WASHINGTON TAX NEWS

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

Unlike the September Congressional work period during which Congress faced a number of pressing deadlines, the **October work period will have tax reform as its focus** as Members of Congress work to achieve a key legislative success before the end of the year. In September, the President struck a deal with Congressional Democratic leaders which resulted in a short-term agreement on the debt limit and government funding which will expire December 8th.

For the past several months, the "Big Six" – Secretary of the Treasury Mnuchin, National Economic Council Director Cohn, Senate Majority Leader McConnell (R-KY), Senate Finance Committee Chairman Hatch (R-UT), House Majority Leader Ryan (R-WI), and House Ways and Means Committee Chairman Brady (R-TX) – have been meeting to outline a framework for tax reform. On September 27, 2017, they released their "Unified Framework for Fixing Our Broken Tax Code."

The **key principles at the heart of the Framework** are simplification, tax reduction for individuals and businesses, and repatriation of business earnings currently kept offshore. The proposals outline extensive changes to the taxation of both domestic and international business, as well as to the taxation of individuals.

The Unified Framework released by Republican leadership in Washington last week outlines a comprehensive rewrite of the tax code but leaves many important questions unanswered and delegates the details that will make or break tax reform legislation to Congress.

Susan Rogers

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In This Issue

Health Care—ACA "Repeal and Replace" Legislation

Senate Republican leadership announced on September 26th that they **would not bring the Graham-Cassidy health care legislation to the Senate Floor for a vote**, which was necessary by September 30th, the expiration of the FY 2017 budget resolution that included the instructions that would have allowed for fast-track consideration of legislation to modify the Affordable Care Act (ACA). Several Senators had announced their opposition to the bill which meant that the 50 votes needed for passage (with Vice President Pence being the 51st vote) was unattainable.

The legislation would have dismantled the overall structure of the ACA by 2020, including expansion of the Medicaid program, tax credits to help lower-income individuals afford the cost of health insurance coverage, and cost-sharing reduction subsidies, and replaced it with block grants for states to use to administer their own health plans. With respect to the revenue issues, the bill would have effectively repealed the individual and employer mandates by reducing the penalties for noncompliance to zero retroactive to calendar year 2016, and it would have repealed the medical device tax, but would have left most of the other tax offsets in place including the 3.8 percent net investment income tax and the 0.9 percent Medicare Hospital Insurance tax on certain upper-income individuals.

Senate Majority Leader McConnell stated that Senate Republicans remain committed to repealing the ACA but would now turn to consideration of tax reform. President Trump conceded defeat but continued to urge the Congress to act soon on health care issues.

Treasury and the IRS

The U.S. Department of the Treasury has announced that it will **amend or completely repeal eight tax regulations** issued under the Obama administration, **including rules regarding corporate debt and transfers of estates**, as part of an effort to simplify the tax code.

A **Texas federal court invalidated temporary regulations containing an anti-inversion rule** that was published in April 2016 under Code Section 7874. The judge found that the regulation was unlawfully implemented without giving the public adequate time or notice to comment and concluded that the contested rule is a substantive, legislative regulation that has the force and effect of law, and not just one that interprets the underlying statute. Under the Administrative Procedures Act, there is a legal exception permitting interpretive rules to be issued without a notice-and-comment period, but the judge found that this rule did not qualify under the exception.

The plaintiff's brief also argued that the rule exceeded Treasury's statutory jurisdiction and was arbitrary and capricious. The court ruled in favor of the government with respect to these two points stating that Treasury is legally allowed to "treat stock as not stock" and disregard certain foreign parent stock attributable to prior inversions and that the agencies offered a plausible explanation for the rule's existence. Because the judge determined that decisions on how to treat stock constitute substantive modifications and not merely interpretations of an underlying statute, however, the APA notice-and-comment requirements could not be disregarded.

International Issues

The OECD issued updated **guidance for competent authorities and multinational corporations on its Country-by-Country (CbC) reporting regime**, which is part of the OECD's BEPS initiative to reduce tax avoidance. The new guidance addresses these issues: (1) the definition of revenues; (2) the treatment of MNE groups with a short accounting period; and (3) the treatment of the amount of income tax accrued and income tax paid.

The OECD issued a request for input on the i**mpacts of digital commerce and companies "on business models and value creation, challenges and opportunities for tax systems**," related to the OECD's BEPS Action 1 Report, "Addressing the Tax Challenges of the Digital Economy," which was released in October 2015 and endorsed by the G20. Comments are due by October 13th, and the OECD will hold a public meeting on digital taxation in November in California. Addressing the same issues, the European Union adopted a communication that outlines a path for fundamental reforms of international taxation and digital commerce and companies.

The timeline for completion of a tax reform bill is ambitious with NEC Director Cohn stating at the release of the Framework, "We would hope that we get through the House in October. We would hope to be in the Senate in November. And we would hope to have a bill done by this year."

House W&M Committee Chairman Brady is expected to take the lead on moving on tax reform since revenue bills must originate in the House, and his plan is to release a legislative draft in October with a markup and vote in the Committee by Thanksgiving. One issue that will complicate movement in the House is the proposal to end the deduction for state and local income taxes, which has drawn significant opposition from a large number of Republican House members.

SFC Chairman Hatch has said that the SFC will work simultaneously on tax reform proposals, and that the Committee will not necessarily reach the same conclusions as the House. Although both chairs of the tax-writing committees have said that they welcome input from Democrats, this is not expected to be a bipartisan process. During a September hearing, Chairman Hatch said, "I hope we don't need Democratic votes, but I hope we get them."

The Unified Framework for Fixing Our Broken Tax Code

The Framework released by Republican leadership in Washington last week outlines a **comprehensive rewrite of the tax code** but leaves many important questions unanswered and delegates the details that will make or break tax reform legislation to Congress. The release of this document continues the process that began in the summer of 2016 with the House Republican Blueprint for Tax Reform while adding focus to vague principles subsequently advanced by the Administration.

The Framework summarizes a **package of comprehensive tax changes** that include tax rate cuts for corporations, passthrough entities, and individuals; more generous temporary business expensing; shifts to a territorial tax system for international activities while imposing a tax on repatriation of foreign earnings; increases to the individual standard deduction and child tax credit; and repeal of the estate tax and the individual alternative minimum tax. The plan clearly assumes that there will be repeal or modification of business and individual tax incentives necessary to offset the cost of these proposals, but there are few details provided other than to preserve the charitable contribution and mortgage interest deductions.

Timeline and the Budget Resolution Process

On September 29th, the Senate Budget Committee released the text of a **draft FY 2018 budget resolution** that is intended to be a vehicle for moving tax reform through the Senate by using the reconciliation fast-track procedure requiring only a majority vote in the Senate for the tax reform legislation. The draft resolution mandates that a bill be written by November that loses no more than $1.5 trillion in government revenue over the next 10 years. The Senate Budget Committee is expected to mark up the legislation this week with a Senate Floor vote expected the week of October 16th. The House will need to pass their version scheduled for a vote this week, and then the two chambers will conference the legislation over the next few weeks to reach a final FY 2018 budget resolution. The House version requires a tax plan that does not add to the deficit, so it may be challenging to work out the differences in conference keeping in mind that the final product must pass the Senate, where leadership can only lose 2 Republican votes.

What are some of the issues that could complicate the timeline and delay tax reform? As noted above, Congress agreed to a short-term agreement on the debt ceiling limit and funding the government, but that legislation expires on December 8th, so they will need to face those issues again prior to the end of this Congressional Session. Although there seems to be some agreement from many groups within the Republican party to proceed now with tax reform, there is still no clear consensus on many of the key issues underpinning the legislation, and there is likely to be opposition from both conservatives and moderates. Finally, the release of the Framework without many details is certain to now get business and their representatives working overtime to protect many of the incentives and deductions that are currently in the tax code. It will not be an easy task to gain consensus and approval of inclusion of the necessary revenue offsets that will be required.

Tax Reform (continued)

Call to Action for the Business Community

Included in the Framework is language that refers to plans to repeal or rollback "numerous" exclusions and deductions, and to "modernize" tax rules affecting specific industries "to ensure that the tax code better reflects economic reality and that such rules provide little opportunity for tax avoidance." **This language should be read as a call to action for businesses** to pay significant attention to the legislative drafting process that will now begin with both the House and Senate tax-writing committees.

Miscellaneous Issues about the Framework

One detail missing from the Framework is the overall net impact on the federal budget, which must be addressed if the budget reconciliation process is to be used. The non-partisan Tax Policy Center has reported that the Framework is expected to cost $5.6 trillion over the next 20 years. Budget reconciliation legislation cannot increase the deficit in any year beyond the budget window (which is typically 10 years) or it is subject to the "Byrd rule" that requires 60 votes in the Senate for waiver. This means that if Republican leadership want to move this type of tax reform package through the Senate with tax law changes that are permanent, there will be a need to identify revenue raising proposals to offset the cost of the tax cuts. Otherwise, they could make some of the tax changes temporary so that they expire at the end of the 10-year budget window with the hope that a future Congress and President would extend the cuts. This is the procedure that was followed with some of the individual tax cuts enacted in 2001 and 2003.

Determining the effective date of any new legislation will be important to taxpayers, and at this time, there is no certainty from the drafters of the Framework on this issue. Republicans would like the changes to be retroactive effective as of January 1, 2017, in order to produce an economic boost from the changes, but it isn't clear whether this would be possible, and W&M Committee Chairman Brady has said that discussions on this issue are ongoing. This issue is also of critical importance to the IRS, which must prepare months in advance for the upcoming tax year filing season and would have to integrate any retroactive changes into their documents and procedures.

As noted above, there are many proposals in the Framework that lack key details about the specifics of how they will work. As the "Big Six" begin to make the rounds of press briefings and interviews, it is likely that more of the discussions behind the Framework proposals will be disclosed. For example, NEC Director Cohn stated that the **proposed repatriation tax** on offshore profits would be "in the 10 percent range," although the Framework does not specify a rate. He did not comment on whether that rate would apply to cash or non-cash holdings.

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

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