WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—May 2017 | Susan Rogers

The White House and Congress continue to face a **full legislative agenda** including budget deadlines, tax reform, health care reform, and House and Senate intelligence committee hearings on Russian involvement in the 2016 election. April 29th marked the end of the **first 100 days of the Trump Administration**.

Other issues which Congress will need to address this year include the **debt limit**, which will likely need to be raised by September, an infrastructure bill, veterans' legislation, defense policy legislation, and reauthorizing the children's health insurance program, the Federal Aviation Administration and the government flood insurance program. It is expected that there will be a need for all of these issues to gain some bipartisan support to advance.

The White House released a one-page fact sheet outlining principles for **comprehensive tax reform**, but did not include legislative language or technical explanations of the specific provisions. Treasury Secretary Mnuchin and National Economic Council Director Cohn said that a formal proposal would be released later this summer.

The Ways & Means Committee is expected to begin holding **hearings** in the near future on the Administration's **tax reform** proposal. W&M Committee Chairman Brady has commented that a markup in the Committee on tax reform may not take place prior to the August recess, but that his goal is to complete tax reform prior to the end of the year.

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

The White House unveiled a tax reform plan with plans to hold "listening sessions" with stakeholders and meetings with Congressional leadership in May to refine the plan and provide technical details in order to produce a formal legislative proposal this summer and complete tax reform by the end of the year.

Susan Rogers

In This Issue

Congressional Activity

Federal Government Funding: The current **Continuing Resolution funding the government** expired on April 28th so Congress approved a one-week extension and has now reportedly agreed to a bipartisan deal to fund the government through September. The $1 trillion budget deal increases defense spending to fight terrorism by up to $15 billion (with $2.5 billion contingent on the White House presenting a strategy to defeat the Islamic State to Congress) and provides $1.5 billion in new border security spending but does not include funding for a wall between Mexico and the US to which Democrats objected. The bill also includes $2 billion in increased spending for the National Institutes of Health, the extension of expiring health benefits to retiring coal miners, and continues to fund Planned Parenthood. This bill is expected to pass both the House and Senate.

Health Care reform: House Republicans have continued to work to draft **health care reform** legislation that could garner enough votes for passage, but the urgency of dealing with the expiration of the Continuing Resolution has delayed consideration of this issue. Working from the legislation which was pulled from the House Floor prior to a vote last month, House leaders have focused on an amendment that would allow states to remove some insurance requirements established by the Affordable Care Act (ACA) if the states could argue to Washington that it would enable them to lower the cost of premiums or insure more people. Under the proposal, states could relax requirements that set which benefits health plans must cover (such as maternity services and mental health services), as well as allow insurers to charge higher premiums to people with pre-existing conditions and older enrollees under certain conditions. Although the revisions have been endorsed by the conservative Freedom Caucus, there is a risk of losing support from Republican moderates. President Trump has urged Congress to move on health care reform as quickly as possible.

Regulatory Activity

President Trump signed an **Executive Order** (EO) instructing Treasury Secretary Mnuchin to **review all significant tax regulations since the beginning of 2016**. He commented that "this regulatory reduction is the first step toward a tax reform that reduces rates, provides relief to our middle class, and lowers our business tax, which is one of the highest in the world and has stopped us from so much wealth and productivity." The EO directs the Treasury Secretary to send an interim report to the President by June 20th (with a final report due September 18th) of all regulations that: (1) impose an undue financial burden on US taxpayers; (2) add undue complexity to the Federal tax laws; or (3) exceed the statutory authority of the IRS. The report is to also include recommendations on specific actions to ease the regulatory burden by causing "the effective date of such regulations to be delayed or suspended, to the extent permitted by law, and to modify or rescind such regulations as appropriate and consistent with law, including, if necessary, through notice and comment rule making." Regulations that may be affected by this EO include the Code section 385 final regulations on earnings stripping and the Code section 7874 regulations on corporate inversions.

International Issues

Following the **G20 Finance Ministers** meeting, the OECD Secretary-General issued the Report to G20 Finance Ministers including the latest developments in the international tax agenda and a progress report on the Global Forum on Transparency and Exchange of Information for Tax Purposes.

The fourth meeting of the **OECD Global Forum on VAT** took place on April 12-14, during which the OECD Deputy Secretary-General announced the release of the Recommendation of the Council on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles.

Treasury and the IRS

The IRS issued Notice 2017-17, which seeks comments on a new approval process for taxpayers to **change a method of accounting** for recognizing income to comply with new FASB and IASB revenue recognition standards. The IRS wants to clarify whether new standards are permissible methods of accounting that may be used for federal income tax purposes.

The IRS announced the suspension of certain **excise taxes and reporting requirements** under Code section 4975, which is intended to conform IRS policy with the temporary enforcement policy described by the Department of Labor (DOL) with respect to the final fiduciary duty rule issued on April 8, 2016. At the direction of the President, DOL is re-examining whether the final fiduciary rule "may adversely affect the ability of Americans to gain access to retirement information and financial advice."

The IRS issued Revenue Procedure 2017-29, which updates for 2017 the annually published **depreciation and inclusion tables** for owners and lessees, respectively, of passenger vehicles, trucks and vans.

One of the President's key legislative initiatives is to enact comprehensive tax reform, and the White House has now moved to this issue in the search for a major legislative success in 2017. Tax reform will likely prove to be more challenging than health care reform, and it remains to be seen whether Republicans will proceed with plans for tax reform or scale back their plans and advance a tax cut bill.

House Republican leadership has considered moving legislation that would include significant tax cuts for a 2-3-year period but not comprehensive tax reform as part of the budget reconciliation process. Doing so would likely not please the business community which has waited years for comprehensive tax reform.

The Joint Tax Committee has informed Speaker Ryan that a 3-year tax cut would add to the deficit outside the 10-year budget window with a loss of $5.9 billion in year 2027. That result would trigger a challenge to the use of the budget reconciliation process by the violation of the Byrd rule which prevents the inclusion of proposals if they increase the deficit beyond the 10-year budget window. The inclusion of revenue offsets in the budget reconciliation legislation, however, could take care of the revenue shortfall.

Tax Reform Update

Secretary Mnuchin's plan is to **complete tax reform by the end of 2017**. The White House released its tax reform plan to "get the conversation started" with a package of principles and proposals designed to set the stage for Congressional debate. Speaker Ryan has also stated that tax reform could take all year noting "We can clearly get this done by the end of summer but if it needs to go a little longer, we'll do that."

The plan does not include an **infrastructure package**, although there were reports that this was being discussed as a way to gain interest from Democrats. Congressional leadership continues to discuss using the budget reconciliation process to advance tax reform indicating that they do not expect to get Democratic support, and they are not working currently to explore ways in which to make tax reform a bipartisan initiative.

President Trump's Tax Plan

Treasury Secretary Mnuchin released the Administration's tax reform plan on April 26th with proposals that are similar to those Trump proposed during his campaign. Comments from the White House indicate that they plan to take the lead on tax reform in light of the problems that health care reform encountered, but tax reform legislation must be written and approved by Congress, so a partnership between the two branches will be necessary.

Following the tax reform announcement by the Trump Administration, House Speaker Paul Ryan (R-Wis.), Senate Majority Leader Mitch McConnell (R-Ky.), House Ways & Means Committee Chairman Kevin Brady (R-Texas), and Senate Finance Committee Chairman Orrin Hatch (R-Utah) issued the following joint statement:

"The principles outlined by the Trump Administration today will serve as critical guideposts for Congress and the Administration as we work together to overhaul the American tax system and ensure middle-class families and job creators are better positioned for the 21st century economy. Lower rates for individuals and families will allow them to keep more of their hard-earned money and empower them to invest more in their future. Getting tax rates down for American companies, big and small, will create new jobs and make the United States a more inviting place to do business. With an eye toward fairness and simplicity, we're confident we can rebuild our tax code in a way that will grow our economy, better promote savings and investment, provide our job creators with a competitive advantage, and bring prosperity to all Americans."

Business Tax Reform

- Lower the top marginal rate for corporations and certain business income earned by pass-through entities to 15%
- Shift to a territorial tax system from a worldwide income tax system
- Impose a one-time tax on unrepatriated earnings

Individual Tax Reform

- Shift to three tax brackets for individuals with marginal rates of 10%, 25% and 35%
- Double the size of the standard deduction
- Repeal the alternative minimum tax and the estate tax
- Eliminate all itemized deductions except for mortgage interest and charitable donations
- Provide increased tax relief for child and dependent care expenses
- Eliminate the 3.8% tax on net investment income
- Preserve favorable tax treatment for retirement savings

Tax Reform Update—Issues to Note

In contrast to the Administration plan, the House GOP Blueprint proposes a 20% corporate tax rate and a 25% top rate on pass-through businesses. The Blueprint also includes a "repatriation tax" of 8.75% on earnings held offshore as cash or cash equivalents and a 3.5 % rate on earnings that have been invested otherwise.

The disparity in the tax rate for pass-through businesses and the individual tax rate in the Administration plan could create opportunities for tax planning that inappropriately take advantage of the 15% rate by individuals who form limited liability companies. Staff of the W&M Committee have stated that they are working on a set of rules to be administered by the IRS that would address how the rules would operate for pass-through businesses.

The Administration plan is not revenue neutral and thus will add to the deficit over time, unlike the House GOP Blueprint and the commitment of Speaker Ryan and Chairman Brady that tax reform be deficit neutral. It will be challenging to find enough business tax incentives to repeal to cover the cost of lowering the rate to 15%. The cost of lowering the rate 20 percentage points would be $2 trillion over a decade. Secretary Mnuchin has stated that faster economic growth from the tax cuts would increase revenue and avoid the risk of increased deficits, but some economists have questioned whether such economic growth could be sustained. He has also made it clear that the Administration will use dynamic scoring for its proposals, which takes into account the impact of new tax proposals on the economy.

The Administration plan does not include the border adjustment proposal, which is the key revenue raiser in the House GOP Blueprint and which has drawn significant opposition from several Senators and businesses groups. Secretary Mnuchin has not opposed it altogether but has said "We don't think it works in its current form." W&M Committee Chairman Brady's position on this issue has not changed stating "I'll continue to make the case that with changes, modifications and transition rules that address the issues that have been raised since we first put the blueprint in place that we can come up with a good solution." Speaker Ryan has said "We all agree that in its present form it needs to be modified." Although Chairman Brady has not been specific about modifications he is considering, one idea that has been suggested is a 5-year phase-in which would be similar to the new passive loss rule that was included in the Tax Reform Act of 1986.

One issue that remains with the failure of health care reform to advance is whether repeal of the ACA taxes is included in tax reform. House leadership thus far has indicated they do not want to include these issues in tax reform preferring to keep them in the health care reform package, but SFC Chairman Hatch has said he would consider repealing those taxes as part of tax reform, which would create a significant increase in the cost of the legislation.

The White House issued a statement in response to a media report stating that a Value Added Tax and a carbon tax are not in play with respect to tax reform. The statement said "As we have said many times, the President's team is hearing input from experts on all sides of the tax reform debate as we formulate what will ultimately be the President's plan to enact the first significant tax reform since 1986. As of now, neither a carbon tax nor a VAT are under consideration."

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@potomaclaw.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.