# WASHINGTON TAX NEWS

Potomac Law Tax Newsletter—May 2018 Susan Rogers

Members of the Senate Appropriations Committee are planning to meet with Senate Majority Leader McConnell (R-KY) and Minority Leader Schumer (D-NY) to work out a **plan of action for moving the FY 2019 appropriations bills**. House Speaker Ryan is promoting a strategy that would plan for approval of as many spending bills as possible by fall and then a continuing resolution in September to get Congress past election day. This process could be challenged, however, by discussions about clawing back billions of dollars in spending from 2018 appropriations bills that have taken place between the White House and House Majority Leader McCarthy (R-CA), who wants to replace outgoing Speaker Ryan. The **White House is planning to release its "rescission plan"** by May 1st, which could propose cutting $30-60 billion from the $1.3 trillion bill with signals from the President that targeted areas include foreign aid and nondiscretionary domestic programs.

House conservatives including Freedom Caucus Chair Meadows (R-NC) have criticized Congressional leaders for not actively pursuing key issues prior to the elections such as **infrastructure, entitlement reform, welfare reform, or immigration reform**. They believe that with Republicans in control of the House, Senate, and the White House, the time is now for action on issues important to Republicans, but **it appears unlikely that this kind of ambitious legislative agenda will be pursued in 2018**.

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

***House and Senate Republican leaders are working on a plan to move appropriations bills quickly this year and avoid any drama over government spending prior to the fall mid-term elections.***

***Susan Rogers***

## In This Issue

**Politics & Congressional Activity**

**House Speaker Paul Ryan (R-WI) announced that he will retire from Congress** when the current legislative session officially ends in early 2019 (following the 2018 mid-term elections). He has served 10 terms in the House, became Chairman of the Ways & Means Committee in early 2015, and then became speaker in 2015 after the surprise resignation of then-Speaker John Boehner. Ryan has said that he intends to remain Speaker through the end of this congressional session, but there is speculation that he might step down sooner to give the Republican party new leadership ahead of what is expected to be a challenging mid-term election for Republicans. House Majority Leader McCarthy (R-CA) is seen as the most obvious successor, but Majority Whip Scalise (R-LA) may also seek the position.

In recent comments, Assistant Democratic Leader Jim Clyburn (D-SC) stated that the **Democratic leadership of the House should change** if Democrats fail to regain control of the House in the upcoming fall elections, including not only himself but also Minority Leader Pelosi (D-CA) and Minority Whip Hoyer (D-MD). Reports are that a younger class of Democrats is interested in change no matter the outcome of the elections.

The House approved legislation that would **extend expenditure authority for the Federal Aviation Administration (FAA)** through September 23, 2023, along with the **excise taxes on fuel and passenger tickets** that provide the dedicated funding for the agency. Approval will now be necessary in the Senate with the current authority set to expire on September 30, 2018. **This legislation is one of the "must-pass" bills with a revenue title, which could turn it into a potential "train" for other tax issues** such as renewal of the expired tax provisions ("tax extenders"), IRS reform, permanent extensions of the 2017 tax cuts for individuals, and technical corrections to the 2017 tax law. The House version of the FAA legislation does not include any of these miscellaneous tax issues.

House Legislation to Reform the IRS

The House approved 12 bipartisan bills, including the Taxpayer First Act and the 21st Century IRS Act, calling for **changes to the IRS organizational structure, enhancements to its information technology and cybersecurity operations, revisions to its enforcement policies, and improvements in customer service**. If this bipartisan package of bills is enacted, it would be the first significant overhaul of the IRS since enactment of the IRS Restructuring and Reform Act of 1998. **The Taxpayer First Act** would require the IRS to submit a comprehensive reorganization plan to Congress by September 30, 2020, limit the IRS's authority to seize property of taxpayers who are suspected of "structuring" financial transactions to avoid the Bank Secrecy Act, strengthen taxpayer rights during the appeals process by codifying the IRS Independent Office of Appeals, eliminate the IRS Oversight Board, and require the IRS to develop and submit to Congress a comprehensive customer service strategy.

**The 21st Century IRS Act** is designed to modernize the IRS's information technology systems and expand the use of electronic systems for interactions between taxpayers and the IRS, enhance the IRS's cybersecurity infrastructure, protect taxpayers from identify theft, and provide assistance to taxpayers who have been victims of identity theft.

The House-approved bills now move to the Senate, where no specific date for action has been announced. SFC Chairman Hatch has stated the Committee will hold hearings on this legislation, commenting that there are "some improvements that can be made but we're going to have to look at everything and be very, very careful how we handle it."

Comments by Acting IRS Commission Kautter indicate that the IRS **worked with the Ways & Means Committee staff on the legislation** and "[F]or the most part, we're supportive of the provisions of that bill," referring to the Taxpayer First Act, which would redo many IRS internal administrative procedures.

**South Dakota v. Wayfair—Online Sales Taxation**

The Supreme Court has now heard oral arguments in the case of *South Dakota v. Wayfair*, which could decide **whether states can collect taxes on online purchases made by residents from retailers** that do not have a physical presence in the respective state. Following the hearing, the court appeared to be divided, but there is certainly a chance that it will vote to overturn the Quill v. North Dakota case from 1992, where the Supreme Court decided that states could not compel retailers to collect and remit use taxes unless they have a physical presence there. If the court does decide in favor of South Dakota, it is expected that other states will immediately pass laws requiring retailers to collect and remit tax regardless of having a physical presence in the state. If respondent Wayfair Inc. prevails, the issue would then be left to Congress, which has struggled to pass legislation in this area for years.

***<u>Tax Extenders</u>*: The W&M Tax Policy Subcommittee has been collecting comments from members of Congress and stakeholders on the issue of tax extenders, which are the tax provisions that regularly expire and must be renewed by Congress. Chairman Buchanan (R-FL) has said that legislation may be introduced in May that would eliminate some of these tax provisions. He has held a closed-door roundtable for House members and is expected to schedule public hearings in the near future. The Bipartisan Budget Act of 2018, which was signed into law in February, retroactively renewed most of the 28 extenders until the end of 2017.***

***<u>TCJA guidance</u>*: Acting IRS Commissioner Kautter testified at a Senate Finance Committee hearing that the IRS will publish new forms and instructions related to the TCJA by this summer. In response to a question about when the guidance on the pass-through rules would be released, he responded that the IRS would have the guidance out by early summer.***

***The IRS issued the 2018 edition of Publication 505, "Tax Withholding and Estimated Tax," for use by employees to determine how much income an employer should withhold for tax payments. Form W-4 was also updated.***

## <u>TAX REFORM UPDATE</u>

### <u>Senate Finance Committee Hearing—Early Impressions of the New Tax Law</u>

The Senate Finance Committee (SFC) held a hearing on the early effects of the 2017 tax reform legislation. SFC Chairman Hatch (R-UT) stated at the hearing that many companies have announced increased wages, benefits, and investment in the United States due to the new law, but SFC Ranking Democrat Wyden (D-OR) stated that the new law has not benefited small businesses.

Much of the discussion at the hearing focused on the **new Code section 199A deduction for the business income of certain pass-through entities** with Senator Wyden commenting that a recent Joint Tax Committee report stated that 44 percent of the benefit of the new pass-through rate is going to taxpayers with incomes over $1 million with that rate increasing to 52 percent in 2024.

Senator McCaskill (D-MO) commented that the **new law is creating massive complexity and uncertainty for small businesses**, but witness Douglas Holtz-Eakin of American Action Forum (and a former head of the Congressional Budget Office from 2003-5) responded that the income threshold for the pass-through deduction ($157,500 for single taxpayers and $315,000 for joint filers) simplifies its application so that small businesses should be able to easily claim it. Senator Wyden said that the complexity of the pass-through deduction has made it challenging for small businesses to calculate their estimated tax payments. Two of the hearing witnesses testified that the complexity of the rules was creating **opportunity for "gaming" the system** especially for wealthy taxpayers who can afford sophisticated tax planning advice.

Committee Democrats also criticized the **impact of the new tax law on federal revenues** over the next decade with the decrease in federal tax receipts expected to be $1.5 trillion over 10 years. They anticipate Congressional Republicans using this increased federal debt load to argue for reduced entitlement spending for programs such as Social Security and Medicare. Republicans continue to take the position that the new tax law will pay for itself over time through increased economic growth.

### <u>Congressional Action on Tax Cut Permanency</u>

Congressional Republicans are contemplating **legislation this year that would make permanent the 2017 tax cuts on the individual side** that are currently set to expire at the end of 2025. Retiring House Speaker Ryan has said "We fully intend to make these things permanent, and that's something we'll be acting on this year." Ways & Means Chairman Brady has floated the idea of also including several other provisions such as indexing for capital gains and making immediate business expensing permanent.

The **Permanent Tax Cuts for Americans Act**, introduced in the House, would set the new law's individual and corporate provisions on an equal footing by permanently extending the lower marginal rates, the increased thresholds for the individual alternative minimum tax, the increased standard deduction amounts, and the expanded child tax credit as well as the increased exemption for the estate and gift tax and the deduction for qualified business income for passthroughs under Code section 199A.

Senate Majority Leader McConnell has said he may seek a vote also, but he has some **doubts about whether such legislation would garner enough support from Democrats** to meet procedural requirements for advancing. Republicans hold just 51 seats in the Senate, so McConnell would have to gain the support of 9 Democrats to get the three-fifths supermajority he would need to avoid procedural issues for moving legislation under regular Senate order. To date, Democrats appear to be opposed to permanently extending tax cuts they feel are skewed to benefit the wealthy. McConnell might also face defections in his own party from Senators Corker (R-TN), Flake (AZ) and Purdue (GA).

**TCJA Guidance**

Treasury and the Office of Management and Budget (OMB) have released the **text of an agreement** that updates the **process by which OMB will review tax regulations**. Under a 1983 agreement, Treasury's tax regulations were exempt from routine OMB review, but in April of 2017, President Trump directed Treasury and the OMB to review the scope and implementation of this exemption. The agreement creates a "new review process tailored to tax regulations – it focuses on reducing regulatory burdens while providing timely guidance to taxpayers." The Office of Information and Regulatory Affairs will now review a subset of tax regulatory actions and provide expedited review for these actions. This new policy takes effect immediately, which means that **many of the yet-to-be released regulations for changes enacted by the TCJA will go through review**.

The IRS issued **Notice 2018-38** providing guidance on **blended tax rates for corporations operating on a fiscal year**. Under a provision in the TCJA, a corporation with a fiscal year that includes January 1, 2018, will pay federal income tax using a blended tax rate and not the flat 21 percent tax rate under the TCJA that would generally apply to taxable years beginning after December 31, 2017.

Treasury and the IRS issued **Notice 2018-28**, announcing the **intention to issue proposed regulations for Code section 163(j)** as amended by the TCJA to provide new rules limiting the deduction of business interest expense for taxable years beginning after December 31, 2017. The notice also provides interim guidance relating to the treatment of "disqualified interest" from the last taxable year beginning before January 1, 2018; C corporation business interest expense; the application of Code section 163(j) to consolidated groups; the impact of Code section 163(j) on earnings and profits; and business interest income and floor plan financing of partnerships, partners, S corporations and S corporation shareholders pending the issuance of regulations.

The IRS issued **Notice 2018-26** with additional guidance on **computing the "transition tax"** on the untaxed foreign earnings of foreign subsidiaries of US companies under the TCJA. This guidance describes regulations to be issued, including rules intended to prevent the avoidance of Code section 965, rules and procedures relating to certain special elections under Code section 965, and guidance on the reporting and payment of the transition tax. The notice also provides relief to taxpayers from certain estimated tax requirements and penalties arising from the enactment of the transition tax. The IRS also issued **informal guidance on compliance with the new repatriation tax** in the form of **12 frequently asked questions (FAQs)**. The FAQs include "how to report section 965 income and how to report and pay the associated tax liability as well as details on several elections under section 965 that taxpayers can make."

The IRS issued **Notice 2018-23** providing transitional compliance guidance on **nondeductible penalties** under Code sections 162(f) and 6050X, which were amended and enacted respectively by the TCJA. The Notice also describes proposed regulations that the IRS intends to publish relating to the deducting and reporting of fines and penalties. Reporting will not be required under Code section 6050X until the date specified in forthcoming regulations and that date will be set after January 1, 2019. Comments are requested on all aspects of Code sections 162(f) and 6050X with the citation of several areas of specific interest.

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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.**