WASHINGTON TAX NEWS

Potomac LAW GROUP PLLC

Potomac Law Tax Newsletter—February 2017 **Susan Rogers**

Congressional Republicans held an annual retreat to discuss **their agenda for 2017 including a "Two Hundred Day Plan."** President Trump joined the retreat and encouraged an **aggressive agenda on health care, tax reform and new trade deals**. Speaker Ryan has commented that the "Two Hundred Day Plan" may eventually take the entire year to complete, although he plans to have the bulk of the work done before the August Congressional recess. Congressional Democrats also held a retreat in January.

Congressional leaders have suggested that the **border wall between Mexico and the US** will be paid for initially through a supplemental appropriations bill, while the Trump Administration has proposed covering the cost of the wall through an import tax on Mexican goods. The current funding legislation for this fiscal year for the Federal government runs out at the end of April and the extension could serve as a vehicle for the supplemental appropriations bill, although 60 votes will be needed in the Senate for approval.

In the initial days of the new Administration, **President Trump** signed a number of **executive orders** that included several focused on the economy, trade and jobs. He also held a series of meetings with business leaders to discuss tax reform and job creation. He released the name of his nominee for the Supreme Court, and he has suggested to Senate Majority Leader McConnell the idea of killing the filibuster rule in the Senate in order to achieve confirmation – a move McConnell may be reluctant to advance, since Senate rule changes can adversely impact a political party when they are not in control of the Senate.

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House Speaker Ryan outlined a legislative schedule for the House for the "first 200 days" that includes repeal of the Affordable Care Act, a funding plan for increased border and national security, and a comprehensive tax reform plan by August. Senate Majority Leader McConnell has said the Senate will not move as quickly, and Democratic support will be needed for most legislation.

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In This Issue

The Budget

President Trump has been invited to address a joint session of Congress on February 28th, and he is expected to release the outline of his first budget in February, which will be a blueprint for his plans for government spending and will then be developed further in March and April by Congress as part of the budget process. Disagreements within the Republican party over spending priorities are likely as the President has publicly stated that he will not cut entitlement programs, such as Medicare and Social Security, and he will support spending for infrastructure and defense – positions which could lead to bigger deficits.

Senate Majority Leader McConnell said that there would be three parts to the **ACA repeal process** including legislation passed by Congress; administrative actions to stabilize the insurance market; and replacement legislation which will need 60 votes to pass in the Senate. The House and Senate both approved a Republican-sponsored budget resolution with reconciliation instructions to four specific committees to report out $1 billion in savings over the next 10 years – with the intention that this savings be the result of repeal of the ACA.

Congress will also be working on an **infrastructure plan**, which is a key part of the Trump agenda to boost the economy. A group of Senate Democrats introduced a $1 trillion infrastructure plan that would rely on direct federal spending and closing tax loopholes, and would cover not only bridges and roads, but the nation's broadband network, hospitals and schools. Trump advisers have stated that their proposal will rely on federal tax credits and public-private partnerships rather than federal spending.

Regulatory Activity

The President signed an executive order that provides that, unless prohibited by law, whenever an executive department or agency publicly proposes a new regulation, it must identify at least two existing regulations to be repealed.

White House Chief of Staff Priebus sent a memorandum to the heads of executive departments and agencies directing a **temporary regulatory freeze pending review**. Agency heads are directed to refrain from sending regulations to the Office of the Federal Register (OFR) until a department or agency head appointed by the President reviews and approves the regulation. Regulations that have been sent to the OFR but not yet published are to be withdrawn from the OFR, and regulations that have been published but have not yet taken effect are to be temporarily postponed for 60 days for the purpose of reviewing any questions of fact, law and policy. **Tax regulations that could be affected** include final regulations relating to US-source dividend equivalents and final regulations relating to the qualifying income exception for publicly traded partnerships, while the proposed regulations relating to the new partnership audit regime have already been pulled by the IRS.

Also, the House has passed a **bill that would repeal "Midnight Regulations**," which are defined as any regulations released in the last 60 days of the Obama Administration, but the bill is unlikely to get the 60 votes needed in the Senate to prevent a filibuster. Both Treasury and the IRS must agree to withdraw regulations, and some business groups are working on this effort directly with the Administration and through Congressional contacts targeting regulations issued under Code sections 367(d), 901(m) and 987.

Treasury and the IRS

The IRS issued **final and temporary inversion regulations** (TD 9812) under Code section 7874. The final regulations adopt prior temporary regulations issued in 2014 and 2016 with certain amendments. They are intended to address cases structured to avoid Code section 7874 where the assets of domestic corporations or partnerships are directly or indirectly acquired by a foreign corporation.

The IRS issued a set of final, temporary and proposed regulations under the **Foreign Account Tax Compliance Act (FATCA)** regarding the information reporting of, and withholding on, transactions between certain US persons and foreign financial institutions (FFIs). The IRS also issued **new guidance under FATCA** that includes an updated model agreement for FFIs and a new agreement for qualified intermediaries (QIs).

The IRS and Treasury issued Notice 2017-09 providing guidance regarding the de minimis error **safe harbor for information reporting penalties** under Code sections 6721 and 6722.

House Speaker Ryan has stated that Congress will work on tax reform between April and August finishing prior to the August Congressional recess. Whether this ambitious schedule can be met depends in part on whether the Administration and Congress can agree on key issues including the border adjustment tax plan. Both the Speaker and Chairman Brady have made high-profile public appearances in recent weeks and defended the House GOP Tax Reform Blueprint and the border adjustment provision that exempts exports and taxes imports.

W&M Committee Republican members have formed informal working groups to examine and develop consensus around certain questions raised by the GOP Tax Reform Blueprint covering issues such as passthroughs, retirement taxation, the treatment of carried interest, tax deductions for mortgage interest and charitable deductions, and energy tax incentives. Chairman Brady has said they will make their recommendations soon. Ranking Member Neal is viewed as a more business-friendly Democrat than his predecessor and has created a new staff position to increase outreach to the business and advocacy community. SFC Chairman Hatch met with President Trump to discuss tax reform.

Tax Reform Update—Secretary of the Treasury Nominee, Steve Mnuchin

Steve Mnuchin, who is nominated to be the Secretary of the Treasury, was questioned for several hours at his SFC confirmation hearing on January 19th. He was questioned on his past business experience including his involvement in OneWest, a bank he led during the financial crisis. It appears likely that he will be confirmed.

He stated that he would be in charge of tax reform for the Administration. In his comments on tax reform, he aligned himself with the GOP position of simplifying the tax code by lowering rates and broadening the base leading to economic growth that would benefit taxpayers at all income levels. He also stated that lowering the corporate rate would make US businesses more competitive on the global playing field and would help stop inversions.

With respect to the Trump proposal to allow certain passthrough entities to elect to be taxed as corporations (subject to a proposed 15% tax rate) rather than as individuals (subject to a proposed 33% tax rate), he did not specify the mechanics, but said that anti-abuse rules would be developed to prevent passthrough businesses from gaming the system by recharacterizing wage income as more lightly taxed business income.

On a question about transition rules related to changes that would be included in tax reform, he commented that phase-out rules are necessary when changes are made. When asked about tax complexity and the tax gap, he noted that reductions in IRS staff and funding have contributed to the tax gap and stated that tax simplification and fewer deductions are “absolutely critical.” He was asked specifically whether international tax reform would be a priority, and he responded yes, noting that President Trump wants to see rates lowered and the money held offshore by companies return home to the US.

On dynamic scoring, he endorsed the need for it in order to accurately reflect the effects of positive tax changes, but stated, “I think we want to make sure that tax reform doesn’t increase the size of the deficit.” He clarified that the President’s 35% import tax is only for certain companies who move jobs out of the US and not intended to be applied broadly – and he distinguished it from the GOP blueprint border adjustment proposal.

On most other issues including the border adjustment proposal, the Treasury Secretary nominee offered few details in written responses to Congressional questions, instead offering to work with Congress on the specifics.

Budget Reconciliation & Revenue Neutrality

There are reports that some Administration officials and Congressional members have discussed the possibility of a tax reform package that is not “revenue neutral,” but Speaker Ryan and Chairman Brady have both stated that the tax reform package will be “revenue neutral” so that it will pay for itself and not add to the deficit.

If the budget reconciliation process is used to advance tax reform including tax cuts, the legislation is not permitted to increase budget deficits in years after the time period covered by the budget resolution, which is typically 10 years, but legislators can avoid this rule by sunsetting the tax provisions that would cause the revenue loss so that they expire at the end of the 10-year period even if the intention is that the cuts would be extended at that time. The Congressional Budget Office (CBO), which is the nonpartisan office that provides official budget information to Congress, would then likely have to issue two different budget outlooks, which would include a standard baseline in which temporary laws expire as scheduled and an alternative fiscal scenario in which many of the laws are permanently extended. This type of “fiscal ambiguity” existed at the time of the Bush tax cuts in 2001 and 2003 and resurfaced during the Obama Administration when there was debate and legislation to address the expiration of the tax cuts. The use of a single budget baseline provides clarity about the future impact on budget deficits, but the use of the budget reconciliation process to advance tax legislation may inject uncertainty into the budget debate with respect to baseline issues.

Tax Reform—The Border Adjustment Tax Proposal

In connection with comments about increasing border security through a wall between Mexico and the US, President Trump and his advisers suggested paying for the wall with a 20% border tax on Mexican imports, which appears to be consistent with the proposal in the GOP tax reform blueprint for a border adjustment tax – but the Administration later stated that this was only one of many options being considered.

There is significant opposition to this tax idea from many groups in the business sector including retailers, oil refiners and other industries who are significant importers, but this new tax provides $1 trillion in revenue over a 10-year period, which would be hard to replace in the GOP blueprint were this proposal to be dropped. Also, there are factions of the business community who would benefit from a plan that exempts exports from taxes, and they have formed a new group to lobby in support of the proposal. Note that a border adjustment is different from the tax the President has described as a targeted levy on firms that outsource production and import products back into the US.

The Office of Tax Analysis in the Treasury Department issued a working paper examining a destination-based cash flow tax concluding that the proposed style of reform was "promising" but outlining a long list of issues that need to be resolved.

International Issues

The OECD released an updated version of the BEPS Action 4 Final Report that sets out a common approach to addressing BEPS involving **interest and payments economically equivalent to interest**. The update includes further guidance on two areas included in the 2015 version of the report: (1) the design and operation of the "group ratio rule," which allows an entity to claim higher net interest deductions based on a relevant financial ratio of its worldwide group, and (2) approaches to dealing with risks posed by the banking and insurance sector.

The OECD released for public comment a discussion draft under its BEPS initiative on the **treaty entitlement of non-collective investment vehicle (CIV) funds**. The OECD report focuses on the interaction between the tax treaty provisions of the Action 6 Final Report (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) and the treaty entitlement of non-CIV funds.

On January 1st, Switzerland began the collection of information under the OECD's International Convention on the Automatic Exchange of Information (AEOI). These new rules will change the **historic "secrecy" of Swiss bank account information** bringing Switzerland in line with international standards for exchange of financial information.

For additional information and advice on these issues, please contact:

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