WASHINGTON TAX NEWS

Potomac Law Tax Newsletter— July 2017 | Susan Rogers

At the end of June, Congress left Washington to return home for a week-long July 4th recess with **no progress on the FY 2018 budget, the debt ceiling limit, health care reform, or tax reform.** The Senate continued to focus on health care reform in an effort to move on from that issue to tax reform, but leadership was unable to close the issue out before Congress left for the July 4th recess.

The House Budget Committee had hoped to release a **budget plan for FY 2018** before Members left for the July 4th recess, but that action was delayed when several Committee chairs expressed opposition to plans to cut $50 billion from several mandatory programs including entitlement programs to fund an increase in defense spending. This budget resolution is intended to provide the framework for work to begin on tax reform in the House through budget reconciliation instructions, so the delay in scheduling a markup of the budget resolution presents another serious challenge to the advance of comprehensive tax reform.

The Congressional Budget Office (CBO) issued a report that stated that the **Federal government is likely to run out of cash in early to mid-October**, which will necessitate Congressional action to increase the debt ceiling limit prior to that time. Since the debt limit expired in March, the Treasury Department has been taking "extraordinary measures" to avoid exceeding the debt ceiling, but without an increase, the government could default on its debt and be forced to delay payment for federal spending.

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Members of Congress appear to be increasingly concerned about the lack of legislative progress on key Republican agenda items for 2017 with very few legislative days left when they return before the month-long August recess.

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In This Issue

Health Care Reform—Richard McHugh

Senate Majority Leader McConnell (R-KY) released a **discussion draft of a Senate version to repeal and replace the Affordable Care Act (ACA)** on June 22nd. Although McConnell hoped to get a bill passed in the Senate before the recess, he announced on June 27th that the vote in the Senate on the bill would be postponed until after that recess since the GOP lacked the votes to pass the procedural motion needed to begin debate on the Senate floor (and presumably to pass the bill itself). The Senate bill generally follows the approach of the House-passed legislation but includes some key changes related to the Medicaid expansion provisions and the premium tax credit regime that are intended to assist taxpayers who purchase insurance on the individual market. Like the House bill, the Senate bill would reduce to zero the penalties for violation of the individual mandate to obtain coverage and the employer mandate to coverage, thus effectively rendering those mandates meaningless. House Ways & Means Committee Chairman Brady (R-TX) has stated publicly his position that if these taxes are not repealed as part of health care reform, they would not be included in the tax reform legislation and so would remain in place.

The **CBO score of the Senate bill** shows a deficit reduction of $321 billion in the 10-year budget window and a $701 billion reduction in federal revenues. The CBO score also shows that the number of uninsured would increase by 22 million over that same window and that average premiums would rise through 2020 but decline after that time with enrollment in Medicaid decreasing by 15 million (although certain segments of the population, including older persons, likely would experience higher premiums). Senate leadership is continuing to work with individual senators to make changes to the bill responding to concerns, including the retention of one or more of the ACA's taxes (such as the 3.8 percent tax on investment income) to pay for more generous tax credits and programs to help lower-income individuals. Based on a concern that the bill as drafted insufficiently induces healthy persons to secure coverage (at least until they are faced with health care concerns, thus raising adverse selection concerns), the bill is likely to be revised to include some sort of penalty for letting coverage lapse (such as a 6-month delay in securing new coverage after a lapse in coverage).

In response to the opposition this draft has produced and the difficulty in arriving at a suitable compromise, there is renewed discussion from some Republicans (which President Trump himself has noted) about pursuing a strategy of repealing the ACA now and replacing that law at some point in the future. Many observers have predicted this approach could cause havoc within the health care industry, and at least so far there is little indication that Senate leadership is considering this approach.

Treasury and the IRS

The IRS reissued proposed regulations intended to implement a **new centralized partnership audit regime** enacted by the Bipartisan Budget Act of 2015 (BBA) which sets a process that assesses and collects tax at the partnership level. Regulations were first released in January but were not published in the Federal Register due to an Executive Order that mandated a freeze on regulations. A public hearing on the proposed regulations is scheduled for September 18, 2017. The new regime applies to returns filed for partnership taxable years beginning after December 31, 2017, and to certain partnerships that elect application of the regime. The proposed regulations provide rules for partnerships subject to the new regime, including procedures for electing out of the centralized partnership audit regime, filing administrative adjustment requests, and determining amounts owed by a partnership or its partners attributable to adjustments that arise out of an examination of a partnership.

The Treasury Department issued a **request for comments due by July 29th on Treasury regulations that can be eliminated, modified, or streamlined** under Executive Order 13771, which directs agencies to eliminate two regulations for each new regulation issued. A task force will evaluate existing regulations and make recommendations to the Treasury Secretary to prioritize their possible repeal, replacement or modification.

International Issues

On June 7th, the **Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting (MLI)** was signed by 68 countries and jurisdictions with eight additional countries expressing their intent to sign the MLI and many more countries expected to sign in the future. The MLI is designed to implement efficiently the tax treaty-related measures arising from the G20/OECD BEPS project. "Minimum standard" changes to the functioning of existing bilateral tax treaties in the areas of treaty abuse, mutual agreement procedures (MAPS,) and treaty preambles will be implemented through the MLI.

The OECD has released the key document which will form the basis of the **peer review of the BEPS Action 6 minimum standard on preventing the granting of treaty benefits in inappropriate circumstances**. The new document includes the criteria for assessing implementation of the Action 6 minimum standard as well as the procedural mechanism for conducting the review with peer reviews expected to start in 2018.

Administration officials have said that they will send Congress a detailed tax reform plan after lawmakers return to work in early September following the August recess. National Economic Director Cohn and Treasury Secretary Mnuchin have been meeting regularly with House and Senate leadership (including Speaker Ryan, W&M Committee Chairman Brady, Senate Majority Leader McConnell and SFC Chairman Hatch) with the intent to agree on a single tax reform plan that would be approved by both the House and Senate. The negotiations will continue through the summer. Key issues where agreement has not yet been reached include revenue neutrality for a tax reform package and inclusion of the border adjustment tax.

Permanency is a key issue relating to whether GOP leadership decides to continue to advance comprehensive tax reform or settle for tax cuts. Tax cuts without tax revenue offsets would have to be temporary to comply with budget reconciliation rules, which do not allow legislation that increases the deficit beyond the 10-year budget window. One suggestion on how to work around these rules is to lengthen the budget window, a proposal supported by Chairman Hatch but opposed by Speaker Ryan and Chairman Brady.

Tax Reform Update

Ways & Means Committee/House

On June 20th, **Speaker Paul Ryan (R-WI) gave a key speech** to the National Association of Manufacturers' annual conference on tax reform urging passage of comprehensive tax reform by the end of 2017. He stated, "I am here to tell you: We are going to get this done in 2017. You know why we're going to get this done in 2017? Because we have to get this done in 2017."

The speech generally aligned with the GOP House Blueprint with the Speaker calling for a **lower corporate tax rate** and a **transition to a territorial system**, but he did not include support for the **border adjustment proposal (BAT)**, which has drawn significant opposition. The Speaker was asked about the BAT following the speech, and he said that the SFC Republicans are working on an alternative, noting that dropping the proposal creates a "revenue hole" (of more than $1 trillion) and makes it necessary for lawmakers to find another way to address the US tax base erosion problem. Senate Republicans are reportedly looking at the proposal in the Camp draft tax reform legislation that would have created a bifurcated minimum worldwide effective tax rate of 15% on foreign base company intangible income and 12.5 % on sales income.

With respect to **policies on individuals**, he called for the elimination of the estate tax and the alternative minimum tax, the reduction of the number of individual tax brackets from seven to three, and the retention of the mortgage interest, charitable contribution, and retirement savings deductions. He emphasized that the tax reforms/tax cuts must be permanent, although the following day, he stated to reporters that "there are also provisions in tax reform that don't have to be permanent. But the key ones like rates, the things that businesses plan on, those things require the certainty of permanence, and that's where you get economic growth."

In an interview on the same day as the Speaker's comments, **Treasury Secretary Mnuchin** said he was **aligned with GOP leaders in Congress**, saying "The speaker, myself, the Senate leadership, we are all 100 percent committed to getting it done this year."

Senate Finance Committee/Senate

In June, **SFC Chairman Hatch (R-UT) publicly provided an update on the status of tax reform** noting that bipartisan support is still possible and remains his goal, and that he intends that there be an open debate with "full process" in the SFC and on the Senate Floor. He commented that the BAT faces challenges in the Senate, but he is not yet ruling any revenue offsets out. He stated that he has not committed to any specific tax rates for individuals or businesses, noting that rate reductions will depend on the results of base broadening and which preferences and credits are eliminated. He stated that major changes to the international tax system are needed suggesting "a conversion to a territorial system with safeguards in place to prevent base erosion." According to Chief Tax Counsel, Mark Prater, the Committee is also still considering a corporate integration plan that would lower the effective tax rate for corporations by combining a dividends received deduction and a withholding tax on corporate dividend and interest payments.

Chairman Hatch has assigned SFC members to lead the development of tax reform policies in certain areas including: (1) Enzi and Portman on international tax issues; (2) Thune on the business tax system and estate tax; (3) Heller and Cassidy on energy tax policy; (4) Grassley on individual tax issues; and (5) Roberts on agriculture tax issues.

Chairman Hatch has requested feedback from stakeholders by July 17th on how to improve the American tax system, specifically in the areas of: (1) providing tax relief to middle-class individuals; (2) lowering tax rates and broadening the tax base for businesses; (3) removing disincentives for savings and investment in the tax code: and (4) making the international tax system more competitive and preserving the tax base.

Tax Reform Update (continued)

Treasury and the White House

National Economic Council Director Cohn, who with Treasury Secretary Mnuchin is leading the tax reform effort for the Administration, focused recent public comments on the difficulties of dealing with the issues affecting **pass through entities**. He also stated that there is consensus between the White House and Congressional leadership on the need to adopt a **territorial system** for taxing foreign-sourced income of US multinationals, although he said that other issues in the international area remain unresolved. He restated the Administration position in favor of base broadening to achieve significant tax rate cuts.

Border Adjustment Tax

In mid-June, W&M Committee Chairman Brady outlined **possible changes to the House BOP Blueprint relating to the border adjustment tax**. He suggested a **5-year phase-in** for the border adjustment tax, which would tax all imports into the US at 20 percent and exempt all exports from taxation. He explained the proposed phase-in stating "Businesses need plenty of time to assess their current supply chain and decide what, if any, can return to the United States. And they want plenty of time to see how the dollar adjusts and at what level." Chairman Brady and Speaker Ryan have argued that implementation of the border adjustment tax would result in a stronger US dollar, which would make it less expensive to import goods and effectively cancel out the higher tax on imports, but opponents are concerned that exchange rates won't adjust enough to offset the tax.

Initial reactions from taxpayers and groups who oppose the BAT indicated that the **phase-in was not enough to gain their support**, and some members of Congress who have voiced concerns about the proposal said they would need more details on the phase-in before they could support it. The non-partisan Tax Foundation released a revenue estimate showing that a 5-year phase-in would raise $1 trillion in revenue over a 10-year period while immediate imposition of the tax would raise more than $1.2 trillion.

Chairman Brady also suggested that he is considering **special treatment for certain business sectors** including financial services, shipping, communications, insurance, and digitally-focused businesses, where cross-border transactions are more challenging to identify. To date, he and Speaker Ryan have resisted consideration of exemptions, but the opposition to the BAT has put it in jeopardy and created the need to change it or find a revenue substitute.

Net Interest Deductibility

Another provision in the House GOP Blueprint that has raised controversy is the proposal to eliminate the current-law deduction for net interest expense paired with a provision that allows full expensing of business investments. W&M Committee Chairman Brady has also suggested a possible change to this proposal to make it more palatable to critics by describing an **exemption for small businesses** from the repeal of the interest expense deduction but still allowing the full expensing of business investments.

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