Inflation dominates the discussion as taxwriters quiz Yellen on FY 2023 budget proposals

The recent spike in inflation—and what the Biden administration intends to do about it—took center stage this week as the two congressional taxwriting committees held separate hearings with Treasury Secretary Janet Yellen to discuss the White House's budget proposals for fiscal year 2023; but Yellen also fielded questions on a range of issues such as a pending global tax pact, the federal tax gap, retirement security, and the federal debt ceiling. (For a summary of the tax provisions in the White House's latest budget blueprint, see *Tax News & Views*, Vol. 23, No. 12, Mar. 29, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220329_1.html

Yellen appeared before the Senate Finance Committee on June 7 and the House Ways and Means Committee on June 8.

Inflation

During both hearings, Democratic and Republican taxwriters alike raised the issue of soaring inflation and its impact on US households, but there was a distinct partisan split on questions regarding what caused the problem and how to address it.

Yellen repeatedly told both panels that the current inflation rate of more than 8 percent is "unacceptable" and stated that lowering inflation should be the country's number-one priority. She also noted that even though the Federal Reserve has a role to play in bringing down inflation and the administration has taken what action it can (such as releasing fuel from the Strategic Oil Reserves to increase supply), Congress can do a great deal to address high costs.

Build Back Better: Democrats agreed with Yellen's argument that the key to lowering inflation is for Congress to pass provisions in the House-approved Build Back Better Act that would reduce the cost of child care, elder care, housing, energy, and prescription drugs. The cost of that relief would be offset through tax increases directed largely at multinational corporations and certain wealthy individuals. (The House approved its version of Build Back Better legislation last year. That measure is currently stalled in the Senate, although Democrats hope to craft a narrower compromise package that can win passage in the chamber under fast-track budget reconciliation rules. See separate coverage in this edition for an update on the status of those efforts. A detailed summary of the tax provisions in the House-passed legislation is available from Deloitte Tax LLP.)
URL: https://www2.deloitte.com/us/en/pages/tax/articles/build-back-better-tax-legislation.html?id=us:2em:3na:tnv:awa:tax:061022&sfid=7015Y000003bKPoQAM

But GOP taxwriters criticized the proposed tax increases in the Build Back Better Act—such as a 15 percent corporate minimum tax on book income. Finance Committee ranking member Mike Crapo, R-Idaho, questioned whether it is appropriate for the government to consider raising taxes and increasing spending at a time when the economy faces the prospect of stagflation. Yellen reiterated her position that the Build Back

Better legislation would drive down costs for consumers in several key areas. She also defended the administration's plan to offset the cost of that relief through tax increases.

"It is appropriate to pay for it or more than pay for it," she said, adding that "asking high-income taxpayers and large corporations to pay their fair share is the right way to finance those investments."

American Rescue Plan: Republican taxwriters also took aim at the $1.9 trillion American Rescue Plan (P.L. 117-2), the emergency COVID relief legislation that was enacted in 2021, saying that this third major bill addressing the economic fallout from the global pandemic was untargeted and injected far too much spending into the US economy, increasing household liquidity and demand at a time when global supply chains were already showing signs of breaking.
URL: https://www.congress.gov/117/plaws/publ2/PLAW-117publ2.pdf

Democrats generally countered that passing the American Rescue Plan was the appropriate action to take in the face of a singular and unexpected economic calamity—an assessment that Yellen endorsed.

In an exchange with Ways and Means Committee member Brian Higgins, D-N.Y., for example, Yellen said that the Biden administration came into office facing economic conditions rivaling those of the Great Depression and that it was critical for Congress to act decisively to avert a disastrous outcome. Enactment of the legislation led to a strong economic recovery with low levels of unemployment and higher levels of personal savings, she said.

In response to a question from Ways and Means Chairman Richard Neal, D-Mass., Yellen contended that the temporary enhancements to the child tax credit, the earned income tax credit, and Affordable Care Act premium assistance credits enacted in the American Rescue Plan provided a measure of economic stability for low- and middle-income households.

Rethinking 'transitory': Yellen took significant fire for statements she made last year—similar to those made by President Biden and Federal Reserve Chairman Jerome Powell—indicating she expected the growth in inflation to be "transitory." With the rate now at a 40-year high, Yellen acknowledged in a recent television interview that she was wrong—an admission she repeated as she took questions from taxwriters.

"We could have used a better term than 'transitory,'" she said in an exchange with Finance Committee Republican John Thune of South Dakota, adding that she now expects inflation to remain elevated and that the administration's estimate of 4.7 percent inflation for 2022 is likely to be revised higher in an upcoming forecast.

However, Yellen argued that spending in 2021 on benefits such as the enhanced and expanded child tax credit contributed "little or nothing" to inflation and instead pointed to "Putin's war in Ukraine" and multiple COVID-19 variants that disrupted global supply chains as the key drivers of consumer price increases.

“There is no question that inflation is too high, and it has to be addressed, but we’re starting to do that from a situation of strength,” she said, highlighting the country’s historically low unemployment rate and the higher household savings rate compared to pre-pandemic levels.

But Finance Committee member John Barrasso, R-Wyo., took the harshest line against Yellen in his comments, pointing to her description of the inflation risk from the American Rescue Plan as “manageable.”

“Given that, it makes me wonder why Americans should put any confidence in your pronouncements, and decisions, and recommendations today,” Barrasso said.

OECD agreement

Republican taxwriters also expressed concern that the commitments the Biden administration made on behalf of the US in last year’s international tax agreement led by the OECD and G-20 would erode both US competitiveness and tax revenue. That agreement, which nearly 140 countries signed in October, seeks to reallocate some of the taxing rights of countries (Pillar 1) and to ensure that multinational corporations are paying a minimum level of tax globally (Pillar 2).

Sen. Mike Crapo, the top Republican on the Finance Committee, led the GOP’s criticism of the global tax agreement at that panel’s hearing this week, saying that the deal will “harm US businesses and undermine tax provisions enacted by Congress to encourage certain activities.”

Pillar 2 and nonrefundable tax credits: A significant challenge that US multinational companies have raised since the OECD released model rules for Pillar 2 in December is that nonrefundable tax credits could lower a company’s effective tax rate below the 15 percent minimum and allow other countries to impose a “top-up” tax on companies receiving them.

Many key tax incentives US businesses use are nonrefundable, including the credits for research and development and low-income housing, leading business groups and lawmakers alike to argue for a change in the rules. OECD officials have said recently that the rules will not be reopened.

Although she did not provide any details, Yellen said in an exchange with Finance Committee member James Lankford, R-Okla., that Treasury will work with Congress to ensure the incentives Congress has intended “are structured so that they will be available.”

Revenue impact: Addressing the potential impact of the agreement on the US fisc, Yellen told Senate taxwriter Pat Toomey, R-Pa., that Pillar 1 could gain or lose revenue, depending on the specific details in place when the pact is finalized; but she said the impact would be small compared to that of Pillar 2, which was scored by the Joint Committee on Taxation staff as a revenue raiser in the House-passed Build Back Better Act.

“We will gain revenue [under Pillar 1] from our ability to tax foreign corporations that are doing business in the United States,” Yellen said. ”We will lose some revenue—taxing authority—that’s reallocated to foreign countries. Net, it could be positive or negative, depending on details that have not yet been worked out—and that's why we've not provided data."

Toomey disputed Yellen's assertion that that the OECD agreement will be beneficial because it would end a perceived global race to the bottom on tax rates. He stated that he would characterize the current global tax climate as one that promotes competition among countries to create an attractive environment for investment.

"We should be looking to win the race, not prevent it from taking place," he said.

Advise and consent: GOP Finance Committee members also argued that the Treasury Department has not engaged in meaningful consultation with Congress or shared its analysis of the agreement's likely impact on the US, despite the fact that they believe implementing the reallocation of taxing rights under Pillar 1 will require tax treaty changes and therefore will need Senate approval.

This latter point has been a question since Yellen told the Senate Banking Committee last October that a treaty "would be one way" to implement Pillar 1. Responding to a question from Sen. Toomey at the Finance Committee hearing, Yellen stated that "ratification requires Congress's approval—I think there is no doubt about it," but she added that "the form that that needs to take is still to be determined."

A 'surrender' of taxing authority?: Across the Capitol, Ways and Means Committee ranking member Kevin Brady, R-Texas, contended that if the US signs on to the OECD agreement, it would essentially be "surrendering" the domestic tax base to foreign governments and that the bulk of the revenue generated under the agreement would flow from US-based companies.

Yellen disputed the assertion that the US would be ceding its taxing authority, stating that the US would gain the ability under Pillar 1 to tax a share of the profits generated by foreign companies. She also commented that the agreement includes enforcement mechanisms under Pillar 2 that allow signatories to impose penalties on noncompliant countries.

In an exchange with Ways and Means Committee Democrat Lloyd Doggett of Texas, Yellen argued that participating in the agreement is "very much in the US national interest." She noted that the US is currently the only nation in the world to impose a minimum tax on its multinational corporations and that Pillar 2 of the OECD agreement would level the playing field for US multinationals and their global competitors.

She also commented that inaction on Pillar 1 would leave US technology companies subject to a "global proliferation" of unilateral digital services taxes. Adopting Pillar 1 would avert that outcome and "create an environment of tax certainty," she said.

Foreign tax credit regulations

Taxwriters from both parties asked about foreign tax credit final regulations that were issued late last December and took effect on March 7 of this year. Business organizations have raised numerous concerns with the final regulations since January and have requested a one-year delay in their implementation. (For prior coverage, see *Tax News & Views*, Vol. 23, No. 16, May 6, 2022.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220506_3.html

In response to questions from Finance Committee Republicans James Lankford of Oklahoma and Rob Portman of Ohio, Yellen said she does not expect that Treasury will delay the implementation of the regulations; however, she said that some changes could be applied retroactively.

At the Ways and Means hearing, Democratic taxwriter Brad Schneider of Illinois argued that retroactive revisions to the regulations may not provide adequate relief for some taxpayers and urged Treasury to consider delaying the implementation date. Republican taxwriter Kevin Hern of Oklahoma went a step further and asked if Treasury would consider withdrawing the regulations.

Yellen did not change her position, however, and stated in response to Hern that the rules are intended "to protect the American tax base and make sure that foreign tax credits are allocated when foreign countries have a taxing right, but not when they do not."

Fossil fuels and green energy

With consumer fuel prices at record highs (not adjusted for inflation), GOP Finance Committee members including John Barrasso of Wyoming, Bill Cassidy of Louisiana, and Mike Crapo of Idaho took issue with the administration's stance towards the fossil fuel industry, pointing to proposals in the fiscal year 2023 Green Book to repeal numerous tax incentives for oil and gas companies, as well as to decisions about pipelines and drilling on public land.

"On one hand you and the president both say gas prices are too high, to which I agree," said Barrasso, "but on the other you are targeting American energy with taxes, and that's going to result in higher costs for Americans."

Yellen argued that the way to lower prices for American consumers in the "medium term" is to incentivize increased production of renewable energy to reduce US dependence on global oil markets. In the short term, with the US affected by uncertainties in the global oil market stemming from the Russia-Ukraine war, she argued that US producers hold leases on 37 million acres of land and can increase domestic production by drilling there. (Barrasso, however, retorted that the federal government will not issue the permits necessary to drill much of it).

A similar dynamic unfolded at the Ways and Means Committee hearing, where Republican taxwriter Tom Rice of South Carolina argued that fuel prices were on the upswing before the start of the Russia-Ukraine war. He asked whether the government intends to do more to increase the domestic energy supply.

Yellen replied that the Biden administration has done what it can by opening up Strategic Oil Reserves. She also commented that domestic oil producers, who lost money as oil prices fell in the early days of the COVID pandemic, made a deliberate decision to decrease oil production.

In response to a question from West Virginia Republican taxwriter Carol Miller, Yellen stated that “over time, it’s important to transition away from fossil fuels” and toward green energy sources to address what she called the “existential threat” of climate change.

IRS funding and the ‘tax gap’

Democratic taxwriters on both panels decried recent reports indicating that lower-income taxpayers are more likely than wealthier taxpayers to face an IRS audit—a situation they attributed to years of congressionally mandated cuts to the agency’s budget—and lauded the administration’s request (which is included in the House-passed Build Back Better Act) to beef up the agency’s enforcement budget by roughly $80 billion over 10 years.

Yellen agreed that the Service’s fiscal position is dire.

“The IRS is under siege,” she told Finance Committee member Elizabeth Warren, D-Mass. “It is suffering from huge underinvestment. It has massive problems that it is dealing with.”

Responding to a question from Finance Committee Democrat Bob Casey of Pennsylvania, who cited declining audit rates of large passthrough businesses, Yellen observed that the Service’s budget has been “cut to the point where they have largely cut back on the complicated audits … of high-income taxpayers.”

In an exchange with Ways and Means Committee Chairman Richard Neal, D-Mass., at that panel’s hearing, Yellen noted that the dearth of experienced enforcement agents at the IRS makes it easier for wealthier taxpayers—who often have “opaque” sources of income and engage in complex financial transactions—to avoid paying taxes. The resulting underpayment, she said, drives up the “tax gap” (the difference between the amount of tax legally owed to the government and the amount actually paid on a timely basis). Yellen noted in contrast that lower- and middle-income taxpayers—who primarily have income from wages and other sources that are subject to third-party reporting—are largely compliant.

“It’s unjust that ordinary wage earners are compliant with tax returns, yet for high earners who accrue income in opaque ways tax compliance is, in effect, voluntary,” she said.

Yellen also commented that reducing the tax gap—which is currently estimated to be roughly $600 billion a year—is “critical to ensuring fiscal responsibility.”

Yellen told House taxwriters that increasing IRS funding across all of its program areas—as proposed in the administration's fiscal year 2023 budget request—would allow the agency to shore up its customer service ranks and mitigate the impact of unanticipated emergencies such as the COVID-related shutdowns that left the agency with a backlog of unprocessed paper returns and refund claims, along with an inadequate number of employees to process them once service centers were reopened.

Funding problems or misplaced priorities?: For his part, Kevin Brady, the top Republican on Ways and Means, argued that the problems at the IRS are largely the result of misplaced priorities rather than a lack of money.

"For the past year, Treasury has ignored the tax refund crisis, with an unconscionable total of 26 million returns backlogged at the IRS. Americans hit hard with inflation can't even get their own refunds back to help keep their family budgets afloat," he said in his opening statement at the Ways and Means hearing.

"Congress gave the IRS over $1.8 billion in emergency funding, but instead of using it to work off the backlog, Treasury instead focused on pushing a dangerous bank surveillance scheme that targets the privacy of families, small businesses, and farmers"—a reference to a proposal in the administration's fiscal year 2022 budget blueprint that would have imposed an annual information return requirement on business and personal accounts from financial institutions, including bank, loan, and investment accounts, except those meeting a *de minimis* threshold. (That proposal was not included in the administration's latest budget package.)

Brady also criticized the proposed 10-year boost in IRS enforcement funding in the House-passed Build Back Better legislation, saying that it would "unleash 80,000 new IRS agents on American taxpayers—including low- and moderate-income families."

High-wealth minimum income tax

In an exchange with Ways and Means Committee member Don Beyer, D-Va., Yellen endorsed a proposal in the administration's fiscal year 2023 budget blueprint that would impose a minimum tax of 20 percent on total income, generally inclusive of unrealized capital gains, for all taxpayers with wealth greater than $100 million.

Yellen said the proposal was "well crafted" and would make it easier for the government to collect tax on income "that is often undertaxed and sometimes untaxed" altogether. She noted that because capital gains would be taxed regardless of whether the underlying asset is sold, the proposal would eliminate the "lock-in effect" and encourage taxpayers to invest in productive assets.

Retirement security

Senate Democratic taxwriter Ben Cardin of Maryland noted that the Finance Committee is preparing to mark up legislation that would build on the retirement security protections in 2019's Setting Every Community Up for Retirement Enhancement (SECURE) Act, a bipartisan measure that was enacted into law as part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94). He urged the White House to share its priorities with the panel as it decides what provisions to include.

URL: https://www.congress.gov/116/plaws/publ94/PLAW-116publ94.pdf

“We need your push here to get to the finish line,” Cardin said.

Yellen indicated that Treasury is willing to work with taxwriters to advance such a package.

Finance Committee Chairman Ron Wyden, D-Ore., recently told reporters that his panel is currently sorting through an array of proposals with a goal of holding a mark-up on a so-called “SECURE 2.0” bill this month. The House, meanwhile, approved its own version of a SECURE 2.0 bill—the Securing a Strong Retirement Act of 2022 (H.R. 2954) on March 29 by a vote of 414-5. (For prior coverage, see *Tax News & Views*, Vol. 23, No. 13, Apr. 1, 2022.) Leaders in both chambers have indicated that they hope to send a bipartisan retirement security bill to the White House later this year.
URL: https://www.congress.gov/bill/117th-congress/house-bill/2954/text
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2022/TNV/220401_1.html

Debt ceiling

Ways and Means Committee member Brendan Boyle, D-Pa., asked Yellen for her thoughts on legislation (H.R. 5415) he introduced last year with House Budget Committee Chairman John Yarmuth, D-Ky., that would transfer authority for raising the debt ceiling from Congress to the Treasury Department but allow Congress to rescind a debt ceiling increase by adopting a resolution of disapproval. (A disapproval resolution would require a 60-vote supermajority to clear the Senate.)
URL: https://www.congress.gov/bill/117th-congress/house-bill/5415/text

Yellen said she was “strongly supportive” of that approach, adding that it is “simply insanity” that the government is periodically brought to a crisis point when legislation to raise the debt ceiling comes before Congress.

In response to a separate question from Boyle, Yellen indicated that she does yet not know exactly when the government will next be forced to address the debt ceiling.

Congress late last year approved and President Biden signed into law a resolution (S.J. Res. 33) that increased the federal statutory borrowing cap to roughly $31 trillion, an amount likely sufficient to ensure the nation can continue to pay its bills until after the November 2022 mid-term elections. (For prior coverage, see *Tax News & Views*, Vol. 22, No. 55, Dec. 17, 2021.)
URL: https://www.congress.gov/bill/117th-congress/senate-joint-resolution/33/text
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/211217_2.html

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