WASHINGTON TAX NEWS

Potomac LAW GROUP PLLC

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

President Trump addressed Congress on February 28th, presenting his budget and legislative priorities for this year, but provided no details. The White House has stated publicly that they will release an outline of the President's FY 2018 budget proposal by mid-March with a detailed budget to follow later this spring.

Congress will have to address **budget deadlines** including the **debt limit** on federal borrowing, which is suspended until March 16th. Treasury has the ability to manage its accounts and obligations for a short period to avoid exceeding the limit, but it is likely that Congress will want to deal with this issue in a timely manner due to Republican control of the Congress and the White House.

Congress must deal with expiration of the current **Continuing Resolution (CR)** on April 28th, and it is unclear whether Congressional leadership will choose to attach potentially controversial measures to that legislation. The budget is also expected to include a trillion-dollar infrastructure plan and increases in defense spending. There are currently budget spending caps in place, so the White House budget must include spending cuts to offset spending increases or the spending caps will have to be lifted, which will draw opposition from Republican fiscal conservatives.

Other issues which Congress must address include completion of confirmation of the Administration's cabinet appointees, consideration of the nomination of Neil Gorsuch to the Supreme Court with hearings to begin on March 20th, and investigations by the intelligence committees into Russian involvement with Trump campaign officials.

For more information on these issues, please contact Susan Rogers at srogers@potomaclaw.com or 202.492.3593.

Congress faces a full legislative agenda for the spring including budget deadlines, health care reform, and tax reform. The White House and House leaders have called for tax reform by the August recess, while the Senate appears to be on a slower pace for completion of a comprehensive tax package.

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Congressional Activity

The official deadline for Congress to pass a **budget resolution** is April 15th. The first budget resolution was passed earlier this year and dealt with health care reform, but a second resolution is expected to advance covering tax reform.

Congressman Mick Mulvaney was confirmed as the new director of the Office of Management and Budget and is expected to be the key player in developing the **President's annual budget plan**. The President's budget is expected to include a request for funding for construction of the wall between the US and Mexico, which could exceed $20 billion. House Republicans have not determined how to proceed on this issue since passage in the Senate of this legislation will likely require the approval of eight Senate Democrats.

When the **expiration of the CR** is addressed at the end of April, it is unclear whether Congressional leadership will choose to attach potentially controversial measures such as the Mexico wall funding issue to that legislation. House Democratic Caucus Chairman Crowley (D-NY) has said Democrats won't support an extension of the CR if the border wall provision is included.

House Republicans are expected to release legislation to revise the **Affordable Care Act** (ACA) in the near future. They have released the outline of a plan for repealing the ACA that provides a set of policy specifics, including an overhaul of Medicaid, repeal of the penalty for Americans without insurance, tax credits, repeal of the ACA taxes, and a modification of the individual insurance market. Congressional leadership hopes to move this legislation by the Easter Congressional recess.

The **Joint Committee on Taxation** (JCT) issued its annual "**Blue Book**," which provides a detailed explanation of every tax law change enacted in 2016, covering the six major tax bills signed into law last year. The JCT also issued its **annual summary of revenue estimates for tax expenditures**. This year's report may be useful during the debate on tax reform which will incorporate the potential elimination of many corporate tax expenditures.

Regulatory Activity

The President signed an **executive order** that provides that whenever an executive department or agency publicly proposes a new regulation, it must identify at least two existing **regulations** to be repealed. The Office of Information and Regulatory Affairs on February 2nd issued interim guidance for implementing it. The guidance states that effective immediately, for each significant regulatory action, agencies should (1) identify two existing regulatory actions the agency plans to eliminate or propose for elimination on or before September 30, 2017 and (2) fully offset the total incremental cost of such new significant regulatory action as of September 30, 2017. It **is not clear how this executive order will impact tax regulations.**

International Issues

The **Government Accounting Office (GAO) released a report** titled, "Information on the Potential Impact on IRS and US Multinationals of Revised International Guidance on Transfer Pricing," requested by SFC Chairman Hatch (R-UT) addressing the **impact of transfer pricing and country-by-country (CbC) reporting guidance** produced by the OECD as part of its BEPS project.

Treasury and the IRS

On January 31, Representative Rokita (R-IN) introduced H.J. Res. 54, which calls for using the Congressional Review Act (CRA) process to roll-back the **Code section 385 debt-equity regulations** finalized by Treasury during President Obama's last year in office. House Democrats have come out strongly against the proposed legislation, and sixteen Democratic members of the Ways & Means Committee signed a letter to their Republican colleagues urging them not to repeal these regulations. To date, the Trump Administration has not moved forward with any specific attempts to undo the regulations.

In January, the IRS issued proposed regulations that would impose a **centralized audit regime for partnerships** that determines income and collects tax at the partnership level rather than the partner level. These proposed regulations have now been withdrawn by the IRS. The audit structure established by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) was repealed by the Bipartisan Budget Act of 2015 with new rules covering centralized partnership audit regime rules.

The White House has announced that they will release an outline of a comprehensive tax reform plan in the next few weeks. During the President's address to Congress on February 28th, he called for "historic tax reform," but he did not provide details, and he did not state a position on the Border Adjustment Tax (BAT).

With respect to timing, Congressional leadership have indicated that they want to move ACA reform before they move tax reform – whether they can combine the two in one budget reconciliation bill is an open question with some Members willing to consider this but no consensus on that approach. House Speaker Ryan has stated he expects the House to complete tax reform by the August Congressional recess, but the Senate is unlikely to get tax reform legislation to the Floor until the fall, so the final legislation would be worked out in a conference committee by the end of the year.

Steven Mnuchin was confirmed to serve as Secretary of the Treasury and is expected to play a key role in developing the Administration's tax reform plan. He commented publicly in one of his first interviews that the goal of the White House is to achieve tax reform by the August Congressional recess.

Tax Reform Update—The Border Adjustment Tax Debate

House Republican leaders continue to defend a key provision of their tax reform blueprint, the **Border Adjustment Tax (BAT)**, which exempts exports from tax and taxes all imports regardless of origin. House Speaker Ryan recently stated that the "drama" over the BAT and tax policy was expected, saying "We know this, and we will get tax reform done." They are also facing concerns from some House conservatives who are not on board with a big new tax.

Chairman Brady has said that there will be hearings on "key aspects" of tax reform, but he has not scheduled anything yet. Chairman Barr (R-KY) of the House Financial Services Committee's Monetary Policy and Trade Subcommittee has also indicated that he will assert his subcommittee's jurisdiction over the BAT because of its potential impact on the value of the dollar.

The debate on tax reform may come down to differences between the House and the Senate on issues such as the BAT, which has not gained much support in the Senate. Only 3 GOP Senators are needed to block the House tax plan, because the Senate leadership does not expect Democratic support for the GOP tax reform package. Senator Graham (R-SC) commented recently that "it wouldn't get 10 votes in his chamber." Both SFC Chairman Hatch and Majority Whip Cornyn (R-TX) have expressed skepticism about the proposal with Senator Cornyn asking Senator Hatch to hold a committee hearing on the proposal, which he will schedule once the House produces legislative language for the BAT. SFC members Grassley (R-IA) and Roberts (R-KS) have raised concerns about the impact on the agriculture industries in their states. Without the revenue that the BAT raises, however, the House GOP plan cannot pay for the tax cuts included, and the legislation would lack the provision that would help prevent corporations from moving their operations out of the US.

No alternative plan has been developed in the Senate. Chairman Hatch has stated that he is aligned with the President and Chairman Brady on "virtually every fundamental tax reform question," but his panel would advance tax reform legislation on a parallel legislative track rather than starting with the House bill. Chairman Hatch said Republicans agree on lower and fewer tax brackets for individuals, reducing the number of tax preferences, repealing the estate tax, lowering the corporate tax rate and moving to a territorial system.

Chairman Hatch recently commented that "A major concern on tax reform is producing a bill that can get through the Senate, and that is likely going to require a separate Senate tax reform process, which will almost surely end up looking different from what passes in the House." In a recent speech, he stated that several committee members have reservations about the BAT, and they are working to understand how it would operate citing questions about who would ultimately bear the tax, whether it would be consistent with US trade obligations, and whether adjustments would be necessary to avoid undue burden on particular industries. He said, "We don't have definitive answers to any of those questions at this point and without them, I don't think I can give a definitive position on the proposal."

After a closed-door Senate GOP lunch during which Speaker Ryan made the case for the BAT, Senator Cornyn called it a "high-risk gamble" and said he is "still a question mark." Both Senators Blunt (R-MO) and Portman (R-OH) said that they are not yet supporters, and Senator Thune (R-ND) said he is keeping an open mind.

Tax Reform—The Border Adjustment Tax Debate (continued)

The President has expressed concern about the BAT, calling it "too complicated," but he has also praised it as a job creator. Treasury Secretary Mnuchin commented publicly that the White House is studying the BAT but has some concerns about it. Supporters of the BAT proposal are concerned that if the Trump tax plan does not include the BAT, it could be harder to rally support for it in the Senate.

Dueling coalitions have formed and are lobbying Congress and the White House with the American Made Coalition comprised of more than 25 members including GE and Boeing who support the BAT, and the Americans for Affordable Products, which has more than 100 companies and trade associations as members and who oppose the BAT.

Chairman Brady has stated that he is listening to the concerns of stakeholders in the business community and that the committee would try to ease the transition from current law to the new system. He has said that he does not expect there to be carveouts or exemptions from the BAT, but some industries, such as financial services, believe their transactions should be treated differently.

Congressional leaders are considering the use of the budget reconciliation process to advance tax reform, but the Byrd rule requires that the legislation cannot increase the deficit in any year outside of the 10-year budget window. Reconciliation measures that do increase the budget in the out years must sunset at the end of the 10 year budget period. If the BAT is part of the tax reform package, it could present problems as it raises more than $1 trillion in the first decade, but long term, it starts to lose money when the US starts to run a trade surplus. It would be necessary to find other provisions that would address the revenue issue in the out years that are part of the budget reconciliation package. Speaker Ryan and Chairman Brady have consistently said that their goal is to craft a proposal that doesn't increase the deficit assuming economic growth and excluding the costs of repealing the ACA taxes. Secretary Mnuchin has not indicated whether the White House also has a goal of revenue neutrality with respect to tax reform.

There has also been considerable discussion about whether the BAT would be considered an impermissible export subsidy under the World Trade Organization (WTO) rules. Chairman Brady continues to state that the BAT framework will be written in a way that is WTO-compliant, and that the US will prevail if a challenge is brought, which is likely. A WTO challenge to an American border adjustment system would take a period of time to run its course, but countervailing duties can be imposed outside the WTO in retaliation.

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

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