WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—February 2018 **Susan Rogers**

Congress returned in January to face a **full agenda of issues that must be addressed in 2018** but which will certainly be affected by the politics of the year with **mid-term elections** in the fall providing an opportunity for Democrats to take control of either the House or Senate – or both. The successful **completion of tax reform** legislation with the enactment of The Tax Jobs and Cuts Act (TJCA) will be the key element of Republican messaging this year with a focus on the economy.

Senate Majority Leader McConnell has said he wants to pursue issues in 2018 that have bipartisan support, but it is questionable whether Democrats will want to work with Republicans on any issues if to do so would give the party in control additional "wins.' Republicans will want to send a message to swing voters and independents that they can work across party lines in governing.

The current ratio in the Senate is 51-49 but the Democrats will have a challenging path to control, since there are 24 Democratic seats in play and 2 Independents but only 8 Republican seats in play. In addition, Senator Tina Smith (D-MN) who replaced Senator Franken must run to complete the term to 2020.

In the House, the current ratio is 238 Republicans to 193 Democrats and 4 vacancies. The Democrats must pick up 25 seats for control, which will be difficult, but it has been done in the past in mid-term election cycles.

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

The mid-term elections will play a key role in all legislative work that is done in Congress in 2018 with the possibility that control of either the House or Senate — or both — could change.

Susan Rogers

In This Issue

The 2018 Legislative Agenda

Another short term Continuing Resolution (CR) funding the federal government was approved on January 22nd and will expire February 8th. The agreement, which included reauthorization of the Children's Health Insurance Program (CHIP), was reached after a 3-day government shutdown when Republicans and Democrats could not agree on a resolution of the **Deferred Action for Childhood Arrivals (DACA) program**, which has an expiration of March 5th. As part of the latest CR, Senator Majority Leader McConnell has committed to bringing an immigration bill to the Senate Floor by February 8th. Should a bipartisan bill be approved by the Senate, this could prove to be challenging for House Speaker Ryan who may face opposition from conservatives to it but will be pressured to bring the bill to the House Floor for a vote.

Congress is also working on **budget issues for FY19** including the Republican plan to increase defense spending which is currently limited by discretionary spending caps in the Budget Control Act with the Democrats taking the position that there should be equivalent increases in domestic spending. The lack of agreement on this issue has slowed down the work of the Appropriations committees. If and when agreement is reached, there will likely be an omnibus bill that incorporates multiple spending packages.

Congress must then decide whether to advance a budget for FY 2019, and there has been consideration reportedly about not doing so. Failure to do a budget, however, means that Republicans would not have available to them the process of budget reconciliation to move issues without the threat of filibuster as was done with tax reform in 2017.

Congress must address the issue of increasing the **debt limit** soon as Treasury will likely not be able to use "extraordinary measures" to avoid exceeding the current limit beyond mid-March. With the latest CR expiring in early February, it is possible that the debt limit issue could be part of those negotiations with Congressional Democrats using that issue as leverage to resolve the DACA issue.

Other issues that have been discussed for this year's agenda include **infrastructure** and **entitlement reform.** Some details on a plan from the White House on infrastructure have been reported with a formal proposal expected in February that will likely provide for a federal government contribution in the $200 billion range designed to draw in state, local and private investment in major public work projects that could total $1 trillion.

House Speaker Ryan and the President have both said they want to work on entitlement reform, but Senate Majority Leader McConnell is doubtful of the ability to work on this in the Senate with the slim majority control, and the President now appears to have less interest in tackling this issue in 2018.

Health Care Reform

Congressional Republicans have been working to enact the **suspension of several health-care related taxes** from the Affordable Care Act (ACA), and those provisions were included in the latest CR. The taxes included are the medical device tax (2-year moratorium for 2018 and 2019), the excise tax on high-cost employer health coverage ("Cadillac tax") which will go into effect in 2022 rather than 2020, and a 1-year moratorium for the annual excise tax imposed on health insurers for calendar year 2019.

Senate Finance Committee

SFC Chairman Hatch (R-UT) announced that he **will retire** when his current term expires at the end of 2018. Senator Grassley (R-IA) could reclaim the SFC chair but he would have to give up his position as chairman of the Senate Judiciary Committee. Next in seniority are Senator Crapo (R-ID) and Senator Roberts (R-KS).

Tax Extenders Legislation

The Joint Tax Committee (JCT) released its annual list of **expired and expiring tax provisions**. SFC Chairman Hatch introduced legislation in December 2017 that would retroactively extend most of the 2016 expired provisions through the end of 2018, but Republican leadership in Congress has yet to announce a plan for addressing these issues. The JCT list now includes 82 provisions (up from 58 in 2017) in part because of the addition of several individual tax provisions that expire in 2025 as a result of the TJCA. W&M Committee Chairman Brady has said that he would like to make many of these provisions permanent, but that will be difficult to do unless they have Democratic support for the legislation.

Treasury Secretary Mnuchin has commented on the process by which he believes most of the issues and questions about the TJCA will be addressed. He noted that nearly 80 sections of the law require the promulgation of regulations, and he expects a significant amount of guidance to be issued by Treasury and the IRS in 2018.

He has acknowledged that there may be some issues that could require a legislative correction and that technical corrections legislation would need Democratic support to advance in Congress, because such legislation cannot move as part of the budget reconciliation process, which requires only a simple majority vote for approval.

Businesses who have questions or concerns about technical issues with the bill would be well-advised to contact both the Treasury/IRS and the tax-writing committees of Congress along with the Joint Tax Committee in order to request guidance and to alert government officials to the issues. It is also possible that with further understanding of the way the new law works, government staff will find unintended consequences or loopholes that must be addressed. Unlike with a true technical correction, these fixes may require revenue offsets.

TAX REFORM UPDATE

IRS Guidance

Withholding: The IRS issued Notice 1036, which provides updated income tax withholding tables for 2018. The IRS says that employers should begin using the 2018 withholding tables as soon as possible, but not later than February 15, 2018. More guidance is coming from the IRS, and they are still working on a revised Form W-4 to reflect additional changes in the new law, such as changes in available itemized deductions, increases in the child tax credit, the new dependent credit, and repeal of dependent exemptions, which employees may be required to file by 2019.

Taxing Repatriated Earnings: The IRS has issued additional guidance on the taxation of repatriated earnings of foreign subsidiaries of US companies with Notice 2018-13, which states that the Treasury and IRS intend to issue regulations for determining amounts included in gross income by a US shareholder by reason of Code section 965 as amended by the TCJA. It also considers issues in connection with the repeal of Code section 958(b)(4), announces the IRS's intention to update the Instructions for Form 5471 as a result of such repeal, and describes the effective dates of the regulations and other guidance described. The Notice also asks for suggestions on what issues subsequent guidance should cover.

Technical Corrections

W&M Committee Chairman Brady has already commented that **technical corrections legislation will likely be necessary in 2018**, but will not be done quickly. House Speaker Ryan (R-WI) has also suggested that technical corrections will likely be needed although he expects them to be minor. Some Congressional Democrats, however, have suggested that they may not be willing to work with Republicans to fix problems with the new law since they did not support it, and should there be a shift in party control in either the House or Senate or both, Democrats may believe there will be an opportunity in 2019 to make substantive changes to the tax law.

Because of the perceived difficulty of moving technical corrections legislation through Congress in an election year, it is likely that the primary focus in 2018 will be on providing guidance to taxpayers through the regulatory process. There are limits, however, on the authority of Treasury to issue interpretive guidance in order to make sure that the intent of Congress is followed. Areas that most likely will see the need for technical corrections include the international law changes and the new pass-through rules.

State Tax Issues

Many of the changes in the TJCA will have **major impacts on state governments** across the country. Some states use the calculation of federal taxable income as the starting point for the calculation of state taxable income while others use federal adjusted gross income, and each state will have to make decisions about whether to conform to the changes in the TJCA or decouple from some or all of the new provisions. Most state legislatures convene their legislative sessions in January, and this year, they are facing decisions about how to react to federal tax reform.

For the business community, this means uncertainty about the level of taxes that will be due on the state level as companies wait to see what changes state governments make. It also means that the importance of state tax planning will likely increase for many companies. There are a number of issues that could have an impact on states including the new deduction for pass-through income, the treatment of repatriation income, full-expensing, limits on business interest, changes to the subpart F regime, the participation exemption for foreign dividends, and the loss of tax credit bonds and tax-exempt advance refunding of government debt.

IRS and Treasury

President Trump is reportedly planning to nominate **Charles Rettig** to be the **next IRS Commissioner**. He is a tax controversy lawyer from California, and his nomination requires Senate confirmation.

Treasury and the IRS issued **final regulations for electing out of the centralized partnership audit regime** that assesses and collects tax at the partnership level. The rules finalize the portion of the rules proposed on June 14, 2017 relating to Code section 6221(b). The final regulations reflect, despite commenters' suggestions, Treasury's decision not to expand the definition of eligible partners for qualification to elect out, to continue to require foreign eligible partners to provide TINs for valid elections out, and to continue not to permit unilateral revocations of elections out.

The IRS also issued **proposed regulations that further implement statutory changes to the audit regime for partnerships and partners**. The proposed regulations provide rules addressing how pass-through partners should take into account adjustments under the alternative to payment of the imputed underpayment described in Code section 6226 (the "push-out" election). In addition to instructing on assessment and collection, penalties and interest, and period of limitations, the regulations also address the rules for seeking judicial review of partnership adjustments.

Courts

The US Supreme Court granted certiorari in *South Dakota v. Wayfair, Inc. et al*, No. 17-494, which is a case challenging South Dakota's "economic nexus" law requiring remote sellers without a physical presence in the state to **collect use tax on sales** to South Dakota customers. South Dakota's law is one of several state legislative initiatives designed to directly challenge the physical presence standard for remote sales and use tax collection established in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). If Quill is overturned, online businesses could be required to collect and remit taxes regardless of their physical location. Several members of Congress have called on Congress to pass legislation that would address this issue, and bills in both the House and Senate have been introduced including S.976, the Marketplace Fairness Act of 2017, introduced by Senators Durbin (D-IL), Alexander (R-TN), Heitkamp (D-ND) and Enzi (R-WY).

International Issues

The OECD released an **updated model tax treaty** that incorporates policy changes reflecting its BEPS project. The Model Tax Convention serves as a model for negotiation and application of bilateral tax treaties between countries designed to assist business while helping to prevent tax evasion and avoidance. It also provides a means for settling on a uniform basis the most common problems that arise in the field of international double taxation.

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

Susan Rogers, Partner
Potomac Law Group, PLLC
One International Place, Suite 1400
Boston, MA 02110
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.