WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—January 2018 Susan Rogers

Congress returns in January to face several challenging issues with pressing deadlines, including funding the federal government for the rest of FY 2018, raising the debt limit, extensions of the Children's Health Insurance Program (CHIP) and the Foreign Intelligence Surveillance Act (FISA), a disaster relief bill, bipartisan legislation to stabilize Obamacare, and a legislative solution for the Deferred Action for Childhood Arrivals (DACA) program. **The 2018 mid-term elections will dominate political discussion** and complicate any attempts at agreement between the two parties on these types of issues because of the possibility that control in either chamber could flip as a result of the elections.

The President plans to meet with Senate Majority Leader McConnell and House Speaker Ryan at Camp David January 6-7th to discuss the 2018 agenda. Prior to adjournment, Senate Majority Leader **McConnell suggested that bipartisanship on legislation would be his goal in 2018**, perhaps reflecting the reality of the 51-49 split resulting from the seating of Senator Doug Jones from Alabama, which switches that seat from Republican to Democrat. **Democrats may be reluctant to work with Republicans** if the result is to give the White House legislative achievements before the elections, but they also won't want to pass up the opportunity to advance their priorities should that be possible.

Predictions on how 2018 will unfold must take into account unknown events that are likely to occur and cannot be predicted or controlled, whether they are international, such as the ongoing tensions between the US and North Korea, or domestic, such as natural disasters or terrorist incidents.

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The White House and Republican leadership in Congress made passage of the tax reform bill their highest priority, because of their belief that this key legislative achievement would be necessary for success in the November 2018 mid-term elections and retention of control of the House and Senate.

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In This Issue

The 2018 Legislative Agenda

The November **2018 mid-term elections will be the key political event of the year** and will have an overriding impact on the legislative agenda in Washington. Polls generally indicate that a majority of Americans would like the Democratic party to control Congress, but there are structural obstacles that will make that difficult for Democrats to achieve. As noted above, Congress comes back to Washington in January facing a challenging agenda, but the politics of these elections will be front and center in all debates on all issues because the last two years of the Trump presidency will be affected by the outcome of the elections and which party controls Congress. Democrats need to take over 24 seats in the House to gain control and 2 seats in the Senate. The challenge for Senate Democrats, however, is that they have 24 seats to defend in the election, while Republicans have only 8 seats to defend. Senate Finance Committee Chairman Hatch (R-UT) has announced his retirement, which means new leadership there in 2019.

Majority Leader McConnell has said that the Senate would be "moving on" from **efforts to repeal Obamacare**, although other Senate Republicans may not be on board with that. He has differed with House Speaker Ryan about **entitlement reform**, including Social Security and Medicare, by expressing no interest in dealing with the topic before the elections, stating that bipartisanship would be needed to advance that legislation. The Speaker recently said that he would like to deal with Social Security and Medicare in 2018 – before he retires from the House – as part of an effort to rein in government spending. His focus on government spending comes in the wake of passage of the tax reform bill that cuts taxes by $1.5 trillion over 10 years and is expected to increase the annual deficit to $1 trillion in 2019. Most members of Congress of both parties are unlikely to be interested in dealing with entitlement reform in an election year.

Senate Majority Leader McConnell has said that he would bring **immigration legislation** to the Senate Floor in January if lawmakers and the White House can reach a deal on issues including the DACA program. The President has indicated that he will send an **infrastructure package** to Congress in January, and the Senate Majority Leader has expressed his willingness to tackle this issue should there be interest from the Democrats in making it a bipartisan initiative.

FY 2018 Budget

On December 21st, both the House and Senate approved legislation that would continue **funding the federal government through January 19th**, thereby avoiding a government shutdown while Congress was on recess. This continuing resolution included temporary extensions of CHIP (until March) and FISA, and it also provided for a waiver of the Pay As You Go Act that allowed the tax reform bill to become law in 2017 without triggering mandatory spending cuts in programs like Medicare.

House and Senate Democrats wanted the year-end legislation to fund CHIP permanently, reform the FISA program, cover opioid crisis funding, deal with the DACA program, and address private pensions, but these issues were left for Congress to address in the new year. An $81 billion disaster relief bill to provide relief for Texas, Louisiana, Florida, Puerto Rico and the US Virgin Islands was approved by the House, but the Senate failed to act on it. Congressional leadership said that one more continuing resolution is expected to be needed before Congress will be able to reach agreement on omnibus legislation to fund the remainder of FY 2018.

Part of the challenge of reaching agreement on these issues lies with the goal of some Republicans to lift the **statutory spending caps** on defense spending for the rest of FY2018 while leaving the caps in place for domestic spending – a plan that is opposed by Congressional Democrats who want the spending caps left in place for both types of spending. Appropriations legislation cannot move under the budget reconciliation process, so Democratic support is necessary in the Senate in order to break a filibuster if it should occur. The President's desire to include **funding for a border wall** will likely also complicate completion of the omnibus funding legislation.

Debt Ceiling Limit

Congress will once again have to consider the issue of **raising the debt ceiling limit** because the Treasury will run out of ways to avoid exceeding the limit in March 2018 according to the Bipartisan Policy Center. Typically, Democratic support is needed for debt ceiling limit increase legislation because many Republicans refuse to vote for the increase on principle. This would give leverage to Democratic leadership to insist that some of the issues important to their party are included.

Health Care Reform Legislation

A bipartisan bill sponsored by Senator Alexander (R-TN) and Senator Murray (D-WA) would **temporarily fund the Cost Sharing Reduction (CSR) payments to health insurers** that are designed to defray their costs of covering low-income individuals under the Affordable Care Act, since the President announced that the government would no longer fund these payments. Senator Susan Collins (R-ME) conditioned her support for the tax reform bill on a promise from Senator Majority Leader McConnell that this bill would be considered on the Senate Floor.

On December 22nd, the President signed into law HR 1 (P.L. 115-97) (the "Tax Act"). The legislation makes sweeping changes to the individual, corporate and international sections of the tax code.

The Tax Act is generally effective for tax years beginning on or after January 1, 2018, but because the President signed it in 2017, companies on a calendar-year schedule will have to reflect much of the effect of the Tax Act in their 4th-quarter financial statements, which many companies start to release in mid-late January.

The Joint Committee on Taxation released a revenue estimate on the HR 1 conference agreement stating that the overall cost of the bill for 2018-2027 would be $1.456 trillion, which was within the parameters set by the budget resolution of $1.5 trillion for the tax legislation. Changes to the individual section of the code cost $1.126 trillion, business changes cost $653.8 billion and international tax changes raise $324.4 billion.

To comply with a Byrd Rule provision that prohibits reconciliation bills from increasing the deficit outside of the 10-year budget window, nearly all the individual tax changes will sunset at the end of 2025.

TAX REFORM SUMMARY

The Tax Act is a massive tax reform package that lowers rates on corporations, pass-throughs, and individuals, while taking steps to move the US toward a territorial-type system for taxing foreign-source income of domestic multinational corporations. In order to offset the cost of this tax relief, many current-law deductions, credits, and incentives for businesses and individuals are repealed or modified.

Some of the highlights include:

- **Corporations**: The current graduated rate structure is replaced by a flat 21% rate, effective in 2018, and the corporate alternative minimum tax is repealed. Items that are currently amortized can be fully expensed in the year placed in service through 2022 with a phase-out thereafter. The Tax Act sets new limits on the deduction for net business interest, repeals the Code section 199 manufacturing deduction, and disallows like-kind exchanges other than for real property.

- **Pass-throughs**: The Tax Act allows a deduction of up to 20% of income for specified service business owners with income under $157,000 (twice that for married filing jointly). The deduction is available to electing small business trusts (EBSTs) as well as individuals, and owners are permitted to calculate their maximum deduction based on ether 50% of their share of W-2 wages paid or a combination of 25% of their share of W-2 wages paid plus 2.5% of the unadjusted basis of all qualifying property. Carried interest income continues to be treated as capital gain income but subject to a longer holding period in order to qualify (now 3 years).

- **Individuals**: The Tax Act continues the current law seven tax bracket system with the top individual rate of 37% (with a significant marriage penalty). It nearly doubles the standard deduction, repeals the limit on itemized deductions, and expands the refundability of the child tax credit. It retains the deduction for unreimbursed medial expenses and the capital gains exclusion on the sale of a primary residence. It repeals personal exemptions, retains the individual alternative minimum tax (with higher exemption levels), cuts back the home mortgage interest deduction, and imposes new limits on the deductibility of state and local taxes. Individual tax changes expire after 2025.

- **International**: The Tax Act shifts the US from a worldwide tax system to a participation exemption system through a 100% dividends received deduction for dividends distributed by a controlled foreign corporation. As part of the transition to that new system, the Tax Act imposes a one-time deemed repatriation tax, payable over 8 years, on unremitted earnings and profits at a rate of 8% for illiquid assets and 15.5% for cash and cash equivalents. There are new base erosion rules, but the legislation does not include the proposed change that would have placed additional limits on interest deductions of multinational corporations.

IRS Guidance—The Tax Act

On December 27th, the IRS released guidance regarding the **deductibility of real property taxes** saying that as a general matter, whether a taxpayer is allowed a deduction for the prepayment of state or local real property taxes in 2017 depends on whether the taxpayer makes the payment this year and whether the taxes are assessed prior to 2018. "A prepayment of anticipated real property taxes that have not been assessed prior to 2018 are not deductible in 2017," the IRS stated.

The IRS has announced that it is working to develop **withholding guidance**. They anticipate issuing the guidance in January, and employers and payroll service providers will be encouraged to implement the changes in February. The guidance will be designed to work with the existing Form W-4. In the meantime, the IRS states that employers and payroll service providers should continue to use the existing 2017 withholding tables and systems.

The IRS and Treasury issued **Notice 2018-07 announcing forthcoming regulations for the repatriated earnings tax.** Treasury states that the forthcoming regulations are intended to be effective for the first taxable year in which Code section 965 becomes effective, which is the last taxable year of foreign corporations that begin before January 1, 2018, and for US shareholders the taxable years in which or with which such taxable years of the foreign corporations end. Taxpayers may rely on the rules described in the notice until the regulations are issued, and comments on the rules are requested.

Technical Corrections Legislation — What Should Taxpayers Know?

Every major tax bill that is enacted is followed by a technical corrections bill. Due to the accelerated legislative process that was used to produce the Tax Act and the complexity resulting from the changes included, it is certain that **there will be technical corrections legislation in 2018, and that it will be important legislation for taxpayers to monitor**. There also may be problems with the Tax Act that will emerge that are too substantive to fix with technical corrections.

Whether and how a technical corrections bill to the Tax Act will advance is unpredictable. Committee staffs have already begun collecting possible issues, and at some point, legislation may be introduced. Even if the bill doesn't advance quickly, **inclusion of an issue in the introduced bill may give taxpayers some information about an issue** that is unclear from the statute. There may also be multiple technical corrections bills related to the Tax Act in future years. The technical corrections to the 1986 Act took years – this bill is likely to surpass that.

Typically, technical corrections legislation is non-controversial and bipartisan. But Democrats, who opposed the tax bill across the board, may not want to fix problems with the bill. Rather, they may be focused on the mid-term elections and regaining control of either or both chambers, so they can reverse changes in the law. The Tax Act was able to pass the Senate with only a simple majority vote because it moved under the budget reconciliation process, but any other tax legislation in 2018 will have to have 60 votes in order to prevent a filibuster.

What is a technical correction and what types of issues will be candidates for inclusion in this type of legislation? A technical correction does not change the substantive meaning of legislation, but rather it clarifies the existing statute; this means that the types of issues that can be addressed in a technical corrections bill are limited. The principal factor in determining whether a provision is technical is the original intent of the underlying legislation. The highly accelerated pace of the development of this legislation means there is less legislative history and intent available than there normally is with a bill of this magnitude.

Generally, **technical corrections should have no revenue impact** because they are enacted with the purpose of ensuring that a tax statute operates with the original intent of Congress. Any revenue gain or loss would have been included in the JCT revenue estimate of the original provision.

Also, typically a **technical correction will take retroactive effect** and be treated as if it were included in the original legislation although historically, there have been limited instances in which a technical correction was applied prospectively, for example, if retroactive application of it would have been difficult to administer.

Technical corrections legislation will be an important tool for businesses to consider with respect to changes in the Tax Act which affect them either positively or negatively. Interpretation of the changes in the Tax Act will be provided by guidance which is issued by Treasury and the IRS, and that is the first resource to be used by taxpayers. There is no doubt, however, that there will be issues where the intent of Congress may not be clear or where the statute is silent on issues that cannot be dealt with through guidance from Treasury and the IRS. **Those are the cases where a taxpayer will need to consider technical corrections both to keep an eye on what might be included with respect to changes that affect the taxpayer and also as a resource to request a technical correction in order to address an issue of interest to the taxpayer.**

Technical corrections can be proposed by taxpayers and tax practitioners as well as staff of the tax-writing committees, JCT, and Treasury. They are reviewed and assessed by the staffs of the tax-writing committees and the Treasury Department and typically accepted only if all staffs agree to it. Discussing a technical correction with staff may result in it being addressed through regulatory guidance, a quicker way to resolve the issue.

IRS and Treasury

The IRS issued **proposed regulations related to 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 and Treasury filed a **notice of appeal** indicating their intent to appeal the decision of the US District Court for the Western District of Texas in *Chamber of Commerce of the U.S. v. IRS*, W.D. Tex., No. 1:16-cv-00944, which invalidated the Treasury Department's April 2016 regulations aimed at preventing **corporate inversions**.

International Issues

The European Council adopted **new rules designed to make it simpler for online businesses to comply with their value-added tax (VAT) obligations**. The new rules expand access to online portals for registration and reporting and require that the VAT be paid in the member state of the consumer. The new regulations had been proposed in December 2016 and are intended to end the VAT exemption for certain online sales from outside the EU and to reduce compliance costs for businesses.

The OECD released **additional country-by-country reporting guidance** for multinational groups and tax administrators. The guidance addressed several specific issues, including how to report amounts taken from fair-value financial statements; how to treat mergers, acquisitions, and de-mergers; how to treat short accounting periods; and the definition of total consolidated group revenue.

The OECD released a consultation document proposing **model rules requiring disclosure by advisers and service providers who market schemes designed to circumvent the Common Reporting Standard (CRS) for automatic exchange of taxpayers' financial account information**. The proposed rules, which are non-binding recommendations for countries that follow the CRS, would require such intermediaries to disclose information on schemes and their users to their national tax authority. The rules provide that information on those schemes (including the identity of any user or beneficial owner) would then be made available to other tax authorities in accordance with the requirements of the applicable information exchange agreements. The United States has not yet adopted the CRS although the OECD based the standard on the US Foreign Account Tax Compliance Act (FATCA). Public comments on the draft are due by January 15, 2018.

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