Deloitte.

Yellen continues push for 'expeditious' congressional action on debt limit, defends new IRS mandatory funding

Treasury Secretary Janet Yellen this week renewed her call for Congress to act "expeditiously" to raise or suspend the federal debt limit and faced questions about newly enacted mandatory funding for the Internal Revenue Service during separate appearances before House and Senate appropriators to discuss the Biden administration's fiscal year 2024 budget proposals.

Debt limit issues

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. But current projections from the Congressional Budget Office (CBO) 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.
URL: https://www.cbo.gov/publication/58906

Consequences of inaction: Appearing at a Senate Appropriations Financial Services and General Government Subcommittee hearing on March 22, Yellen stated in response to a question from Chairman Chris Van Hollen, D-Md., that failing to raise the debt ceiling would "cause an economic catastrophe" and lead to a "loss of confidence" in the US dollar as a secure currency.

Van Hollen noted that Standard and Poors downgraded the nation's credit rating in 2011 when the US bumped up against its default date, even though Congress ultimately raised the debt limit shortly before the deadline and averted a default.

Yellen replied that the experience of 2011 underscores why Congress needs to address the pending breach as quickly as possible.

"We don't want to go to the 'X-date' and push this because damage can occur and we could be downgraded . . . if it looks as though Congress isn't willing to [act]," she said.

Yellen elaborated on that point during a March 23 hearing by the House Appropriations Financial Services and General Government Subcommittee that addressed the administration's fiscal year 2024 budget proposal and the broader US economic outlook.

"If we fail to raise the debt ceiling and have to cut spending to match the inflow of revenues that we had, we would be certain to have a recession or worse," she stated in response to a question from Rep. Steny Hoyer, D-Md., the subcommittee's ranking member. "It would be a dramatic cut in spending and the financial market consequences would be disastrous," she said.

Copyright © 2023 Deloitte Development LLC
All rights reserved.

Debt prioritization not an option: Echoing the position she took at a recent Senate Finance Committee hearing on the administration's budget blueprint, Yellen rejected the idea of prioritizing payments of principal and interest on the publicly held debt and similar intragovernmental payments on obligations held in the Social Security and Medicare trust funds should the US breach the statutory debt limit in the coming months. Debt prioritization has been endorsed by Republicans on the House Ways and Means Committee in the Default Prevention Act (H.R. 187), which cleared the committee along strict party lines on March 9. (It is unclear when H.R. 187 will be brought to the House floor for a vote. Should the measure win passage in the Republican-controlled House, it is unlikely to be taken up in the Democratic-controlled Senate.)
URL: https://waysandmeans.house.gov/wp-content/uploads/2023/03/Amendment-in-the-Nature-of-a-Substitute-to-H.R.-187.pdf

Yellen told Senate appropriator Martin Heinrich, D-N.M., that the nation's bills need to be paid when they are due and that debt prioritization is simply "default by another name." She added that the Treasury Department does not have the technical capacity to pay its obligations selectively, noting as an example that "for many federal agencies, payments are grouped together in ways that cannot be disentangled."

When asked by House Republican appropriator Michael Cloud of Texas to explain why prioritizing some debts over others would be tantamount to default, Yellen replied that the debt ceiling "is about paying bills for programs that already have been approved" by Congress.

"Bills that come to Treasury cover expenses that Congress has already authorized. If you don't pay bills that come due for services that you have ordered, that's default," she said.

Debt limit and fiscal restraint: Tennessee Sen. Bill Hagerty, the top Republican on the Senate Appropriations Financial Services and General Government Subcommittee, commented in his opening statement at that panel's hearing that the US faces "unprecedented" debt levels and that reducing the deficit requires fiscal reforms and not simply an increase in the debt limit; however, he stopped short of calling for a spending reform package as a prerequisite to voting on debt ceiling legislation—a demand voiced by some GOP lawmakers, particularly in the House.

In a subsequent exchange with Hagerty, Yellen reiterated the administration's position that issues around spending cuts and revenue increases to put the nation on a sustainable fiscal path are "appropriate matters for discussion" between the White House and Congress but added that any such talks cannot take place "under the specter of destroying the country's economic and financial [stability]."

Hagerty countered that the administration's position represents "a false choice." If the US does not address its "unprecedented spending epidemic in a responsible manner," he said, "the capital markets will address it eventually and I think that will be far more catastrophic."

For her part, Sen. Patty Murray, D-Wash., who chairs the full Appropriations Committee and participated in the March 22 Financial Services and General Government Subcommittee hearing, stated that the debt limit should be raised "without drama [and] without delay."

Copyright © 2023 Deloitte Development LLC
All rights reserved.

IRS funding issues

Secretary Yellen also fielded questions from appropriators in both chambers on the increased funding for the IRS that was proposed in the administration's fiscal year 2024 budget blueprint as well as the roughly $80 billion (over 10 years) in mandatory funding for the agency that was enacted last August as part of the Inflation Reduction Act (P.L. 117-169) to beef up its enforcement programs, modernize its information technology systems, and improve its customer service operations.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

Spending plan for new mandatory funding: In the Senate, Appropriations Committee Chairman Murray pressed Yellen on the status of the Treasury Department's plan for spending the Inflation Reduction Act funds. The Treasury secretary had stated earlier this year that the plan would be ready by February 17, and after missing that deadline has said only that the plan would be completed "in a matter of weeks."

Murray told Yellen in her opening statement that "[t]he department has had enough time to produce [a plan] and we expect to see it."

Yellen did not provide a precise timeline for delivering the plan in response to a direct question from Murray, although she noted that she has seen a completed draft that is not yet final.

Murray replied that lawmakers need to see "a real, concrete plan," noting, among other things, that having the details in hand will help congressional Democrats and the White House rebut the narrative circulating among some factions of the GOP that the IRS intends to use the funds to hire an "army" of new revenue agents focused on audits of small businesses and middle-class individuals.

Scope of expanded audit focus: In discussing plans to expand the IRS's enforcement efforts, Yellen emphasized to appropriators in both chambers that the Inflation Reduction Act funds will not be used to increase audits, relative to historic levels, of individuals or small businesses with income below $400,000.

Responding to questions from Maryland Sen. Van Hollen and House Republican appropriator Dave Joyce of Ohio at their respective hearings, Yellen explained that the IRS will focus on audits of wealthy individuals, complex partnerships, and corporations who are underreporting income and underpaying their taxes. These segments of the tax base, she said, are the greatest contributors to the "tax gap"—the difference between the amount of tax owed to the federal government and the amount actually paid on a timely basis.

She told Joyce, who said he was "skeptical" that there would not be an increase in audits of smaller businesses and less affluent individuals, that the IRS has "no motivation" to enhance its scrutiny of these taxpayers, stating that they do not contribute significantly to the tax gap and that she has issued a directive that "clearly prohibits" the agency from using Inflation Reduction Act funds to target them for audits. The bulk of the expanded IRS's expanded enforcement budget, she said, will go to hiring highly specialized tax professionals who are skilled in unwinding the kinds of complex tax transactions undertaken by large businesses and ultrawealthy individuals and recovering unpaid taxes that are legally owed.

Copyright © 2023 Deloitte Development LLC
All rights reserved.

Yellen and Sen. Van Hollen both criticized the Family and Small Business Taxpayer Protection Act (H.R. 23), a House Republican measure that cleared that chamber along strict party lines in January that would rescind some $71 billion of the Inflation Reduction Act funding—specifically, the portions allocated for enforcement activities and operations support—while preserving the remaining $9 billion that is set aside for taxpayer services and business systems modernization. (The measure is not expected to be taken up in the Democratic-controlled Senate.)
URL: https://docs.house.gov/billsthisweek/20230102/BILLS-118HRPIH-IRS-repeal.pdf

Yellen noted in her exchange with Van Hollen that money spent on IRS enforcement efforts to address the tax gap ultimately will generate greater returns for the fisc and that rescinding the Inflation Reduction Act funds as proposed by House Republicans would add to the federal deficit.

The nonpartisan CBO has estimated that H.R. 23, if signed into law, would result in a net increase in the federal deficit of roughly $114.4 billion between 2023 and 2032, through the combined effects of a $71 billion reduction in net outlays and a $186 billion reduction in revenue from foregone tax collections.
URL: https://www.cbo.gov/system/files/2023-01/hr23_IRS.pdf

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Copyright © 2023 Deloitte Development LLC
All rights reserved.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms or their related entities (collectively, the "Deloitte organization") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. DTTL and each of its member firms, and their related entities, are legally separate and independent entities.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte provides industry-leading audit and assurance, tax and legal, consulting, financial advisory, and risk advisory services to nearly 90% of the Fortune Global 500® and thousands of private companies. Our professionals deliver measurable and lasting results that help reinforce public trust in capital markets, enable clients to transform and thrive, and lead the way toward a stronger economy, a more equitable society and a sustainable world. Building on its 175-plus year history, Deloitte spans more than 150 countries and territories. Learn how Deloitte's approximately 415,000 people worldwide make an impact that matters at www.deloitte.com.

Copyright © 2023 Deloitte Development LLC
All rights reserved.