Debt prioritization is 'default by another name,' Yellen tells Senate taxwriters

Treasury Secretary Janet Yellen this week rejected as "incredibly risky and dangerous" the notion of prioritizing payments of principal and interest on the publicly held debt and similar intragovernmental payments on obligations held within the Social Security and Medicare trust funds in the event the statutory debt limit is breached in the coming months.

Speaking at a March 16 Senate Finance Committee hearing on President Biden's fiscal year 2024 budget blueprint, Yellen stated in response to questions from Chairman Ron Wyden, D-Ore., that she "could not give any assurances" about the Treasury Department's technical capacity to implement a debt prioritization plan such as the Default Prevention Act (H.R. 187), which House taxwriters approved along strict party lines on March 9.
URL: https://waysandmeans.house.gov/wp-content/uploads/2023/03/Amendment-in-the-Nature-of-a-Substitute-to-H.R.-187.pdf

"The government makes millions of payments each day and our systems are built to pay all of our bills and not pick and choose which [ones] to pay," Yellen said, adding that it is essential for lawmakers to recognize that raising the debt ceiling is their responsibility.

"Failing to pay all of your bills when they're due is what I think of as default," Yellen said, and prioritizing debts as proposed by House GOP taxwriters is "effectively default by another name."

In a later exchange with Finance Committee Democrat Sherrod Brown of Ohio, Yellen said that if the Ways and Means Committee-approved proposal were to become law, payments to foreign governments such as China would have priority over payments to individuals receiving Social Security or veterans' benefits, and she reiterated that failing to pay all of the nation's bills when they are due would be "a recipe for economic and financial catastrophe."

For his part, Finance Committee ranking member Mike Crapo, R-Idaho, agreed that it is essential to protect the full faith and credit of the US government, but he criticized President Biden for not negotiating with congressional Republicans on a package of fiscal constraints that the GOP believes must be part of any debt ceiling agreement.

Yellen replied that the president believes it is "critically important" for the US to be on "a sustainable and responsible fiscal path," but she added that discussions about fiscal policy should be conducted separately and not as a precondition to raising the debt ceiling.

The US hit the current $31.381 trillion cap on federal debt on January 19 and the Treasury Department has been using so-called "extraordinary measures" to pay the nation's bills since then. Current projections from the Congressional Budget Office and Treasury Department suggest that Treasury's ability to use extraordinary measures likely will be exhausted sometime between June and September of this year, at which time the government would be at risk of defaulting on its obligations.

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URL: https://www.cbo.gov/publication/58906

IRS mandatory funding

Discussions among Senate taxwriters about specific policy proposals in the president's budget blueprint, which was released March 9, yielded no surprises. (For detailed coverage of tax provisions in the fiscal year 2024 budget package, their initial reception by congressional Republicans, and their prospects for enactment, see *Tax News & Views*, Vol. 24, No. 9, Mar. 10, 2023. Also see the Treasury Department's "Green Book" for explanations of the revenue provisions in the budget proposal.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230310_1.html
URL: https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf

Finance Committee members, as expected, were split along party lines over a proposal that would provide a combined $29 billion in new mandatory funding for the Internal Revenue Service for fiscal years 2032 and 2033—in addition to the roughly $80 billion in mandatory funding already allocated under the Inflation Reduction Act (P.L. 117-169) for fiscal years 2022 through 2031—to beef up the IRS's enforcement programs, modernize its information technology systems, and improve its customer service operations.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

Chairman Wyden commented that the funding infusion under the Inflation Reduction Act will help to eliminate the "double standard for tax enforcement" by giving the IRS the resources it needs to hire and train new revenue agents who will be able to focus on audits of highly complex returns involving sophisticated tax transactions undertaken by top-tier corporations, large partnerships, and ultrawealthy individuals. He criticized the Family and Small Business Taxpayer Protection Act (H.R. 23), a measure that House Republicans approved in January that would rescind the bulk of the Inflation Reduction Act funding, and asked Yellen to explain the ramifications for the fisc if that bill were to become law.
URL: https://www.congress.gov/118/bills/hr23/BILLS-118hr23pcs.pdf

Yellen replied that enacting the House-approved legislation would "allow wealthy individuals and large corporations to skip out on taxes they legally owe" and widen the federal tax gap—that is, the difference between the amount of tax legally owed to the government and the amount actually collected. Rescinding those funds also would have repercussions for taxpayer services—most likely in the form of slower telephone response times at IRS call centers, delayed refund payments, and an increased backlog of paper-filed returns resulting from a delay in implementing new scanning technologies, she added.

Yellen also noted that the funds made available to the IRS so far have allowed it to hire 5,000 new taxpayer service employees and that, as a result, the response rate for telephone requests for taxpayer assistance has consistently ranged between 80 percent and 90 percent through the current filing season, up from 13 percent in the previous year.

Republican taxwriter John Thune of South Dakota questioned how the administration could justify requesting additional mandatory funding for the IRS when the Treasury Department has not yet released its plan for spending the initial $80 billion tranche enacted under the Inflation Reduction Act. Reflecting a concern among

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some Republicans that the additional spending would be used to turn the IRS into an auditing behemoth with an inordinate focus on small businesses and less affluent individuals, Thune asked Yellen how much of that $80 billion will be directed to stepped-up audits of middle-class taxpayers.

Yellen replied that the spending plan—which she had initially stated would be ready by February 17—is “almost complete” and will be available “in a matter of weeks.” She also reiterated that she has directed the IRS not to use those new funds to increase audit rates—relative to their historical levels—for taxpayers with incomes of less than $400,000.

Addressing the issue of new hires, Yellen told Thune that the IRS needs to fill anticipated vacancies over the coming decade (the result of normal attrition and expected retirements) but that bringing on experienced auditors who specialize in complex returns remains “an important goal.” Although she acknowledged that the new funding is “a significant investment,” she said it will provide “an enormous payoff” in terms of closing the tax gap.

Global tax agreement

Republicans on the panel also pressed Yellen on the global tax agreement currently being advanced by the OECD/G20 Inclusive Framework on BEPS, which would overhaul the tax treatment of certain multinational businesses by creating new nexus rules for allocating taxing rights between countries (Pillar One) and imposing a 15 percent global corporate minimum tax (Pillar Two). The administration’s latest budget blueprint revives proposals from last year that would modify the Global Intangible Low Tax Income (GILTI) regime, repeal the current-law base erosion and anti-abuse tax (BEAT), and replace the BEAT with an Undertaxed Profits Rule (UTPR) that is intended to be consistent with the UTPR described in Pillar Two of the OECD’s Model Rules.

Ranking member Crapo contended in his opening statement that “Treasury has used the OECD negotiations to attempt to compel changes in US law without regard for the effect on US revenue, US companies, and US workers” and that “[t]he latest OECD guidance confirms the administration has agreed to allow foreign countries to collect US GILTI revenue, and . . . tax US companies on their US profits in violation of our tax treaties.”

In a subsequent exchange with Crapo on this issue, Secretary Yellen asserted that the 137 countries that have signed on to the OECD agreement did so to end “a race to the bottom” on corporate taxation and said that adopting the agreement would be in the US’s best interests.

Responding to a question from Republican taxwriter Charles Grassley of Iowa, Yellen stated that the administration’s proposals to align the treatment of US multinationals with the OECD rules would not violate existing tax treaties.

Grassley disagreed with that assertion, telling Yellen that “[o]nly Congress has the power to approve tax treaties.”

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TCJA and middle-class tax cuts

Sen. Todd Young, R-Ind., questioned Yellen about how the Biden administration squares the pending expiration (after 2025) of lower income tax rates and a host of other tax relief provisions for individuals enacted in the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) with its pledge not to increase taxes on individuals with incomes of less than $400,000. (The administration has called for allowing TCJA provisions to sunset but has vowed to protect less affluent taxpayers from tax hikes.)
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Yellen acknowledged that allowing certain TCJA provisions to expire would be detrimental to lower- and middle-class households and stated that the White House is "ready to work with Congress" on proposals to avoid such a result.

She did not, however, agree to Young's request for Treasury to produce within two weeks a list of specific provisions that would have to be extended in order to shield these taxpayers from future tax increases. She noted that the TCJA includes "a lot of complicated provisions" and that compiling the kind of comprehensive list that Young envisioned would be "a complex exercise."

Montana Republican taxwriter Steve Daines, meanwhile, asked Yellen if the administration would commit to permanently extending the TCJA's 20 percent deduction for passthrough business income under section 199A. He also asked whether the White House would commit to offsetting the cost of extending the 199A deduction by extending the current-law cap on the deduction for state and local income and property taxes (SALT), which is also scheduled to expire after 2025.

Yellen replied that "the president has pledged not to raise taxes on individuals or small businesses making under $400,000" but has made "no promises . . . beyond that."

Across the aisle, Sen. Robert Menendez, D-N.J., criticized the White House for not including a specific pledge to repeal the SALT deduction in its budget blueprint.

Yellen replied that the issue of extending the SALT deduction or allowing it to expire is something Congress needs to address.

In a related development, the Congressional Budget Office this week issued an analysis of the potential fiscal impact of allowing the TCJA tax cuts to become permanent as proposed by many congressional Republicans. (See separate coverage in this issue for details.)

Affordable housing incentives

Sen. Wyden commented in his opening statement that the president's proposals to promote affordable housing—making the new markets tax credit permanent, expanding the low-income housing tax credit, and enacting a new neighborhood homes credit—provide "a clear opportunity for bipartisan cooperation in this

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Congress.” (For details of bipartisan proposals discussed at a recent Finance Committee hearing on the role of tax policy in expanding access to affordable housing, see *Tax News & Views*, Vol. 24, No. 9, Mar. 10, 2024.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2023/TNV/230310_3.html

Finance Committee Democrat Ben Cardin of Maryland agreed with that assessment and stated that the panel should consider moving a package of housing incentives in a freestanding bill.

Yellen commented in an exchange with Cardin that she “absolutely” would work with Congress on such an effort, stating that all of these proposals “are important initiatives.”

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