code
USPS	United States Postal Service
VITA	Volunteer Income Tax Assistance

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