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House back in business as Johnson claims speaker's gavel

After three weeks of legislative gridlock, the House of Representatives resumed normal operations on October 25 as members of the Republican majority coalesced around Rep. Mike Johnson, R-La., to serve as the chamber's new speaker.

The final vote tally broke strictly along party lines: Johnson received 220 votes from a united Republican Conference and his sole challenger, Minority Leader Hakeem Jeffries, D-N.Y., received 209 votes from the chamber's Democrats.

Johnson replaces former Speaker Kevin McCarthy, R-Calif., who was ousted from the top spot after a handful of House Freedom Caucus members pushed through a "motion to vacate" in response to McCarthy's decision to advance a stopgap government funding measure that relied on Democratic votes for passage. (The funding bill, which cleared the House and Senate on September 30 and was quickly signed into law by President Biden, averted a government shutdown that otherwise would have occurred at the start of fiscal year 2024 on October 1. 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

Process of elimination

A four-term congressman who most recently was Republican Conference vice chair, Johnson was the fourth Republican to be nominated as speaker since McCarthy lost his leadership position but the first to lock down enough support from within his own party to prevail on the House floor and claim the gavel. The speaker is elected by a vote of the entire House and Republicans hold an extremely narrow majority—currently, 221 seats compared to 212 for Democrats (2 seats remain vacant). With a margin that tight, a nominee could afford only 4 GOP defections in a floor vote if all members were present and voting, since all of the chamber's Democrats were committed to supporting Jeffries.

Majority Leader Steve Scalise, R-La., was nominated for speaker on October 11, only to withdraw from the race the next day—without receiving a floor vote—after he determined that there were enough Republican holdouts to sink his candidacy. House Judiciary Committee Chairman Jim Jordan, R-Ohio, was tapped for the post on October 13 but subsequently lost in three separate floor votes and saw his opposition from within the GOP increase on each successive ballot before bowing out as a candidate. Majority Whip Tom Emmer, R-Minn., got the nod on October 23 but dropped out just four hours later after it became clear that a majority was out of reach and that he would fail if his nomination went to a vote on the House floor.

Legislative agenda: A narrow window for government funding

Johnson ascends to the speaker's dais as the nation one again moves toward a possible government shutdown when the continuing resolution (CR) keeping the lights on and the doors open expires in just three weeks, on November 17.

In a letter to his GOP colleagues penned during his brief campaign to lead the House, Johnson outlined what he characterized as an "ambitious schedule" for the chamber to clear all 12 individual spending measures required to fund federal government operations. He noted, though, that if an agreement on funding is not in place by the time the current CR expires, he would be open to a stopgap measure "that expires on January 15 or April 15 . . . to ensure the Senate cannot jam the House with a Christmas omnibus." He did not indicate whether he would support a funding extension at the fiscal year 2023 levels in place under the current CR or if he would instead insist on additional spending cuts as demanded by more conservative House Republicans during the last round of House and Senate negotiations on a stopgap leading up to the close of fiscal year 2023 on September 30.
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231027_1_suppA.pdf

Also unclear from the letter is whether Johnson would accept a “clean” CR (that is, with no extraneous provisions) or if he would instead demand certain social policy riders that are favored by some factions within the Republican Conference but are generally viewed as nonstarters by the Senate and the White House.

Any decisions around whether Congress will move a year-end omnibus spending package or a continuing resolution that extends into next year—and what a CR, if adopted, might look like—will, of course, have to be hammered out by Johnson, Senate Majority Leader Charles Schumer, D-N.Y., and Senate Minority Leader Mitch McConnell, R-Ky., (since such a measure would be unable to overcome a Senate filibuster if all Republicans oppose it), and also be acceptable to President Biden.

Schumer, for his part, reiterated to reporters October 26 that an eventual agreement on spending would have to be bipartisan.

“I hope that this new speaker understands that he cannot get things done if he tries to just be partisan. We said we’d talk, so let’s hope,” Schumer said.

Tax policy agenda: Is there one?

The near-term agenda Johnson outlined in his “Dear Colleague” letter does not include a specific reference to tax policy or a year-end tax bill—and his apparent aversion to an omnibus spending agreement, which would be the likely vehicle to carry a tax package, suggests that reaching an accord on taxes might not be among his priorities in 2023.

Since he came to Congress in 2017, Johnson has not played a prominent role in advancing tax-related legislation. He does not sit on the House Ways and Means Committee and the bulk of the legislative proposals on which he is listed as the lead sponsor fall within the jurisdictions of the Judiciary, Energy and Commerce, and Natural Resources panels; moreover, the positions page on his House website includes only a general statement that Congress has “a moral and constitutional duty to . . . pursue continued pro-growth tax reforms and permanent tax reductions” as part of a multi-pronged effort to reduce the federal deficit.
URL: https://www.congress.gov/member/mike-johnson/J000299?q=%7B%22sponsorship%22%3A%22sponsored%22%7D
URL: https://mikejohnson.house.gov/issues/issue/?IssueID=14899

In his campaign for the speakership, however, Johnson apparently did take a position on one fairly divisive tax issue: relief from the $10,000 limitation on the deduction for state and local taxes (SALT) enacted in the Tax Cuts and Jobs Act of 2017 (P.L. 115-97). According to several Republican members of the House’s SALT Caucus—a coalition of lawmakers in both parties who represent jurisdictions with high state and local income and property taxes—Johnson promised that he would not allow a tax bill to come to the House floor in this Congress if it did not include a provision to increase the current-law cap.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

“He acknowledges that providing SALT relief is critical for middle-class Americans burdened by double taxation and must be addressed in any tax bill the House considers,” SALT Caucus Co-Chair Andrew Garbarino, D-N.Y., stated in a press release announcing his support for Johnson ahead of the October 25 floor vote on his nomination.

Rep. Anthony D’Esposito, R-N.Y., told reporters October 25 that he was confident a tax package is “not going to make it to the floor unless the SALT relief is in there, because [Johnson is] going to need . . . votes” from him and other Republicans in the SALT Caucus.

But moving a tax bill through the House that addresses the SALT cap could prove to be a difficult needle to thread. The American Families and Jobs Act, a largely business-focused economic growth tax package that the House Ways and Means Committee approved in June, remains in limbo because Republicans in the SALT Caucus have demanded that Chairman Jason Smith, R-Mo., include some kind of SALT relief. There are enough GOP members in that group to prevent the measure from passing if it comes to the floor without such a provision, as the package is expected to face unanimous opposition from the chamber’s Democrats. But there also is a contingent of House lawmakers representing lower-tax jurisdictions who are just as adamant about keeping SALT relief out of a tax bill. (For details on the American Families and Jobs Act as approved by the Ways and Means Committee, see *Tax News & Views*, Vol. 24, No. 24, June 16, 2023.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/230616_1.html

SALT Caucus member Marcus Molinaro, R-N.Y., told reporters that Johnson encouraged the caucus to pursue further discussions with Ways and Means Chairman Smith on how to include SALT relief in the economic growth legislation.

It’s worth remembering, though, that Chairman Smith hopes to use the American Families and Jobs Act as the foundation for a possible deal on a bicameral tax package that he has been discussing with Senate Finance Committee Chairman Ron Wyden, D-Ore. Those talks are already complicated by the fact that Wyden and many congressional Democrats in both chambers are insisting on adding a provision to significantly expand the child tax credit in exchange for their support for the business-focused tax relief in the Ways and Means legislation and are almost certain to reject Chairman Smith’s proposal to include repeals of several clean energy incentives enacted in last year’s Inflation Reduction Act.

Given that SALT relief is as polarizing an issue in the Senate as it is in the House, the prospect of folding it into discussions around a bicameral tax bill could add yet another layer of complexity to an already precarious undertaking.

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IRS launches new Inflation Reduction Act-funded compliance initiatives targeting large business, high-wealth taxpayers

The Internal Revenue Service announced October 20 that it has launched three new compliance programs—all funded with money allocated to the agency under the Inflation Reduction Act of 2022 (P.L. 117-169)—aimed at curbing tax avoidance among corporations and high-wealth individuals. Meanwhile, Republican and Democratic members of two House Oversight subcommittees sparred this week over whether the IRS intends to use the new funding to ensure compliance among upper-echelon taxpayers or to increase its scrutiny of small businesses and the middle class.
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

As enacted, the Inflation Reduction Act awarded the IRS roughly $80 billion (over 10 years) in new mandatory funding, on top of its annual discretionary budget, to beef up the agency's enforcement programs, enhance its operations support functions, modernize its information technology systems, and improve taxpayer service. Roughly $20 billion of the original allocation will be clawed back as part of a "handshake" deal reached between President Biden and then-Speaker Kevin McCarthy, R-Calif., when they negotiated the Fiscal Responsibility Act (P.L. 118-5), the debt limit legislation that was signed into law this past June.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

Stepped-up enforcement efforts

In announcing the new enforcement programs, the IRS noted that the Inflation Reduction Act resources will enable it to "[keep] pace with the increasingly complicated set of tools that the wealthiest taxpayers use to hide their income and evade paying their share" in taxes.
URL: https://www.irs.gov/newsroom/irs-launches-new-initiatives-using-inflation-reduction-act-funding-to-ensure-large-corporations-pay-taxes-owed-continues-to-improve-service-and-modernize-technology-with-launch-of-business-tax-account

Transfer pricing practices of large foreign corporations: According to the IRS, this initiative will address US subsidiaries of foreign companies that distribute goods in the US but allegedly avoid paying their full share of tax on the profit they earn from their US activity by reporting losses or inordinately low profit margins through the improper use of transfer pricing. The agency stated that it will be sending compliance alerts to approximately 150 subsidiaries of large foreign corporations to remind them of their US tax obligations and encourage them to self-correct any underreported profits.

IRS Commissioner Daniel Werfel told reporters at a conference on October 25 that the compliance alerts are akin to the "soft letters" the IRS has sent to taxpayers in previous campaigns to promote voluntary compliance on certain issues of interest to the agency.

"The idea around a compliance alert is to let both the taxpayer and the broader taxpayer community know that this is an area of focus for the IRS," he said.

Audits of large, complex corporate tax returns: Also on the horizon, the IRS announced, is an expansion of its Large Corporate Compliance (LCC) program, which is part of the agency's Large Business & International (LB&I) Division and focuses on using data analytics to identify large corporate taxpayers for audit. Taxpayers brought into the LCC program are among the "largest and most complex [entities] with average assets of more than $24 billion and average taxable income of approximately $526 million per year," the IRS noted.

LB&I intends to expand the LCC program in early 2024 as new accountants are brought on board by initiating an additional 60 audits of the largest corporate taxpayers. Selection into the expanded LCC program will be determined based on a combination of artificial intelligence resources and subject matter expertise in areas such as cross-border issues and corporate planning and transactions, the IRS said. (The IRS announced in September that it hopes use Inflation Reduction Act funds to hire 3,700 employees nationwide to tackle compliance issues related to large corporations and complex partnerships.)
URL: https://www.irs.gov/newsroom/irs-looks-to-hire-3700-employees-nationwide-to-help-expand-compliance-for-large-corporations-and-complex-partnerships-experienced-accountants-encouraged-to-apply-for-revenue-agent-positions

Increased compliance focus on high-income, high-wealth individuals: On the individual side of the tax code, the IRS stated that it has heightened its scrutiny of high-income, high-wealth individuals who have either not filed their tax returns or failed to pay recognized tax debt. These efforts are concentrated among taxpayers with more than $1 million in income and more than $250,000 in recognized tax debt, the agency said, adding that "dozens of revenue officers are focusing on these high-end collection cases in the coming fiscal year."

The IRS noted that it has begun contacting about 1,600 new taxpayers in this category that owe "hundreds of millions of dollars" in taxes and has already collected $122 million from 100 of these taxpayers. Prior compliance efforts focusing on this segment of the tax base have garnered $38 million from more than 175 high-income filers, the agency said.

On-going program targeting section 199 deduction fraud: The IRS also touted its success in its continuing efforts to crack down on fraudulent claims for refunds of the now-repealed domestic production activity deduction under section 199. According to the IRS, after the section 199 deduction was repealed in the Tax Cuts and Jobs Act of 2017 (P.L.115-97), the agency received "hundreds of claims collectively seeking more than $6 billion in refunds, with a significant portion of filers claiming the deduction for the first time." A campaign to address noncompliance and review high-risk claims in this area has been "incredibly successful in ensuring revenue is collected," the agency said.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Familiar partisan divide over new funding at House Oversight hearing

Since the Inflation Reduction Act was signed into law, the mandatory funding infusion for the IRS—particularly, the boost for the agency's enforcement efforts—has exacerbated longstanding partisan tensions in Congress over the IRS budget generally.

Democrats contend that the 2022 law gives the IRS the resources it needs to make up for a decade of budget cuts under GOP-controlled Congresses by hiring and deploying specialized audit staff to address noncompliance among those segments of the tax base that engage in the highly complex transactions and frequently have opaque sources of income.

Republicans have countered that the IRS will use the funds to hire an "army" of new revenue agents that will bear down on small businesses and middle-class individuals. One of the first measures that the new House Republican majority moved through the chamber at the start of the 118th Congress in January was the Family and Small Business Taxpayer Protection Act (H.R. 23), which would eliminate some $71 billion of that new 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 legislation has not been taken up in the Democratic-controlled Senate.) Across the Capitol, a proposal from Sen. Rand Paul, R-Ky., to rescind just over $25 billion in Inflation Reduction Act funds allocated to enforcement—which he offered as an amendment to a three-bill appropriations "minibus" making its way to the Senate floor—is set to receive a vote in the coming days. (Under an agreement between Senate Democratic and Republican leaders, Paul's proposed amendment would require 60 votes to be approved.)
URL: https://www.congress.gov/118/bills/hr23/BILLS-118hr23pcs.pdf

That partisan rift was evident when IRS Commissioner Werfel appeared at an October 24 joint hearing held by the House Oversight Subcommittee on Government Operations and the Federal Workforce and the House Oversight Subcommittee on Health Care and Financial Services.

Republicans question enforcement focus: The GOP majority at the hearing asserted that the Inflation Reduction Act funding prioritizes enforcement over taxpayer service at a time when the IRS has been plagued by problems such as lengthy wait times on telephone assistance lines, delays in processing tax returns and refunds, and threats to the security of private taxpayer information. They also questioned the need for increased audit resources and were concerned that the IRS might not confine its increased audit scrutiny to large corporations and highly affluent individuals.

"The IRS needs stronger leadership, not more money and not more audits," said Health Care and Financial Services Subcommittee Chairwoman Lisa McClain, R-Mich.

Government Operations and the Federal Workforce Subcommittee Chairman Pete Sessions, R-Texas, acknowledged that the IRS is under-resourced in certain areas, but he questioned why the agency cannot readily spot tax avoidance and evasion among individuals at the upper end of the income scale.

Werfel replied that tax evasion takes many forms, ranging from overstated deductions to "extremely complicated structures using offshore tax havens." Cuts to the IRS budget in the dozen years leading up to the Inflation Reduction Act, he said, left the IRS ill-equipped to tackle the rapid proliferation of tax-avoidance strategies available to those taxpayers that are in a position "to hire an army of lawyers and an army of accountants." The new mandatory funding, he explained, is allowing the IRS to catch up "by investing in data scientists, engineers, and subject matter experts that are going to help us keep pace and identify with greater specificity and greater accuracy where [the avoidance] issues are and select the right cases for audit and bring those funds that are due back to the American people."

In an exchange with Rep. Virginia Foxx, R-N.C., Werfel explained that under the IRS's three-year staffing plan, the agency expects to hire an estimated 8,000 new revenue agents by the end of 2025. When Foxx asked how the IRS will ensure that those new hires will not be targeting small businesses and middle-class individuals for audits, Werfel replied that IRS audit rates are published annually and are broken down by taxpayer income levels. This transparency means Congress will be able to hold the IRS accountable if statistics show that the agency is inappropriately directing its enforcement resources to audits of less affluent taxpayers, he said.

Democrats decry damage from prior IRS budget cuts: The panel's Democrats, for their part, aligned with Werfel's view that the IRS's current problems on the service, technology, and enforcement fronts stem largely from years of underfunding by Republican-led Congresses and that the new money provided under the Inflation Reduction Act is allowing the agency to play catch-up.

Health Care and Financial Services Subcommittee ranking member Katie Porter, D-Calif., argued in her opening statement at the hearing that "opportunistic politicians" have slashed IRS staff levels by 20 percent since 2010, and that the public has suffered from the resulting decline in the agency's customer service function, the deterioration of its information technology systems, and the reduction in audit rates for large businesses and wealthy taxpayers.

Rep. Jamie Raskin, D-Md., the ranking member of the full Oversight Committee, noted the IRS was operating in an environment of systematic disinvestment in the 10 years before the Inflation Reduction Act became law, and that providing adequate resources to the agency will result in improved services for taxpayers across the board. He specifically asked Werfel about how the agency's new enforcement funds will enable it to crack down on tax avoidance among high-income, asset-rich business entities and individuals.

Werfel replied that the Inflation Reduction Act funding has allowed the IRS to undertake more audits of large corporations and complex partnerships using data analytics to select those taxpayers that pose the greatest risk of noncompliance and to recoup unpaid "back taxes from millionaires and billionaires."

Rep. Gerry Connolly, D-Va., discussed how past reductions in the IRS's enforcement budget have led to the widening tax gap—the difference between the amount of tax owed to the government and the amount paid and collected on a timely basis. Werfel stated in response to a question from Connolly that the latest estimates show the average tax gap is currently $540 billion a year.

Connolly commented that Republicans' willingness to cut funds for audit and enforcement over the past decade resulted in "money left on the table" that could have been applied to deficit reduction—a result he found to be at odds with the GOP's stated concerns about rising deficit levels. (It's worth noting that the nonpartisan Congressional Budget Office has estimated that Sen. Paul's proposal to slice $25 billion from the IRS's newly increased enforcement budget would result in a net increase to the federal deficit of nearly $23.8

billion over 10 years, through the combined effects of a $25.04 billion decrease in outlays and a $48.8 billion decrease in revenues from forgone tax collections.)
URL: https://www.cbo.gov/system/files/2023-10/Whitehouse_letter-SA1226_10-16-2023_1.pdf

"You'd think people who are deficit hawks might want—before we talk about raising taxes—to make sure that everyone who owes tax pays it," Connolly said.

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House GOP taxwriters plug section 529 expansions at hearing focused on expanding 'educational freedom'

Republicans on the House Ways and Means Committee used an October 25 hearing on "educational freedom" as a forum to discuss various tax code changes that they say would expand school choice at the elementary and secondary levels and encourage entry into the skilled trades.

Smith: Build on TCJA changes

In his opening statement, Ways and Means Committee Chairman Jason Smith, R-Mo., noted the changes to the rules for tax-favored section 529 education savings plans that Republicans made in the Tax Cuts and Jobs Act (TCJA, P.L. 115-97)—particularly a provision that allows distributions from a section 529 account to fund a beneficiary's tuition expenses, up to $10,000, at an elementary or secondary public, private, or religious school. (Notably, unlike the vast majority of TCJA changes on the individual side of the tax code that are scheduled to sunset after 2025, this particular change was enacted on a permanent basis.)
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Calling that provision a "first step," Smith went on to argue that it should be liberalized to permit the funding of other, nontuition expenses as well.

"[Section] 529 accounts could also be amended to cover other educational costs like books, tutoring to help kids catch up after multiple years of . . . virtual school, educational therapies for students with disabilities, and supplies for the many families now choosing to homeschool." (Under the general 529 rules, other post-secondary education expenses such as student activity fees, books, supplies, and equipment required for enrollment or attendance are already considered "qualified higher education expenses.")

Skilled trade and licensing programs: Several Republicans also spoke in favor of legislation that would allow 529 plans to cover the costs of skilled trade and licensing programs—in particular, the Freedom to Invest in Tomorrow's Workforce Act (H.R. 1477), which was introduced in March by Rep. Robert Wittman, R-Va.
URL: https://www.congress.gov/bill/118th-congress/house-bill/1477/text

A witness at the hearing, Jerome Redmond, president and CEO of American Truck Training, based in Oklahoma City, told lawmakers that the bill would give “families who sponsor a 529 plan for their children, grandchildren, or other relatives . . . additional ways to use the funds they were able to set aside to get the education they need for a rewarding career.”

Relatedly, Chairman Smith also alluded to the Aviation Workforce Development Act (H.R. 1818), legislation introduced by GOP Rep. Mike Collins of Georgia that would make training at Federal Aviation Administration-certified commercial pilot and aircraft maintenance technician schools a qualified expense under the 529 rules.
URL: https://www.congress.gov/bill/118th-congress/house-bill/1818

“This issue has come up again and again at our field hearings and when the committee considered an [FAA funding] extension earlier this year,” Smith said.

New tax credit for contributions to organizations funding private school scholarships: GOP members of the panel also discussed the Educational Choice for Children Act (H.R. 531), introduced in January by Ways and Means Committee member Adrian Smith, R-Neb., which would provide tax credits (subject to a volume cap of $10 billion per year) for individuals and businesses that contribute to tax-exempt “scholarship granting organizations” that fund scholarship awards for private education expenses at elementary and secondary schools.
URL: https://www.congress.gov/bill/118th-congress/house-bill/531

Democrats lambast GOP proposals

For their part, Democratic taxwriters sharply criticized the Republican measures, arguing that the benefits of the proposed tax breaks would flow predominantly to more affluent taxpayers and seek to chip away at the US public education system.

“Today’s hearing is another tangentially related distraction from the party that can’t even achieve what they are best at: cutting taxes for the wealthy and well-connected,” Richard Neal of Massachusetts, the panel’s ranking Democrat, remarked in his opening statement.

Rather than look to the tax code to promote educational opportunity, Neal instead spoke in favor of a recent White House initiative—the American Climate Corps—a nontax-focused program which he said would “train young people for the high-demand skills that will drive the clean energy economy.”
URL: https://www.whitehouse.gov/briefing-room/statements-releases/2023/09/20/fact-sheet-biden-harris-administration-launches-american-climate-corps-to-train-young-people-in-clean-energy-conservation-and-climate-resilience-skills-create-good-paying-jobs-and-tackle-the-clima/

Rep. Danny Davis, D-Ill., did suggest one tax break expansion he could support—namely, doubling the current-law exclusion for employer-provided educational assistance under tax code section 127 that is currently capped at $5,250 per year. Otherwise, like ranking member Neal, he panned the GOP’s tax proposals.

"Rather than advancing policies supporting all charities, today's hearing seem[s] to myopically supercharge only giving to those private education programs," said Davis.

GOP messaging

Given the political dynamics on display at the hearing—and the current reality of divided government—it seems unlikely that the proposals touted by Republican taxwriters will be included in any tax legislation that makes it to President Biden's desk in the current Congress. (See related coverage in this issue for the latest on the House GOP speaker election and the uncertainty surrounding the fate of tax legislation of any kind in the coming months).

But even if these proposals are unlikely to become law in the near term, they give a clear indication of where the GOP might take education-focused tax policy should the party amass more power in Washington following the 2024 presidential and congressional elections.

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