Deloitte.

In this issue:

House GOP struggles to find a path on appropriations as shutdown deadline looms

House Speaker Mike Johnson, R-La., was forced this week to pull two fiscal year 2024 appropriations bills from the House floor—including one that would provide annual funding to the Internal Revenue Service—on account of GOP defections; meanwhile, House GOP leaders have remained mum on their strategy to keep the government's doors open past November 17, when the current stopgap appropriations measure is scheduled to expire.

Appropriations bills pulled

Speaker Johnson's appropriations troubles began on November 7, when GOP leaders were forced to pull a bill providing full-year funding for the Departments of Transportation and Housing and Urban Development due to dueling concerns among some Republicans about the inclusion of a $1.5 billion cut to Amtrak funding.

"I've got about eight or 10 people on one side that want more money for [Amtrak] . . . ," said Rep. Tom Cole, R-Okla., who chairs the Appropriations subcommittee that oversees the so-called "THUD" spending bill. "[And] I've got eight or 10 who'd probably like to get rid of Amtrak altogether."

That same push-and-pull among moderate and conservative Republicans was on display again two days later when Speaker Johnson pulled the plug on the fiscal year 2024 Financial Services and General Government (FSGG) appropriations bill which provides funding to dozens of federal departments and agencies, including the Treasury Department, IRS, and the Office of Management and Budget.

In this case, the intraparty GOP feud centered on an abortion-related policy rider opposed by some moderates, and funding for a new Federal Bureau of Investigations headquarters, which came under fire from a handful of conservatives including Rep. Matt Gaetz, R-Fla.

The FSGG measure that had been teed up for a floor vote this week would give the IRS $11.2 billion for fiscal year 2024—$1.1 billion less than the companion measure awaiting consideration in the Senate.

It is worth noting that the decision to cut bait on the THUD and FSGG appropriations measures, while embarrassing for House Republicans, is likely of little practical short-term import since the bills—both of which include sizable spending reductions relative to fiscal year 2023 levels—face strong opposition from Senate Democrats and the White House.

Johnson still mum on his stopgap funding strategy

Of more immediate concern is how House Republicans intend to prevent large portions of the government from shuttering after November 17. Although Democrats and Republicans remain far apart on fiscal year 2024 appropriations in general, they did come together on a bipartisan basis in late September to pass a "clean" continuing resolution (CR) that continued fiscal 2023 spending levels through next Friday—although Rep. Kevin McCarthy, R-Calif., likely lost the speaker's gavel because he authored that legislation, which was only able to clear the chamber with support from Democrats. (For prior coverage, see *Tax News & Views*, Vol. 24, No. 33, Oct. 6, 2023.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231006_1.html

Johnson's ladder: For his part, new Speaker Mike Johnson still has not tipped his hand as to his strategy, though reports suggest he may be leaning toward a so-called "laddered" CR—a novel approach favored by some House conservatives that apparently would extend programs within particular appropriations measures along a staggered schedule, reportedly with deadlines of mid-January and mid-February of next year. In theory, laddering the stopgap deadlines would compel legislative action on individual spending bills as those various deadlines arrive and, in the process, help avoid the type of so-called "omnibus" spending measure that has drawn the ire of House GOP conservatives.

But this approach has come under heavy fire from both Democrats and Republicans in the Senate, raising a high level of doubt that such a plan could actually make it to President Biden's desk.

"That's the craziest, stupidest thing I've ever heard of," Senate Appropriations Committee Chair Patty Murray, D-Wash., said of a laddered CR.

Her GOP counterpart on the Appropriations Committee, ranking member Susan Collins of Maine, echoed Murray's sentiments.

"I have a lot of reservations," Collins said. "I don't see how that would work, and it seems unnecessarily complex. You'd have to go through the threat of shutdowns of part of [the] government over and over again."

A clean CR plus aid to Israel?: Pairing a clean CR with aid for Israel is also apparently under consideration by the speaker. However, last week Johnson pursued—and the House passed, on a largely partisan basis—a $14.3 billion Israel aid package, offset by an equal amount of cuts to the mandatory funding stream provided to the IRS as part of the Inflation Reduction Act of 2022 (P.L. 117-169), an approach that Senate Majority Leader Charles Schumer, D-N.Y., called "stunningly unserious." (For prior coverage, see *Tax News & Views*, Vol. 24, No. 37, Nov. 3, 2023).
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231103_1.html

If Johnson again tries to offset the Israel component of such a bill—with spending cuts to the IRS or to other agencies—it surely would again run into a buzzsaw of resistance from congressional Democrats and from President Biden, who has promised that he would veto such a proposal even if it could get through the Senate and reach his desk.
URL: https://www.whitehouse.gov/wp-content/uploads/2023/11/Israel-Security-Supplemental-Appropriations-Act-SAP.pdf

House Minority Leader Hakeem Jeffries, D-N.Y., alluded to this reality November 9 when we said House Democrats would not "pay a single right-wing ransom demand" in exchange for keeping the government open.

In Jeffries' view, a clean CR—like the stopgap that is currently in place—that simply extends fiscal 2023 spending levels is the only way to avoid a government shutdown next week.

"A continuing resolution that is at the fiscal year 2023 levels is the only way forward because that's the status quo," Jeffries said.

Schumer tees up Tuesday CR vote

In a possible attempt to jam the House by sending the chamber bipartisan funding legislation close to the November 17 deadline, Senate Majority Leader Schumer on November 9 began taking steps to advance a piece of legislation that would become the vehicle for a Senate CR. A first procedural vote on that "shell" bill is expected to occur on Tuesday, November 14.

Though the exact contours of that forthcoming CR—including its end date—are still unknown, reports have suggested that Senate Democrats are eyeing a mid-December deadline, potentially setting up another cliff before the holidays that Senate leaders hope will compel action on a broader "omnibus" spending bill that wraps together full-year funding for all 12 federal appropriations measures.

Although it remains to be seen how Senate Republicans will react to Schumer's proposal, at least one GOP senator said that he was not totally averse to such an approach.

"I hate saying this because I don't want to be here for the holidays, but a December date that doesn't require a lot of extensions of other legislation is useful," said Senate Appropriations Committee member Jerry Moran, R-Kan. "I certainly hope we avoid a later date . . . because it means we'll have less incentive to actually get out of a CR."

Size of potential tax title comes into focus

In related news, the price tags associated with tax policies that Democratic and Republican taxwriters are angling to attach to a year-end spending bill—or potentially another suitable legislative vehicle—should one materialize—came into clearer focus this week.

Reversing some TCJA business tax provisions: According to Politico, Ways and Means Committee member Kevin Hearn, R-Okla., said November 7 that Republicans were eyeing a $35-$40 billion business tax relief package, which presumably would include provisions reversing certain changes that have taken effect pursuant to 2017's Tax Cuts and Jobs Act (TCJA, P.L. 115-97) that have curtailed deductions for research expenditures and business interest expense, and dialed-back immediate write-offs for capital investments.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Rep. Ron Estes of Kansas, another House GOP taxwriter, noted separately this week that reversals of those three policies would "ideally . . . last until 2025"—an approach that would line up their next scheduled lapse with the expiration of the vast majority of individual tax code changes made by the TCJA, as well as a host of other traditional tax extenders—such as the Work Opportunity Tax Credit and the controlled foreign corporation "lookthrough" rule under Subpart F.

Expanding the child tax credit: Meanwhile, also according to Politico, a Senate Democratic aide remarked that Democrats in that chamber have been eyeing a potential short-term expansion of the child tax credit that would come in at around $49 billion—roughly in the same ballpark as the business-focus package referenced by Rep. Hearn.

Democrats have consistently demanded that any business tax relief this year be paired with a more generous child tax credit, though exactly what changes they are pursuing remains unclear. (Modifications that have been discussed in the past include some combination of increasing the size of the credit, enhancing its refundability, making it payable in advanceable monthly installments, and accelerating the phase-in of the credit's full value.) And it should be noted that Senate Finance Committee Chairman Ron Wyden, D-Ore., when asked this week, would not divulge any details about ongoing tax talks among his members.

Republicans, for their part, have consistently demanded coupling an expanded child tax credit with parental work requirements, something that was temporarily done away with during 2021, when the credit was significantly expanded—for that year only—as part of Democrats' American Rescue Plan (P.L. 117-2).
URL: https://www.congress.gov/117/plaws/publ2/PLAW-117publ2.pdf

Hurdles remain: The revelation that Republicans and Democrats may be targeting similarly-sized tax packages would seem to be a good sign for those striving to fold a tax title into a year-end spending bill. It is important to note, however, that details remain scarce and, as discussed above, it remains difficult to predict whether any suitable legislative vehicle that could carry such deal will even come together.

— Alex Brosseau
Tax Policy Group
Deloitte Tax LLP

Wyden urges mark-to-market tax regime for high-wealth individuals

Senate Finance Committee Chairman Ron Wyden, D-Ore., this week called for congressional passage of an annual mark-to-market regime for high-income households.

In his opening statement at a November 9 Finance Committee hearing to examine "how the tax code affects high-income individuals and tax planning strategies," Wyden argued that the federal tax code as currently enacted gives the wealthiest individuals, whose income typically is derived from investment gains, the flexibility to choose when—or if—they will have to pay income taxes based on when they decide to realize those gains. Lower- and middle-class taxpayers, on the other hand, have income that generally is derived from wages and are required to pay tax annually as that income is earned. Moreover, Wyden noted, income from investment gains generally is taxed at more favorable rates than income from wages.

'Buy, Borrow, Die'

One particularly notable—and legal—example of how the tax code allows the most affluent individuals to minimize their tax bills, according to Wyden, is the so-called "buy, borrow, die" strategy in which a wealthy investor buys an asset such as a business, borrows against that asset's appreciating and untaxed value over a period of years to fund "their extravagant lifestyle," and then passes the asset on to their heirs at death subject to minimal taxes, or in some cases no tax at all.

"Right now, the average billionaire wriggles their way into a measly 8 percent tax rate while a nurse or firefighter making $45,000 is paying a 22 percent tax on their wages," Wyden said. "It's time to close these loopholes and make sure those at the very top are paying taxes on their income as it's earned, just like everybody else."

Subjecting high-income, high-net-worth individuals to an annual mark-to-market tax regime on their unrealized capital gains would "restore fairness to the tax code while still rewarding success," Wyden said.

Mark-to-market discussion

Although he did not discuss a specific mark-to-market tax proposal at the hearing, Wyden released a detailed white paper in 2019 proposing an annual mark-to-market regime for high-income households that would also tax resulting capital gains at ordinary rates. (For prior coverage of the white paper, see *Tax News & Views*, Vol. 20, No. 29, Sep. 13, 2019.) He also released a draft proposal for a "billionaires income tax" with a mark-to-market component in 2021 as part of the discussion around what was then known as President Biden's "Build Back Better" tax-and-spending agenda. ("Build Back Better" was ultimately supplanted by a narrower legislative effort that culminated in the Inflation Reduction Act, which did not include any sort of mark-to-market regime for wealthy individuals.)
URL: https://www.finance.senate.gov/imo/media/doc/Treat%20Wealth%20Like%20Wages%20RM%20Wyden.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2019/TNV/190913_2.html
URL: https://www.finance.senate.gov/chairmans-news/wyden-unveils-billionaires-income-tax

Proposals such as these appear to have no path forward in the current Congress, with the House of Representatives under Republican control; however, they do represent the kind of legislation Wyden might try to advance if Democrats win back the House and retain control of the Senate and the Oval Office in the 2024 elections.

What's your damage?: Wyden asked one of the Democrats' invited witnesses at the hearing—Morris Pearl of Patriotic Millionaires—to opine on the potential economic impact of a mark-to-market regime on the universe of individuals that would be subject to such a tax. (According to its website, Patriotic Millionaires is an organization comprising "hundreds of high-net-worth Americans who . . . are focused on promoting public policy solutions that encourage political equality, guarantee a sustaining wage for working Americans, and ensure that millionaires, billionaires, and corporations pay their fair share of taxes.")

Pearl replied that the individuals who would be subject to a mark-to-market tax "earn hundreds of millions in economic income but nothing in taxable income" and would still have substantial wealth even after making an annual tax payment on unrealized gains.

"Wealthy people invest money," he said. "I would certainly rather invest my money at a high return and pay half in taxes than get no return at all."

Pearl argued that the tax code needs to "redefine taxable income as money you make regardless of how you make it," whether that be through wages or investment gains.

"You're making money and you should pay tax on that money the same as everyone else does," he said.

Borrowing as a realization event: Democratic taxwriter Mark Warner of Virginia commented that he "struggles" with proposals that would impose a tax on income when there is no specific realization event. He asked whether, in the context of a "buy, borrow, die" scenario, the act of borrowing against an asset should be treated as a realization event.

Pearl replied that, in his view, borrowing would be economically the same as a realization event if the interest rate on the loan is lower than the rate of return on the collateralized asset.

Pitfalls of equalization: For his part, Finance Committee ranking member Mike Crapo, R-Idaho, said he was skeptical of the notion of equalizing tax rates between wage income and capital gain income. Many individuals across the income spectrum realize capital gains through ordinary transactions such as the sale of a primary residence, he argued, and equalizing tax rates could trigger significant tax increases for less affluent individuals who sell a capital asset.

In an exchange with Crapo, one of the GOP's invited witnesses—Douglas Holtz-Eakin of the American Action Forum—commented that the solution to that dilemma would be to equalize taxes at the lowest possible rates.

Holtz-Eakin also acknowledged that the government needs to collect tax on capital income as well as labor income, but said that goal could best be accomplished through a progressive consumption tax rather than a mark-to-market regime.

Codifying the 'Buffett Rule': Democratic taxwriter Sheldon Whitehouse of Rhode Island touted his own proposal to impose a minimum tax on wealthier taxpayers by codifying what is known informally as the "Buffett Rule." The Paying a Fair Share Act of 2023 (S. 1173), which Whitehouse introduced this past April, generally would require an individual whose adjusted gross income exceeds $1 million to pay a minimum tax rate of 30 percent on the excess of adjusted gross income over the taxpayer's modified charitable contribution deduction for the taxable year. (Whitehouse, who is chairman of the Senate Budget Committee, offered additional thoughts on the taxation of high-wealth taxpayers during a hearing that panel held this week. More on that below.)
URL: https://www.congress.gov/bill/118th-congress/senate-bill/1173/text

Other troublesome tax code provisions

Ranking member Crapo commented in his opening statement at the Finance hearing that the government should not tolerate outright tax evasion and that Congress should examine ways to target "gray areas" in the tax code that may lead some taxpayers to "aggressively structure their affairs to reduce their tax liability." But he added that lawmakers also should scrutinize those parts of the tax code that he characterized as "primarily benefit[ing] a select group of the financially well-off—including tax credits for those who can afford expensive electric vehicles, costly energy-efficient home upgrades, and proposals to repeal the cap or expand the highly regressive deduction for state and local taxes."

Taxwriters—and budget writers—discuss tax gap, IRS funding

Also at the hearing, Finance Committee members largely adhered to entrenched partisan positions on the extent to which tax avoidance and tax evasion among ultrawealthy individuals and large businesses contributes to the rising "tax gap"—the difference between the amount of money legally owed to the government in taxes and the amount actually paid and collected on a timely basis—and the relative merits of a provision in last year's Inflation Reduction Act (P.L. 117-169) that gave the Internal Revenue Service a 10-year mandatory funding stream to strengthen its enforcement programs, enhance its operations support functions, modernize its information technology systems, and improve taxpayer service.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

The Finance Committee discussion in many ways mirrored the comments from lawmakers and witnesses at a November 8 Senate Budget Committee hearing on "promoting fairness and fiscal responsibility" by "cracking down on wealthy tax cheats."

Here are the highlights of observations by lawmakers and witnesses at both hearings.

Tax gap: Finance Committee member Maggie Hassan, D-N.H., commented that the tax gap is largely attributable large corporations and high-wealth individuals and asked witnesses at that panel's hearing for their views on the best ways to reduce it.

Morris Pearl and Douglas Holtz-Eakin, along with Chye-Ching Huang of the Tax Law Center of the New York University School of Law, agreed that the tax gap discussion needs to be bifurcated between tax evasion and tax avoidance. Outright evasion is best addressed by ensuring that the IRS has the audit and enforcement resources it needs to identify and pursue tax cheats. Tax avoidance, which stems chiefly from "gray areas" of the tax code that may encourage some individuals to adopt aggressive tax positions, requires congressional action to clarify ambiguous or troublesome provisions in the code. Another witness—William McBride of the Tax Foundation—called for a "radical simplification" of the tax code, which he said will lead to greater compliance and lower administrative costs.

But ranking member Mike Crapo questioned the premise that wealthy individuals are the primary drivers of the tax gap and argued instead that they are the greatest contributors to the tax base.

"According to the Biden Treasury Department, in 2023, the top 1 percent of earners paid 42.2 percent of all federal income taxes—the highest—despite only earning 19 percent of all income. In 2001, the top 1 percent of earners contributed 33.2 percent of income tax revenue, 9 points lower. In other words, the country's income tax burden is more progressive today than it was decades ago," Crapo said in his opening statement.

At the Senate Budget Committee hearing a day earlier, Chairman Sheldon Whitehouse (who also serves on the Finance Committee) suggested that the amount of the tax gap—estimated to be $688 billion in 2021—may be even higher than the official projections provided by the IRS.

Witness Natasha Sarin—a former Treasury official in the Biden administration who is currently with the Yale Law School and Yale School of Management—agreed with Whitehouse, noting that the IRS has limited capacity to measure the amount of the tax gap attributable to corporations, large partnerships, and digital assets.

"You can only measure what you can see," Sarin said.

Budget Committee ranking member Charles Grassley, R-Iowa, questioned the methodology for measuring the tax gap and suggested that officials who say the tax gap is increasing may be overstating the case. (Grassley also has a seat on the Finance Committee but did not attend that panel's hearing.)

In an exchange with Grassley, Chris Edwards of the Tax Foundation—the GOP's invited witness at the Budget Committee hearing—stated that the latest estimates show that the tax gap has remained steady over time when considered as a percentage of the US gross domestic product.

Budget Committee member Mitt Romney, R-Utah, disputed the premise that complex partnerships—which Democrats regard as a key contributor to the tax gap—are deliberately designed to evade or avoid taxes. Rather, he explained, the structure of a partnership typically reflects "the reality of what happens if you're making multiple investments."

"I recognize as well that a lot of those machinations that go on in the corporate world in particular are done to minimize taxes," Romney said, but those efforts are intended to reduce taxes "in conformity with the laws we have written."

IRS enforcement resources: Finance Committee Democrat Robert Menendez of New Jersey contended that a decade of cuts to the IRS budget under Republican-controlled Congresses led to a deterioration of the agency's enforcement programs and a steep decline in audit rates of upper-income individuals. The new mandatory funding stream authorized under the Inflation Reduction Act, he noted, would reverse this trend by giving the agency the resources it needs to retool its compliance and enforcement efforts.

Witness Chye-Ching Huang commented in an exchange with Menendez that various House Republican proposals to claw back portions of the new IRS funding would decrease federal revenue and add to the deficit. In a subsequent exchange with Democratic Finance Committee member Tom Carper of Delaware, Huang added that giving the IRS the financial resources it needs to pursue "pernicious" instances of tax evasion ultimately brings in far more revenue into the fisc than is expended in audit costs.

A witness at the Senate Budget Committee hearing—Nathaniel Hendren of the Massachusetts Institute of Technology—commented in response to a question from Sen. Chris Van Hollen, D-Md., that the overall return on investment could be as high as $12 for every $1 in audit expenditures, an outcome he said represents the combined impact of back taxes collected plus future compliant behavior prompted by the deterrent effect of a robust enforcement effort.

Budget Committee ranking member Charles Grassley, however, criticized the "lopsided nature" of the Inflation Reduction Act's IRS funding stream, noting that it is more heavily skewed toward enforcement than taxpayer service.

Responding to a question from Grassley, witness Chris Edwards urged Congress to consider a bipartisan compromise that would shift some of the amounts currently allocated to enforcement over to taxpayer services and systems modernization.

Edwards also cautioned that the IRS's heightened audit focus may subject taxpayers to additional burdens in the form of legal expenses and time spent on audit preparation, even if an audit results in a "no change" recommendation.

It's worth noting that Utah's Mitt Romney broke with Republican orthodoxy at the Budget Committee hearing by agreeing with Democrats that a GOP-backed measure recently approved in the House that purports to offset the cost of emergency aid to Israel by rescinding $14.3 billion in Inflation Reduction Act funding earmarked for IRS enforcement efforts would, in fact, increase the federal deficit. The nonpartisan Congressional Budget Office has estimated that the House bill (H.R. 6126) would actually increase the deficit by a net amount of about $12.5 billion over the next 10 years, through the combined effects of a roughly $14.3 billion reduction in direct spending and a $26.8 billion reduction in revenues because of forgone tax collections. (For details on the House-passed measure, see *Tax News & Views*, Vol. 24, No. 37, Nov. 3, 2023.)
URL: https://www.cbo.gov/system/files/2023-11/Letter_to_Hoyer.pdf
URL: https://rules.house.gov/sites/republicans.rules118.house.gov/files/ISRAELFINAL_xml.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231103_1.html

"I'm one of those who believes very deeply in carrying out audits, hiring enough IRS agents so that we're getting as much revenue back as we possibly can," Romney said. "I think it's nuts to somehow think that getting rid of auditors is going to save us money."

Audit thresholds: On a related issue, Republicans on both committees were skeptical of the Treasury Department's promise that an expanded IRS audit program for high-income taxpayers will focus on individuals with income of $400,000 or more and will not result in an increase in audit rates for small businesses and middle-income taxpayers.

Finance Committee member Marsha Blackburn, R-Tenn., noted that IRS Commissioner Daniel Werfel has told taxwriters that the $400,000 threshold would be based on "total positive income," but she contended the term has not been clearly defined, which leaves less affluent taxpayers unsure of whether they could eventually be swept into an expanded audit net. (Finance Committee Chairman Wyden agreed that the term "total positive income" is imprecise and promised to get an official definition from the IRS.)

Witnesses Douglas Holtz-Eakin and Chye-Ching Huang said in response to questions from Blackburn that they were wary of income-based audit thresholds in general.

Holtz-Eakin commented that "audits ought to be applied on the basis of evasion, the probability of evasion, and the [government's] ability to collect taxes. No other criteria should matter."

Huang cautioned that the government needs to be careful not to set a threshold that "would allow the worst tax evaders to file returns pretending to have income below that level" and thus "avoid detection through audit."

At the Budget Committee hearing, ranking member Charles Grassley dismissed the Treasury Department's contention that small businesses and middle-income taxpayers will not see an increase in audits under the IRS's expanded compliance programs as "hogwash."

He specifically criticized the "total positive income" standard as overly broad and noted that the $400,00 threshold amount is not indexed for inflation, which runs the risk that "more and more taxpayers will get caught up in it every year."

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Wenstrup to retire after 2024

House Ways and Means Committee Republican Brad Wenstrup of Ohio announced this week that he will not run for re-election in 2024 and will retire from Congress at the end of his current term.

Wenstrup, a physician, was first elected to Congress in 2012 and joined the Ways and Means Committee in May of 2018 to fill a vacancy created by the resignation of Rep. Patrick Meehan of Pennsylvania. He currently sits on the Health Subcommittee and the Work and Welfare Subcommittee.

Wenstrup is the second House taxwriter in two weeks to announce he will not mount a re-election bid next year. Democratic taxwriter Earl Blumenauer of Oregon revealed on October 30 that he will leave Capitol Hill after the 118th Congress formally adjourns in January of 2025.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP