WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—December 2016 **Susan Rogers**

On November 8th, Donald Trump was elected the 45th president of the United States. During the transition period until inauguration day on January 20, 2017, he is working to assemble a team of advisors and cabinet members. The key appointee for the agenda on tax reform will be Trump's pick for Treasury Secretary, Steve Mnuchin, a former Wall Street executive who served as the campaign finance manager. IRS Commissioner Koskinen's term does not expire until November 9, 2017, but he could be replaced by the President-elect sooner. Efforts by House Republicans to impeach him will not advance this year after a House vote to send the impeachment resolution back to Committee.

President-elect Trump has called for a broad legislative agenda that includes tax reform, major changes to the Affordable Care Act (ACA), expanding the military, and significant infrastructure building. These are programs that will cost billions of dollars and the impact on the deficit will have to be considered by Congressional leadership as these programs are advanced by the Trump Administration in 2017.

Congressional Republicans have indicated that **repeal of the Affordable Care Act** (ACA) will be one of their first priorities, and they are considering use of the budget reconciliation process to advance this legislation. The chairmen of the House and Senate Budget Committees have informally agreed to do both a 2017 and 2018 budget early in the Trump Administration which could pave the way for use of the reconciliation process which avoids the problems of a Senate filibuster by requiring only 51 votes for passage.

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President-elect Trump discussed tax reform as a priority during his campaign and released a package of tax proposals, but it is difficult to predict what the pace and content of tax reform will be under a Trump Administration until key appointments are made and a more detailed package of proposals is available.

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In This Issue

- Election Results
- Congressional Update
- Section 385 regulations update
- EU corporate tax proposals
- Tax Reform—Prospects for 2017

House and Senate Leadership

House: Congressman Paul Ryan (R-WI) will return as Speaker of the House with Congressman Kevin McCarthy (R-CA) as Majority Leader and Congressman Steve Scalise (R-L) as Majority Whip. House Democrats have chosen current Minority Leader Nancy Pelosi (D-CA) to retain her position.

House Ways & Means Committee Chairman Kevin Brady (R-TX) keeps his position and will lead the House effort on tax reform in 2017. Congressman Richard Neal (D-MA) will replace Sander Levin (D-MI) as Ranking Member on the Committee. The Ways and Means Committee currently has 39 members, split between 24 Republicans and 15 Democrats with no announcements yet as to whether that ratio will change.

Senate: Senator Mitch McConnell (R-KY) will return as Majority Leader for the Republicans. His counterpart as Minority Leader will be Senator Charles Schumer (D-NY), who replaces the retiring Senator Harry Reid (D-NV). Senator Schumer named an expanded leadership team of 10 Senators including Senators Bernie Sanders, Dick Durbin, Patty Murray and Joe Manchin. Senate Democrats are viewed as the last line of defense against the Trump agenda due to the general requirement of 60 votes in the chamber necessary to break a filibuster. In the next Congress, the Senate will have 51 Republicans, 48 Democrats, and one independent.

Senator Orrin Hatch (R-UT) returns as Chairman of the Senate Finance Committee. Senator Ron Wyden (D-OR) won re-election and returns to lead the Democrats on the Committee. Several Republican members won re-election including Senators Portman (R-OH), Grassley (R-IA), Burr (R-NC), Crapo (R-ID), Isaakson (R-GA), Scott (R-SC) and Thune (R-SD) with one member to be replaced, Senator Dan Coats (R-IN), who will retire at the end of the year.

Lame Duck Session

The GOP-controlled Congress will likely want to avoid a lengthy lame duck session in anticipation of waiting for the new Administration to move forward with its agenda. With the current Continuing Resolution due to expire on December 9th, Speaker Paul Ryan has announced that House Republicans will pursue a **short-term spending bill to fund the government at current levels** through the end of March 2017. Senate Majority Leader McConnell has given signs that he would also like to move a spending bill that funds the government at current levels through March 2017.

Delaying action until March on budget issues allows the Trump Administration the chance to have an impact on the budget for the rest of the 2017 fiscal year and avoids a fight over these issues in the lame duck session. Some Republicans have expressed concerns about this approach, however, noting that this could result in budget fights early in the Trump Administration, which could lead to a delay in other key elements of the Trump agenda in the first 100 days.

Other **issues that could be considered prior to the end of the year** include the 21st Century Cures Act (a bipartisan House-passed bill on the development of new medical treatments and prescription drugs); water and energy legislation; the Iran Sanctions Act; and the annual defense policy bill. With a short-term limited spending bill, the **prospects for tax extenders legislation** does not look promising.

Treasury and International Issues

Post-elections, W&M Committee Chairman Brady said that he hopes the incoming Trump Administration will reverse position on the Treasury Department's **Section 385 earnings stripping regulations**. Several business groups, including the Business Roundtable, the National Association of Manufacturers and the Organization for International Investment, are also taking the position that the recently finalized anti-inversion rules, including the controversial earnings stripping regulations, should be pulled back by the Trump Administration.

The European Union is moving ahead with its proposals for a **uniform set of rules on taxing corporation profits** requiring multinational companies to pay taxes based on where their assets and employees are located and where their sales take place. These proposals known as **the common consolidated corporate-tax base (CCCTB)** are aimed at curbing creative tax reporting, tax evasion and sweetheart deals that some European countries have used to attract companies as reflected in the information gathered as part of the EU state aid investigations.

With Donald Trump winning the presidential election and Republicans maintaining control of both the House and Senate, the prospects for tax reform in 2017 have significantly increased. Following Trump's pick of Steve Mnuchin as Treasury Secretary, the next key position to be filled will be the Assistant Secretary for Tax Policy.

Even though the path to comprehensive tax reform now looks more promising, many questions and challenges remain.

Will the Republicans want to produce a bipartisan bill and compromise with the Democrats, and, if so, what approach will the Democrats take?

Will Republicans try to use the budget reconciliation process to move tax reform?

To what extent must tax reform be revenue neutral, and how should revenue and distributional effects be measured?

If Trump pairs tax reform with infrastructure spending, will both be advanced as part of a 100-day agenda?

Will the costs of an infrastructure bill be totally offset or will there be a significant increase in the federal deficit if tax reform fails to cover the costs of the infrastructure plan?

Prospects for Tax Reform in 2017

While similar in some respects, there are significant differences between the Trump tax proposals released during the campaign and key proposals in the GOP Blueprint on tax reform released this past summer. Both plans want to lower the 35 percent corporate tax rate, call for a lower rate on pass-through businesses, and suggest a deemed repatriation of offshore earnings of US companies, but they differ in many details including applicable tax rates. Most importantly, the GOP plan for corporate taxes proposes a destination-based approach that would apply taxes based on where goods, services and intellectual property are consumed (rather than produced), and calls for a "border adjustments" system that would tax US imports but not exports, while the Trump tax plan does not specifically include these proposals.

The House

Speaker Ryan has consistently viewed comprehensive tax reform as one of his priorities for the House agenda. Post-elections, W&M Committee Chairman Brady indicated that he plans to move ahead quickly on tax reform commenting "Tax reform is going to happen in 2017," and adding that the panel will be "ready to move this early." He plans to use the House GOP Blueprint released in June as the starting point, and his staff has been working to produce legislative language reflecting the Blueprint proposals after meeting for months with business groups and taxpayers to get their input on the proposals.

The GOP Blueprint calls for cutting tax rates for corporations, pass-through businesses, and individuals; adopting a territorial system for taxing foreign-source income of US multinationals; and moving the US toward a border-adjustable cash flow tax system without adopting an explicit consumption levy such as a national sales tax or value-added tax (although the plan functions economically as a subtraction-method VAT rather than as an income tax). The goal is to produce a revenue neutral bill measured under a "dynamic" scoring model. Whether and when legislative language might be released is unclear, and no schedule for Committee and House Floor action has been released.

House Democrats have targeted inversions and earnings stripping as well as higher taxes on corporations and wealthy individuals, but they have not produced a comprehensive blueprint to counter the GOP plan.

The Senate

Senate Majority Leader McConnell has not shared the interest of Speaker Ryan in making tax reform a top priority issue. SFC Chairman Hatch does support moving ahead on tax reform, but he has focused his attention on an alternative approach consisting of a corporate integration plan that is expected to lower the corporate tax rate by combining a dividends-paid deduction with a withholding tax on dividend and interest payments.

The two leading Democrats on the issue of tax reform are Schumer, the soon-to-be Minority Leader, and Wyden, who continues as the Ranking Democrat on the Committee. Wyden has supported moving on the issue of inversions in the short term, but has also issued several discussion drafts on tax reform topics in the past several years. Schumer, who has not always aligned with Wyden on approach and policy, has been active on the topic of tax reform, supporting international tax reform paired with infrastructure spending.

Tax Reform—Procedural and Policy Issues

A **key procedural issue** that will affect the pace of tax reform legislation and the policy therein is whether a **bipartisan effort** can be successful. A Trump economic advisor, Stephen Moore, has commented that bipartisan legislation is important to this effort, and Ways & Means Committee Chairman Brady would prefer to take a bipartisan approach to tax reform. He commented, "We are going to ask for and seek [Democratic] input, and listen to these ideas as we go forward. Because at the end of the day, I think tax reform is more durable and long-lasting and pro-growth if we can find common ground between Republicans and Democrats." Ranking SFC Democrat Wyden also supports a bipartisan approach to tax reform.

Should bipartisanship not be workable or achievable, it is likely that Congressional Republicans will look to the **budget reconciliation process to move tax reform legislation**. The budget reconciliation process has often been used in past years to advance targeted tax changes through Congress. A budget resolution is necessary first with the inclusion of budget reconciliation instructions, after which the legislation then enjoys certain protections including the requirement of 51 votes for passage (thereby avoiding a Senate filibuster). Under current reconciliation rules, however, the legislation must be deficit neutral over a 10-year period. If it is not, the legislation must sunset after the 10-year period. The plans currently put forward by Republicans would likely result in a significant increase in the deficit, so this issue must be addressed by Republican leadership if they decide to utilize the budget reconciliation process. An alternative to using the budget reconciliation process would require compromise with Senate Democrats, who must decide whether they want to work with Republicans to advance some of their own tax reform proposals or whether they will choose to block tax reform legislation under a Trump Administration.

One of the **key policy issues** in the tax reform debate is what the **treatment will be of the offshore income being held currently by US companies** – whether there will be a requirement that it be repatriated subject to a low tax rate and, if so, how will that money be used – to lower rates generally or to fund infrastructure spending. The GOP Blueprint includes a one-time deemed repatriation of deferred active foreign-source income of US multinationals with differential rates for cash (8.75 percent) and noncash assets (3.5 percent), which could be paid ratably over eight years at the taxpayer's election. Chairman Brady has stated that the one-time revenue generated from deemed repatriation should be used to offset the cost of reducing the corporate tax rate to 20 percent and the pass-through business rate to 25 percent. In contrast, other key players have supported using that revenue for infrastructure spending, notably Speaker Ryan who worked with Senator Schumer on 2016 legislation, and potentially the incoming Trump Administration.

Another proposal in the House GOP Blueprint which has drawn interest relates to "border adjustments" and provides that exports would not be subject to US taxes regardless of where they were produced, whereas imports would be taxed in the US regardless of where goods were made, with businesses taxed not on where the headquarters are but where they sell their goods. This proposal was not included in prior year tax discussion drafts so input from the business community has been requested. Some advocates of this proposal believe it will gain bipartisan support, raise over $1 trillion worth of revenue over a 10-year period and help stop the increase in inversions, but it could also result in a significant tax increase on retailers, which will make it controversial.

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