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TECHNOLOGY

How the IRS Backlog is Hurting Small Business

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It's no secret that the Internal Revenue Service is facing historically high backlogs in processing tax returns, both for individual taxpayers and businesses. According to the Taxpayer Advocate Service (TAS) [2022 Objectives Report to Congress](#), in 2021 the IRS processed 136 million income tax returns, an impressive total. However, according to the same report, the IRS still has a processing backlog of over 35 million individual and business tax returns, and states: "But particularly for low-income taxpayers and small businesses operating on the margin, refund delays can impose significant financial hardships."

The problem has been building for a long time. The Department of the Treasury stated in a [March 10 press release](#) that the IRS has had its budget cut by nearly 20 percent since 2010. The agency employs the same number of people that it did in 1970, though the U.S. population has increased by 60 percent. Census data shows there were approximately 12 million businesses in the U.S. in 1970, and there are more than 32 million today. Beyond the chronic underfunding, the COVID-19 pandemic created new challenges for the agency, including emergency taxpayer relief programs.

It's time for Congress to act, before an overwhelmed and underfunded IRS starts to create a negative impact on our nation's small businesses, startups and entrepreneurs.

How bad is the problem?

My CPA firm, [Kruze Consulting](#), services over 650 startups and yes, delays in processing tax returns often create hardships and headaches. For example, part of the CARES Act reduced certain tax obligations, including expanded carrybacks for net operating losses. According to the US [Government Accountability Office \(GAO\)](#), the IRS not only hasn't been able to process refunds within its 90-day statutory requirement, but as of November 2021, the average time to process carryback refunds was over 165 days. In other words, assistance intended for small businesses is mired in delays.

Another example is the Employee Retention Credit (ERC), which could be worth up to \$26,000 per employee to businesses. [The IRS stated](#) that as of March 9, 2022, they had 2.3 million employer's tax returns (Forms 941 and 941-X) remained unprocessed, delaying ERC refunds. While our clients used to receive ERC funds in about a month, we are now experiencing delays of up to six months. The ERC and other tax credits are critically important to startups and small businesses that have not yet begun to generate profits or that are operating on narrow margins.

In terms of service delays, at Kruze we've found that our call wait times have tripled, and most inquiries go unanswered. To get a Certificate of U.S. Tax Residency, we are waiting anywhere from 30-90 additional days. Fax responses for proposed civil penalties are no longer appropriate, and we are waiting for responses to letters. We are no longer receiving effective, accurate, and timely communication from the IRS, and it has real-world implications for startups and small businesses. Founding a startup or growing a small business are stressful enough endeavors, adding regulator uncertainty on top of that is a lot to ask our nation's entrepreneurs!

What actions are being taken?

On March 10, the Department of the Treasury laid out [new plans](#) to address the filing backlog:

- The IRS launched an 800-person "surge team" in February to address the backlog.
- The IRS will aggressively move to fill 5,000 open positions and add another 5,000 new positions during 2022.

- A second 700-person “surge team” will be created to address the high volumes of paper tax returns.
- The IRS is paying overtime to over 16,000 employees processing original returns, amended returns, and taxpayer correspondence.
- The IRS is also hiring contractors to help with administrative tasks.

These efforts will help address the immediate backlog problem, but remember there are over 32 million businesses in the U.S. and over 140 million individual taxpayers. In February, Erin Collins, the National Taxpayer Advocate, [testified](#) to the Committee on Finance of the United States Senate that the IRS “started the 2022 filing season in a deep hole” and needs a longer-term solution involving sustained, multi-year funding that strengthens both the IRS workforce and its information technology infrastructure.

We need more from Congress

As accountants, we are all facing these problems with our clients, but the numbers show that the problems are going to grow. We know the IRS agents are doing the best job they can under very trying circumstances. It’s a vicious cycle for IRS agents, where the backlog leads to more calls and letters, which leads to a greater amount of inquiries, and that leads to eventual staff burnout. Collins also testified that since 2010, the IRS workforce has shrunk by 17 percent, and in 2019 IRS employees answered less than a third of taxpayer phone calls. We are currently advising our clients to not bother with calling the IRS. Instead, we advise them to respond or inquire with a formal, certified mail letter or fax every three months until the issue is resolved; and keep immaculate records of their inquiry timelines. It’s time for Congress to act and provide long-term funding to support the IRS. If not, the problems that we’re already seeing will become far worse.

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