WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—December 2017 Susan Rogers

SPECIAL EDITION — TAX REFORM

Congress faces a full agenda in December before the planned adjournment for the holidays including funding the government beyond the current Continuing Resolution expiration date, **completion of comprehensive tax reform legislation**, renewal of a children's health program, and work on the Deferred Action for Childhood Arrivals (DACA) program.

The **short term continuing resolution** that was passed in September to fund the federal government **expires on December 8th**, and Congressional leadership has been working to reach agreement on avoiding a government shutdown at that time. The current plan is reportedly to pass two additional short term continuing resolutions with the first to run from December 8th to December 22nd, allowing them time to finish the tax reform bill. The second would run from that date until sometime in January after Congress returns from the holiday recess thereby allowing leadership to reach a longer-term deal which addresses key issues.

In addition, there is now discussion about including an **increase in the debt ceiling** in any end-of-the-year spending legislation, although that action will likely not be necessary until January 2018. Dealing with this issue in an election year is always problematic, but it also is not must-pass legislation, so it could be left until January as Republican leadership do not want this issue to be viewed as leverage by the Democrats in their effort to deal with DACA.

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

After both the House and Senate approved tax reform bills, Republican leadership moved quickly to begin conference committee negotiations on the biggest changes to the tax code since the historic 1986 tax reform legislation. The accelerated pace of tax reform to completion this year will likely result in ambiguities and uncertainty for years to come on many technical issues.

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FY 2018 Budget and Debt Ceiling

It is not clear that rank and file Republicans are on board with the procedural strategy on **funding the government** which would envision the second CR including increased spending caps and miscellaneous programs such as the children's health program. **One of the key issues** involved in the funding debate is the **DACA program**, which Democrats have stated must be dealt with in any spending deal. The continuing resolutions governing spending agreements will need Democratic support to pass in the Senate where the legislation can be filibustered and possibly also in the House where some Republican opposition from the rank and file remains. Democrats are also insisting that any increase in the spending caps for defense spending must be matched by increased caps for domestic spending.

More than two dozen Republicans have sent a letter to House Speak Paul Ryan urging him to include a DACA fix in the year-end spending bill in order to successfully reach a deal with Democrats on long-term funding for the federal government. House Majority Leader McCarthy (R-CA), however, has commented that he does not see a solution for DACA coming until closer to the expiration of the program in March of 2018.

Health Care—ACA "Repeal and Replace" Legislation

The Senate version of tax reform legislation (discussed below) includes a **repeal of the Affordable Care Act's individual mandate**. This provision will generate $318.4 billion over 10 years, according to the Joint Committee on Taxation (JCT), which will be used to help offset the cost of the tax reform bill. Both the Congressional Budget Office and the JCT have projected that the repeal of the individual mandate will result in 13 million fewer people with insurance by 2027. This move has been uniformly criticized by Democrats and by several medical groups who have suggested this move will also result in increased premiums.

IRS and Treasury

The IRS issued **new rules under the revised audit regime for partnerships** enacted in 2015. The proposed regulations address "how certain international rules operate in the context of the centralized partnership audit regime, including rules relating to the withholding of tax on foreign persons, withholding of tax to enforce reporting on certain foreign accounts, and the treatment of creditable foreign tax expenditures of a partnership."

The IRS issued Revenue Procedure 2017-59 which provides guidance on **obtaining consent of the Commissioner of the IRS to change a method of accounting** for federal income tax purposes. This revenue procedure also specifies the Code section 481 adjustment period for elections under Code section 404A that are treated as changes in method of accounting for purposes of Code section 481.

The IRS announced that its **Large Business and International (LB&I) Division** has identified **11 new issue areas** that will get focused compliance efforts in the next several months. The IRS explained this initiative as follows: "The campaigns are the culmination of an extensive effort to redefine large business compliance work and build a supportive infrastructure inside LB&I. Campaign development requires strategic planning and deployment of resources, training

International Issues

The OECD released **new value added tax (VAT) guidance** on the levying of consumption taxes on cross-border sales explaining, "This guidance will support the consistent implementation of internationally agreed standards for the VAT treatment of cross-border trade and is of particular relevance given the rapid and ongoing digitalization of the economy." The guidance covers the collection of VAT on suppliers of services and intangibles by foreign suppliers, and simplification of registration and reporting regimes intended to improve the compliance of foreign suppliers.

The **Netherlands government** has begun a **review of 4000 tax deals** it previously completed with multinationals since 2012 to ensure that proper procedures were followed. This could affect future tax arrangements for some companies operating there and potentially challenge the Netherlands' reputation as a tax-friendly jurisdiction for business. This initiative comes at the same time the European Union is pushing for new rules to target tax avoidance by companies.

Both the House and Senate have approved comprehensive tax reform bills, which now will be reconciled with a target of completion by the end of the year.

The House passed the "Tax Cuts and Jobs Act" (H.R. 1) on November 16th by a vote of 227-205. The Senate passed their version of the bill by a vote of 51-49 on December 1st.

The legislation in both chambers is advancing with the protections of the budget reconciliation process, which allows for passage in the Senate by a simple majority vote rather than the three-fifths supermajority vote normally required to avoid procedural issues such as the filibuster.

The legislation garnered no Democratic support in the House with a handful of Republican defections. In the Senate, no Democrats voted for the bill, with one Republican, Bob Corker (R-TN), voting against the bill.

After Senate passage, House Republican leadership immediately announced that there will be a vote to initiate a formal conference on the legislation, which will be needed to reconcile differences between the two bills before the legislation can be sent to the President to be signed. Senate leadership, however, has not yet publicly committed to a formal conference.

TAX REFORM—SENATE ACTION

The bill reported out by the SFC generally followed the House version of the bill, but included some **key differences including repeal of the ACA individual mandate and sunsets for several of the changes on the individual side (as opposed to permanent changes in the House bill).** Senate Floor action took nearly a week and resulted in passage by a very narrow margin with significant changes made to the SFC version in order to secure enough Republican votes for approval. Some of the last-minute changes were added to the legislation by handwritten changes on the Senate Floor, evidence of which was posted on Twitter by Senate Minority Whip Dick Durbin (D-IL).

Key Changes to the Senate Bill Prior to Senate Floor Approval

Although there was discussion of modifying the corporate rate reduction to a rate higher than 20% and a Senate Floor amendment attempted to raise the rate slightly in order to pay for a larger refundable child tax credit, the final bill includes a corporate tax rate of 20% beginning in 2019.

Changes that were agreed to include:

- An increase in the deduction for pass-through business income to 23 percent from the 17 percent included in the SFC bill. Significant concern had been expressed about the perceived inequitable treatment between the treatment of pass-throughs and corporations.

- The 100 percent expensing provision was scheduled to sunset but was rewritten to phase down after 2022.

- The bill now includes the House provision allowing taxpayers to deduct up to $10,000 in state and local property taxes (SALT) but continues to repeal the deduction for state and local income taxes. The SFC bill had included a repeal for all state and local taxes.

- The bill will permit a deduction in 2017 and 2018 for medical expenses exceeding 7.5 percent of adjusted gross income (AGI). This would be more generous than current law which allows for unreimbursed medical expenses in excess of 10 percent of AGI (with 7.5 percent for those age 65 and older).

- The final bill drops the repeal of the alternative minimum tax (AMT) for corporations that was in the SFC bill, and it includes a modified version of the individual AMT, which would have also been repealed by the SFC bill.

- The bill increases the deemed repatriation tax rates to 7.49 percent for noncash assets and 14.49 percent for cash and cash-equivalents. These are slightly higher than the 7 percent and 14 percent rates included in the House version of the bill, and increased from the 5 and 10 percent rates in the SFC bill.

- The final bill sunsets the suspension of the overall limitation on itemized deductions after 2024 instead of 2025.

The last three changes were included to help raise the additional revenue needed to offset the cost of the more generous provision on pass-through rates, expensing and SALT changes.

TAX REFORM — HOUSE AND SENATE CONFERENCE ACTION — KEY ISSUES

A list of key issues that will need to be addressed include:

- Almost all of the individual tax provisions expire after 2025 in the Senate bill but are permanent in the House bill.
- The treatment of mortgage interest: House bill caps the deduction for future mortgages at loan amounts of $500,000 while the Senate bill retains the current cap of $1 million
- Treatment of the estate tax: House bill repeals the estate tax while the Senate bill includes a larger exemption
- The proposed treatment of pass-through business income
- The individual rate structure: House bill includes four brackets plus a bubble rate while the Senate bill includes seven brackets
- The base erosion prevention provisions applicable to international business activity
- The corporate rate reduction: Senate bill has a delayed effective date of 2019
- The treatment of individual tax incentives for medical expenses and student loan interest
- The repeal of the ACA individual mandate

Senator Corker and the Deficit Issue

Senator Corker (R-TN) and other deficit hawks were concerned about the long-term deficit effects of the legislation after the Joint Tax Committee released a “dynamic” revenue score which estimated that the growth effects of tax reform would increase tax revenue by only $407.5 billion between 2018 and 2027, resulting in an increase to the federal deficit of $1 trillion. They wanted a “trigger” provision added to the bill that would have cut back on certain tax cuts if economic growth failed to hit certain targets. The Senate parliamentarian, however, ruled that this type of “trigger” mechanism would violate the Byrd rule prohibitions against reconciliation bill provisions that have no revenue impact or whose revenue impact is incidental. When Senate leadership was able to modify the bill in other ways and pick up support from other Republican holdouts, the effort to deal with the deficit issue was dropped. Senator Corker voted against the bill.

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

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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.