WASHINGTON TAX NEWS

Potomac Law Tax Newsletter— September 2017 | Susan Rogers

Congress returns on September 5th to face a **full schedule** with some pressing time deadlines. The statutory debt limit ceiling must be raised by the end of September and deadlines for FY 2018 appropriations legislation on September 30th must be met, as well as reauthorizations for the Federal Aviation Administration, flood insurance, the Children's Health Insurance Program, and user fees that fund the Food and Drug Administration. Congress will also have to reach agreement on a new budget resolution for FY 2018 in order to advance tax reform as part of the fast-track budget reconciliation process.

White House officials are also considering how to address their **policy agenda** for the fall to proceed on the **debt ceiling issue, the 2018 federal budget, tax reform, infrastructure spending and health care reform**. The **hurricane and flood disaster in Texas** will be added to the list of issues to address. It is likely that there will be increasing attention paid to the **investigations into Russian interference in the 2016 elections** both in Congress and with the Special Prosecutor, and foreign issues such as **Afghanistan strategy and North Korea** will demand attention from the White House and Congress. The President added **immigration** to the agenda with his announcement that he will end the Deferred Action on Childhood Arrivals (DACA) program in 6 months.

On August 30, **President Trump** gave his first **major speech on tax reform**. He promised that tax reform would: (1) simplify the tax Code; (2) cut taxes for American workers; (3) reduce the business tax rate; and (4) encourage American businesses to repatriate offshore earnings.

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Treasury Secretary Mnuchin and National Economic Council Director Cohn want to address the debt ceiling and budget issues quickly in order to turn to tax reform. Conventional wisdom would say that Congress has until early in 2018 to achieve tax reform, since by the 2nd quarter, the 2018 mid-term election season will have started and may make it more difficult to get the votes of vulnerable members of Congress.

Susan Rogers

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The Debt Ceiling and FY 2018 Budget Update

Once Congress is back in session in September, there are 12 legislative days with both the House and Senate in session that month to deal with the **debt limit issue and the funding of the government** for the new fiscal year. Although President Trump initially stated publicly that a government funding bill had to include money to pay for the **border wall between Mexico and the US** or he would be willing to shut down the government, he has now told Congressional leadership that a short-term funding bill that would likely run to December does not need to include the wall funding. If Congress can reach agreement on a FY 2018 budget by the end of the year, however, the President has said it should include the border wall funding. The House has passed a bill with the funding in it, but getting the 60 votes needed in the Senate for passage will be difficult.

Both Senate and House leadership have stated that a **government shutdown** is not an option with the current expectation being that Congress will approve a short term (i.e., 2 -3 month) funding bill in the form of a Continuing Resolution to give them more time to work out a budget deal by the end of the year. Many rank-and-file Republicans are reluctant to allow a shutdown of the government with Republicans in control of both the executive and legislative branches with fear that this issue could affect the outcome of the **2018 mid-term elections**.

In addition, Congress must now factor in the need to provide **federal disaster assistance to the victims of Hurricane Harvey**, which certainly will run into the billions. The House is scheduled to pass a Hurricane Harvey relief bill, and Senate leadership is planning to attach a short-term (until mid-December) increase in the debt ceiling issue and short-term government funding to that legislation. Congressional Democratic leadership has stated their support for this legislation without requiring inclusion of the DACA issue.

An additional complication to the budget debate will be the fact that the **"sequestration" issue** must be factored into consideration. Statutory caps on all discretionary spending were put into place in 2011 as part of the agreement then to raise the debt ceiling limit, but were lifted for FY 2015 through 2017 in exchange for savings that were produced in other parts of the budget, but the spending caps are scheduled to be back in place on October 1st for FY 2018. It is possible that another deal to lift the spending caps will be reached as part of a short or long-term spending deal.

Treasury Secretary Mnuchin has consistently supported a "clean" debt-ceiling bill and has stated that President Trump supports this position, which conflicts with the position of some Congressional Republicans who would like to attach spending policy changes to the legislation.

Affordable Care Act Repeal—Health Care

After the **failure of the health care reform "repeal and replace" bills to advance in the Senate** prior to the August recess, it is unclear where Congress will move with respect to health care reform in September. Senate Leader McConnell could try again within the framework of budget reconciliation (which requires action by September 30) to return to the issue but with calls for bipartisanship on the issue from prominent Republicans, that may prove to be difficult. Insurance companies must commit to participating in the ACA's health exchanges by September 27th which adds pressure to Congressional leadership about how to proceed this fall.

House leadership has indicated that they plan to continue the debate on health care reform this fall, although it may be challenging to make time for the issue considering the other more urgent issues noted above that must be addressed.

The President continues to call on Congress to act on health reform this fall, but doing so would very likely delay progress on tax reform with Congress occupied with the debt ceiling and spending issues in September.

International Issues

The OECD issued new guidance on the implementation of **Country-by-Country (CbC) reporting**, which is part of the OECD's Base Erosion and Profit Shifting (BEPS) initiative to counter cross-border tax avoidance (Action 13). The additional guidance addresses two issues: (1) how to treat an entity owned and/or operated by two or more unrelated multinational-enterprise groups, and (2) whether aggregated data or consolidated data for each jurisdiction is to be reported in Table 1 of the CbC report.

The OECD invited public comments in July 2017 on the draft contents of the **2017 Update to the OECD Model Tax Convention** and recently released the comments received. It is expected that the contents of the 2017 Update will be approved and published later this year.

The Platform for Collaboration on Tax invited comments by September 25, 2017, on a **Draft Toolkit on the taxation of offshore indirect transfers of assets**. The tax treatment of "offshore indirect transfers (OITs)," has emerged as a significant concern in many developing countries.

A senior Administration official has stated that the White House will not release its own version of tax reform but will look to Congressional leadership and the two tax-writing committees to produce a plan, which is contrary to the position taken earlier this summer when the White House suggested that it would release a tax reform plan in September.

The process now is that the Big Six tax reform negotiators, including National Economic Council Director Cohn, House Speaker Ryan (R-WI), Senate Majority Leader McConnell (R-KY), W&M Committee Chairman Brady (R-TX), and SFC Chairman Hatch (R-UT), will turn over their work product to the committees who will fill in the details, although Secretary Mnuchin has made it clear that the Administration will stay engaged in the work the committees are doing. This group met with the President on September 5th, but the discussion centered on the process of advancing a bill and not the substance of the bill.

In an August meeting at President Reagan's California ranch, W&M Committee Chairman Brady recognized the anniversary of the 1986 Tax Reform Act, stating that his goals for tax reform are the same as for the landmark 1986 law – simplicity, certainty, American competitiveness and economic growth.

Tax Reform or Tax Cuts?

Tax reform typically means a combination of tax rate cuts, elimination or modification of tax preferences, and the creation of new revenue raisers, while **tax cuts** usually means tax rate reductions. Tax reform will be very difficult politically because it will require the elimination of tax breaks that many Republicans will want to retain. Tax cuts will be difficult because Senate rules restrict the ability of Republicans to increase the deficit.

Despite the fact that there is consensus among Republicans in the House and Senate that comprehensive tax reform is needed, there is no agreement about whether that is the right approach to take this fall rather than pursuing a package of tax cuts. Speaker Ryan has consistently made it clear that his preference is tax reform, which would entail revenue offsets in order to meet budgetary rules required by the budget reconciliation process. Some conservatives are arguing instead for a tax cut package that is not fully paid for, but that approach would run afoul of the budgetary rules and be subject to a filibuster in the Senate.

How can Congressional leadership resolve this issue? They can advance a **package of tax cuts that is a mix of permanent and temporary changes** that have an expiration date of 10 years. This approach would allow a tax reform package to be achieved by the end of the year without the need to tackle the more difficult task of addressing many of the revenue offsets that would be needed for permanent changes.

Tax Reform

In September, Congress will need to approve an **FY 2018 budget resolution** if they hope to use the budget reconciliation process to **fast-track a tax reform bill**. In July, the House Budget Committee approved a fiscal 2018 package that included reconciliation instructions that allowed for revenue-neutral tax reform along with $203 billion in spending decreases on entitlement programs. This plan is expected to come to the House Floor for a vote this fall according to House Speaker Ryan but there is disagreement within the Republican caucus about the mandated spending cuts. In addition, the House Freedom Caucus chairman has indicated that conservative Republicans may not be willing to support this legislation allowing for an expedited process until House leadership provides more details on a tax reform plan.

Even if House leadership successfully advances a budget through the House, it will likely be different in significant ways from a Senate version, and it will take time for the two chambers to work out their differences. Once they reach agreement, the final budget must once again pass in both the House and the Senate. Budget resolutions are non-binding and do not require a Presidential signature.

Reportedly the plan of House and Senate leadership is to brief their Republican colleagues on the plan they have been working on in conjunction with the Big Six meetings prior to releasing it publicly in order to assess support. Should their plan be received favorably, they would release details publicly in September and plan for a markup in the W&M Committee in October. This plan is designed to avoid the problems that health care reform legislation faced earlier this year.

Their work product reportedly includes cutting the corporate tax rate to 22-25% with potential revenue offsets of mortgage interest deduction caps, repeal of the state and local tax deduction, and reduction of business interest deductions, coupled with a phase-in of full expensing for small business and changes to the treatment of contributions to 401(k) plans. These potential revenue offsets have significant support and will draw opposition and controversy if they are included.

Reportedly, one change that has been agreed to by Administration representatives, Treasury and Congress is a one-time **repatriation of offshore earnings** to be taxed at a low rate to encourage companies to bring that money back to the US. The tax reform blueprint that was issued by then-W&M Chairman Camp is being reviewed for other ideas for revenue offsets.

Tax Reform Update (continued)

Tax Cuts

There are reports of Republican plans being discussed that would include a **package of temporary tax provisions with some permanent changes** that would be advanced in place of comprehensive tax reform in large part because of the difficulty in finding revenue offsets for all tax cuts to be permanent as required by Senate rules. Speaker Ryan in private briefings has said that the priority of their tax plan will be to lower as quickly as possible the overall business and individual tax rates as well as provide for enhanced expensing for businesses with the hope that these changes will provide economic benefits ahead of the 2018 mid-term elections. House Republican leadership prefers permanent tax changes, but the Speaker has stated that some changes may need to be temporary in order to "make sure that the numbers work."

Should this approach be followed, it remains to be **seen whether tax changes for business and individuals will be treated differently**. One factor that may impact whether a tax proposal is permanent or temporary will be whether it is believed to be politically easy to renew it in 10 years when a temporary tax cut would expire. For example, cuts to business and individual rates may be more likely to be permanent changes with favorable changes to rules such as the standard deduction and business expensing more likely to be temporary.

Treasury and the IRS

In April, an Executive Order instructed the Treasury Department to review all significant tax regulations published since the beginning of 2016, and they identified eight regulations, including the **Code section 385 rules**, to be modified, replaced or removed. Treasury requested public comments on how to proceed with these eight regulations, and they received letters from multiple groups, including the Chamber of Commerce, the National Association of Manufacturers, and the American Institute of CPAs recommending that the Code section 385 rules be repealed or modified. Treasury also received, however, many letters in favor of maintaining and strengthening the rules. A group of Democratic Senators recently wrote to Treasury Secretary Mnuchin urging Treasury to retain the rules to protect the US tax base. If the tax reform effort in Congress progresses this fall, it may be more likely that Treasury will undertake modification of the 385 rules as there is general agreement that some of the rules are burdensome for taxpayers including those on documentation, but consensus on repeal within the Administration and with Congress will be more challenging to achieve.

The IRS issued final and temporary regulations updating the **due dates and extensions for filing certain tax and information returns**. The following forms are covered: Form W-2 (series, except Form W-2G), Form W-3, Form 990 (series), Form 1099-MISC, Form 1041, Form 1041-A, Form 1065, Form 1120 (series), Form 4720, Form 5227, Form 6069, Form 8804, or Form 8870. The rules also reflect statutory changes made by the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 and the Protecting Americans from Tax Hikes Act of 2015.

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