

WASHINGTON TAX NEWS



Potomac Law Tax Newsletter—April 2017

Susan Rogers

Congress and the White House continue to manage a **full legislative agenda** including health care reform, budget deadlines, tax reform, House and Senate intelligence committee hearings on Russian involvement in the 2016 election, and confirmation of a Supreme Court nominee.

The current **Continuing Resolution (CR)** expires on April 28th, and Congress will have to address extension of the CR which funds the government at current spending levels or risk a partial government shutdown. Congress will be on recess for 2 weeks prior to this deadline, returning to work on April 24th. In the past, members of the House Freedom Caucus have supported adding policy riders to the bill to secure their support of the CR with the result that House leadership has often looked to support from some Democrats to replace votes from conservatives.

The White House has requested \$1.4 billion in **border wall funding** (with a final price tag of more than \$20 billion) as part of a package that increases defense spending by \$30 billion and decreases domestic spending by \$18 billion with a plan to attach this to the CR legislation. House Minority Leader Pelosi has stated that Democrats will not support the funding legislation if controversial riders are added such as funding the border wall between Mexico and the US. In the Senate, Majority Leader McConnell will need Democrats to support the funding bill, so it is expected that Minority Leader Schumer will have some leverage with respect to what is included in the bill, and he has also stated that Democrats will oppose the CR if the border wall funding is included.

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

Congress faces an April 28th deadline for reaching a funding deal for the Federal government for the rest of FY 2017 with a two week recess scheduled this month. Senate Majority Leader McConnell has said that he is “very confident” Congress will avoid a government shutdown when the current spending law expires in late April.

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Congressional Activity

Health Care reform: On March 24th, the President and House Speaker Ryan decided to delay indefinitely a final vote on the GOP legislation to repeal and replace the Affordable Care Act (ACA) signaling that Republican leadership in the House did not have majority support for the bill. Leadership had worked throughout the week to make changes to the bill to address concerns of conservatives in the House Freedom Caucus and Republican moderates, but more than 30 Republican members still opposed the bill, and the Speaker could only afford 22 defectors from the GOP caucus as there was no Democratic support. The Speaker and other members of the Republican caucus have indicated that Republicans will continue to work on health care legislation, while they move on to other agenda items, but it seems unlikely that the budget reconciliation process would be used again, which means that they will need to advance bipartisan legislation. The White House has stated that they will leave the ACA in place with their expectation that the program will have problems, which they hope will lead Democrats to work with them on changing the system.

President Trump's FY 2018 budget: President Trump released a preliminary FY 2018 budget on March 16th, which covered discretionary funding levels but did not include tax policy proposals. The budget document stated "The full Budget that will be released later this spring will include our specific mandatory and tax proposals, as well as a full fiscal path." FY 2018 begins on October 1, 2017.

Confirmation of Supreme Court nominee Neil Gorsuch: The nomination of Neil Gorsuch to the Supreme Court is expected to be brought to the Senate Floor this week. Senate Minority Leader Schumer (D-NY) has stated that Senate Democrats will filibuster this nomination due to the fact that the Senate refused to consider the nomination of Merrick Garland in 2016. Senate Republicans will need 60 votes to break that filibuster or be faced with the decision of whether to change the Senate rules to allow confirmation by majority vote. Majority Leader McConnell has stated that he will invoke the so-called "nuclear option" in order to get Gorsuch confirmed.

Federal Government Debt limit: Congress will also likely have to address raising the debt limit by the August/September timeframe when the Treasury Department is likely to have exhausted its ability to use "extraordinary measures" to avoid violating the current debt limit, which would result in the government not being able to pay its bills. Congress could take different approaches to the debt limit issue including stand alone legislation, attaching the legislation to another bill that is likely to pass, or not act to raise or suspend the debt limit, which has never been done.

Regulatory Activity

The IRS announced that it would **resume issuing "subregulatory" guidance**, which includes such routine guidance as revenue procedures, announcements, informal Q&As and similar pronouncements. This announcement came from Commissioner Koskinen because of the Executive Order issued on January 30, 2017, that ordered federal agencies to remove two regulations for each new regulation promulgated. This order had raised questions about how the IRS would interpret the directive with respect to routine taxpayer advice and compliance publications.

International Issues

The European Council reached a compromise on rules designed to target **"hybrid mismatches,"** which allow multinational enterprises to exploit disparities between two or more tax jurisdictions in order to reduce their overall tax liability. The compromise updates EU Directive 2016/1164 issued in October 2016, which provided a framework to address hybrid mismatch arrangements. The Council agreed to a temporary carve-out from the rules for the banking sector; an approach similar to that used by the OECD for financial traders; and a longer implementation timeline.

Treasury and the IRS

The IRS released instructions for the **draft Form 8975** and related Schedule A, for use by US multinationals with \$850 million or more in annual consolidated gross income. The new form is based on the OECD's guidance for **country-by-country reporting**, which was finalized in 2015. According to the instructions, companies that are the ultimate parent of a global group must report the amounts of revenue, profit or loss, capital, and accumulated earnings for each country of operation.

The IRS issued Notice 2017-20, which suspends the March 13, 2017 deadline for employers to issue an initial **notice to employees covered by a qualified small employer health reimbursement arrangement** (QSEHRA) as provided for in Code section 9831(d). The IRS stated that the current reporting deadline presents compliance difficulties for employers without additional guidance, and the reporting deadline will remain suspended until the IRS issues new guidance, which it expects to do in the near future.



The President's legislative agenda had envisioned 3 key legislative initiatives: repeal and replace the ACA, enact comprehensive tax reform, and pass a \$1 trillion infrastructure bill. The failure of the ACA repeal legislation complicates the process for the other two initiatives amid challenging political obstacles. Tax reform is no less complex than health care reform – arguably more complicated without passage of the health care legislation, which included key tax cuts that were intended to assist with the challenge of paying for tax reform.

It has been suggested that the failure of the ACA repeal legislation to advance will impact the momentum of the President's legislative agenda, including tax reform, which the President has now said is his next priority. Speaker Ryan said that the failure of the GOP health care bill would make tax reform "more difficult but not impossible." Chairman Brady issued a statement that said "We have fought hard for this repeal – but I'm not discouraged. Ways and Means Republicans are moving full speed ahead with President Trump on the first pro-growth tax reform in a generation." After the health care bill failure, Secretary Mnuchin stated that his work on a comprehensive tax reform proposal was nearly complete.

Tax Reform Update

Who will be in charge of leading on tax reform – the White House or House Republicans?

It is not clear at this point whether the tax reform legislative process will be led by the Administration or Congress and what document will be used as a starting point for the process. The White House is being encouraged by many Republicans to take more ownership of the tax reform issue and the legislation that advances.

The White House has said that tax reform will be led by Secretary Mnuchin and National Economic Council Director Gary Cohn with input from Commerce Secretary Wilbur Ross and chief strategist Steve Bannon. A Trump tax proposal is reportedly forthcoming, although there continue to be reports of disagreements within the Administration economic team on some of the key issues. Secretary Mnuchin said that drafting the tax reform plan took longer than expected because "we are designing it from scratch."

Secretary Mnuchin continues to state a goal of completing tax reform by August, but he has said that date might slip, while other Administration officials are more cautious about the timeline, and arguably more realistic. With less than 60 legislative days until the August recess, the promise of a signed tax reform bill by that date is unlikely.

W&M Chairman Brady continues to state publicly with support from Speaker Ryan that he believes the best course is to start with the GOP Tax Reform Blueprint. A key provision and revenue raiser in the GOP Blueprint -- the border adjustment tax -- remains controversial with opposition in Congress growing. Other areas of potential disagreement between the Administration and Congress and within the Republican party include whether they should attempt comprehensive tax reform or limit their efforts to corporate tax reform and whether tax reform legislation should be revenue neutral, which is a goal of Chairman Brady with no clear signal on this issue from the White House. President Trump and Speaker Ryan have taken different approaches toward middle-class relief, which is not key in the House GOP blueprint but has been included by the President in his comments about tax cuts.

The tax provisions in the ACA repeal bill were written by Speaker Ryan's policy staff and W&M Committee Chairman Brady with input from Health and Human Services Secretary Tom Price. The bill included several provisions that conservatives did not support including a refundable tax credit. Some White House officials have said that one of the lessons learned was that the President and his staff must drive the process of legislating on key issues from the beginning – which suggests an approach of starting with a Trump tax plan rather than the House GOP Blueprint written by Ryan and Brady

Comprehensive Tax Reform, Corporate Tax Reform or an Infrastructure bill?

Considering the challenges with moving forward on tax reform, some Republicans have argued that the White House should turn next to advancing an infrastructure bill, which potentially could draw support from Democrats. The White House has not, however, suggested how it would pay for its infrastructure bill, so any certainty of a political coalition that could move this legislation forward isn't necessarily there.

Secretary Mnuchin has suggested that the money would come from a combination of public and private money, which may not align with the Democratic position of using direct government spending. In addition, there is a real question as to whether bipartisan legislation is possible on any issue in light of the contentious issues that have already been addressed by Congress, such as the ACA repeal bill, and the ongoing intelligence committees Russia investigations and the Supreme Court nominee confirmation process. If the White House wants to succeed quickly on tax reform, they may consider doing corporate tax reform first and address tax rates for individuals later. An alternative approach would be to package an infrastructure bill with corporate tax reform in order to attract support from moderate Democrats.

Tax Reform Update (continued)

Will success on tax reform legislation be the result of bipartisan agreement or Republican unity?

The White House will need to consider in the months ahead how to form alliances with members of Congress to advance priorities such as tax reform – will they reach out to Democrats by proposing a middle-class tax cut or infrastructure legislation or will they work to address the concerns of the conservative Republicans of the Freedom Caucus or the moderate Republicans who did not support the ACA repeal legislation? In the immediate aftermath of the failure of the health care reform legislation, the Administration gave an indication that they would reach out to Democrats in an effort to work together. Whether this approach will work may be affected by the other political issues ongoing in Washington including the outcome of the work on the CR and the process used to achieve confirmation of Gorsuch to the Supreme Court.

Even if Democrats are on board with the substance and goals of legislation dealing with infrastructure and tax reform, it may be challenging to overcome the politics. In addition, Democrats may be looking forward to the 2018 elections with the hope of picking up seats especially in the House, leading them to be less inclined to support Republican initiatives.

If the White House does believe that working with Democrats to achieve bipartisan tax reform is the approach to take, that likely means that tax reform will take much longer to accomplish since there would appear to be huge disagreements between the two parties on how to overhaul the tax code.

Does tax reform legislation have to be revenue neutral and does the failure of the ACA repeal bill make it harder to do tax reform?

Eliminating the \$1 trillion of ACA taxes and the federal spending associated with that law would have arguably made it easier to design a tax reform package that would comply with the budget reconciliation rules. It will now be more challenging to cut corporate tax rates without adding to the federal deficit. The tax cuts in the ACA repeal bill included the repeal of the 3.8% tax on investment income and the 0.9% tax on wages. Speaker Ryan stated that these taxes would stay in place and would not be included in a broader tax reform package, but many Congressional Republicans are very opposed to these taxes and may not be content to leave them in the tax code. Including them in comprehensive tax reform arguably increases the price tag for that legislation.

The opposition to the border adjustment tax proposal in the Republican blueprint, which would tax imports and exempt exports, has not abated, and in fact continues to grow in the Senate, potentially creating a \$1 trillion deficit in the House GOP blueprint should that proposal be dropped. Chairman Brady has stated that he is making “significant changes” to the border adjustment tax but no specifics have been released.

There is also a question as to whether Republican fiscal conservatives who oppose adding to the deficit will support tax reform legislation that is not offset by new spending cuts or new streams of revenue, like the border adjustment tax, although House Freedom Caucus Chairman Meadows has stated that he does not think the tax reform bill must be fully offset.

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

Susan Rogers, Partner

Potomac Law Group, PLLC

1300 Pennsylvania Avenue, NW, Suite 700

Washington, D.C. 20004

202.492.3593

srogers@potomacclaw.com

Susan Rogers has 30 years of experience in the tax policy field in Washington including several years as Majority Tax Counsel to the House Ways & Means Committee and extensive experience managing global tax issues for a Fortune 100 multinational. Ms. Rogers’ practice focuses on providing information and strategic advice to clients on US and international tax policy issues and advice on how to manage tax policy risks.

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