WASHINGTON TAX UPDATE: CONGRESS, TREASURY, GLOBAL

February 2019 **Susan Rogers**

The 116th Congress convened on January 3rd as **divided government returned to Washington** with the Democrats in control of the House and Republicans in control of the Senate and the White House. Nancy Pelosi (D-CA) was elected Speaker of the House, and Kevin McCarthy (R-CA) was elected House Minority Leader. Top Senate leadership remained the same as in the prior Congress with Senator McConnell (R-KY) as Senate Majority Leader and Senator Schumer (D-NY) as Senate Minority Leader, although Senator Thune (R-SD) assumed the position of Senate Majority Whip from Senator Cornyn (R-TX).

The **government reopened January 26th** with a short-term deal reached to fund those government operations without approved fiscal year spending until February 15th. If the bipartisan Congressional negotiating team cannot reach an agreement that is accepted by the White House, the President has stated that the government could be shut down again or he could bypass Congress by declaring a national emergency to get funding for a border wall.

The **State of the Union address** was originally scheduled for January 29th, but it was postponed due to the government shutdown and has now been rescheduled for February 5th.

In This Issue

Ms. Rogers also publishes "Washington & the World: US & International Tax" covering newsworthy tax issues affecting cross-border business.

For additional information and subscription details, please contact:
Susan Rogers, Partner
202.492.3593
srogers@potomaclaw.com

Susan Rogers has 30 years of experience in the tax policy field in Washington including five years as Majority Tax Counsel to the US House Ways & Means Committee and several years of experience managing global tax issues for a Fortune 100 multinational.

Additional Tax Resources at Potomac Law Group:

- **Viva Hammer joined the firm from the Joint Committee on Taxation where she was a leader on the international provisions of the 2017 tax reform, the Tax Cuts & Jobs Act. She has also served at the Office of Tax Policy at the Treasury Department, focusing on the taxation of financial institutions and products.**
- **Matthew Lykken has 3 decades of planning and audit experience in international corporate tax in a variety of industries, including roles as global head of tax and regional director.**

The Tax-Writing Committees: Tax Reform, Technical Corrections & Tax Extenders

House Ways & Means Committee: Chairman Neal (D-MA) held an organizational meeting for the Ways & Means Committee during which he stated that the Committee would be closely examining the "Republicans' tax law and its various problems," commenting "So we'll be conducting thorough oversight of this law – oversight that frankly is well overdue." His **key priorities for the Committee** include: (1) strengthening Americans' retirement security; (2) protecting pre-existing conditions protections from the ACA and lowering health care costs, including prescription drug prices; (3) ensuring the tax system benefits middle-income Americans and small businesses; (4) ensuring that infrastructure systems are both safe and efficient; and (5) examining problems with the Tax Cuts & Jobs Act (TCJA). The membership of the Committee was finalized with a total of 42 members – 25 Democrats and 17 Republicans. Subcommittee assignments have been made with Congressman Mike Thompson (D-CA), the new Chairman of the Select Revenue Measures Subcommittee (reverting to its original name after being called the Tax Policy Subcommittee under Republican control) and Adrian Smith (R-NE), the Ranking member.

Chairman Neal will undertake **oversight with respect to the TCJA** by holding a series of hearings over the next year. It would be difficult to legislate on a major rewrite of the TCJA in 2020, which is an election year, but the hearings will ensure that all Committee members are well informed on the TCJA and any problems with it so that the Chairman could consider proposing changes, including to the new international rules, after he gets input from his Committee members.

Although former Ways & Means Committee Chairman Brady (R-TX) gained approval of a tax bill before the end of the last Congress, **Chairman Neal** is not expected to reintroduce this bill. He may consider **technical corrections legislation** after Committee hearings including consideration of some of the technical corrections suggested in the Joint Tax Committee Blue Book on the TCJA, but this process may prove to be challenging if Democrats also pursue substantive changes to the TCJA.

Chairman Neal has promised that his Committee will address the **expired tax extenders** provisions quickly this year, but it is unclear what approach he favors, i.e., the continuation of short-term extensions or consideration of making some extenders permanent and phasing out others. The extension of renewable energy sources is a Democratic priority with some support among Republican senators, including SFC Chairman Grassley with the focus possibly expanding to cover subsidies for technologies beyond solar and wind, such as energy storage technology.

Any new tax provisions that result in a revenue cost will have to be offset or contribute to the deficit, which is something that Democrats have repeatedly opposed. For example, infrastructure legislation has been a key priority for Democrats and Republicans, but there are no easy answers to paying for new programs.

Senate Finance Committee: Both parties have named new members to the SFC including three new Republican senators and two new Democratic senators for a total committee roster of 28 members with Chairman Grassley (R-IA) taking over the gavel. He has told reporters that his **priorities for the Committee** include IRS reform, retirement security, US competitiveness, renewable energy incentives, oversight of tax-exempt entities and tax shelters, and permanency of the individual and business tax provisions of the TCJA. He has also said that tax extenders that expired at the end of 2017 are a priority, but action was not taken prior to the beginning of the tax filing season on January 28th. At this point, Congress would have to extend them retroactively for more than a year with a probability that most of them would only be extended through 2018.

Congressional Agenda for 2019

The looming **2020 Presidential election** will begin to have an impact on the Congressional agenda early in 2019. The White House will be focused on re-election, and Congressional Republicans will be focused on preserving the legislative gains they have made including the tax cuts in the TCJA. Democratic Presidential hopefuls running from the Senate will be cautious on their positions on legislation that may advance if it gives a "win" to the Republicans.

The **FY 2020 budget submission** from the White House is required by law to be released by the first Monday in February, but typically that deadline is missed with a release later in the month. Last year, the President's budget proposal was released one week after the due date.

In February of 2018, Congress suspended the **debt ceiling**, which is the federal government's borrowing limit, until March 2nd. According to an estimate from the Bipartisan Policy Center, the government may be able to continue to operate until mid-summer without further action. As part of their rule changes, House Democrats approved a new rule that streamlines the process of raising the statutory debt limit by allowing the House to suspend the debt ceiling with a vote on the annual budget, thereby avoiding a separate vote on the issue, although the Senate must still hold a separate vote. Other issues on the **agenda for 2019** include the new trade deal with Mexico and Canada and the future of the Affordable Care Act. Finally, Democrats are reportedly planning to use their oversight powers in the House aggressively with respect to a number of issues involving the Trump Administration.

Treasury and the IRS

TCJA Guidance

Code section 199A – Deduction for Qualified Passthrough Income: The **IRS issued final regulations** and new guidance under Code section 199A on the deduction for qualified passthrough business income covering how to define and compute the deduction along with an anti-abuse rule under Code section 643 to prevent taxpayers from using multiple trusts to avoid tax and/or improperly claim the deduction. Some of the key differences between the proposed and final regulations include: (1) 3-year look-back rule imposed on independent contractors; (2) rules on "crack-and-pack" strategies, whereby ineligible service firms separate functions in order to qualify, were eased by deleting the 80 percent threshold; (3) health care is defined more broadly so that health care professionals are assessed on the basis of facts and circumstances; (4) aggregation is allowed at the entity level; and (5) triple net leases are not covered by the safe harbor. The IRS also issued: (1) Notice 2019-07 related to regulated investment companies (RICs) and real estate investment trusts (REITs); (2) Revenue Procedure 2019-11 providing methods for calculating W-2 wages; and (3) proposed regulations providing guidance on the treatment of previously suspended losses that constitute qualified business income.

Base Erosion and Anti-Abuse Tax (BEAT): The new regulations provide help with some calculation issues, but the rules also clarify that noncash transactions, such as transfers of property and stock, may be base erosion payments, and there is no exception for transfers of assets from a foreign company to a US affiliate without recognition of gain or loss. The regulations clarify how the BEAT applies to services transactions. Services charged at cost are exempt; the cost portion for services subject to a markup continues to be exempt while the markup portion goes into the BEAT calculation.

Repatriation Tax/Code Section 965: Treasury and the IRS issued **final rules on the Code section 965 transition tax on certain foreign earnings deemed repatriated** under the TCJA covering calculating and reporting a US shareholder's inclusion amount and how to make elections. The regulations "retain the basic approach and structure of the proposed regulations, with certain revisions," according to the IRS. The final rules did include a narrow exception for some commodities and derivatives contracts from the 15.5 percent transition tax. Despite the fact that there were many issues identified by taxpayers and other exceptions requested, the final regulations follow the proposed rules fairly closely.

The IRS has faced criticism over its policy of **denying corporate refunds** on 2017 tax returns by applying them to installments of the one-time repatriation tax, which can be paid in eight interest-free installments. An IRS memorandum in August 2018 from the Office of the Chief Counsel was issued to address taxpayer questions about this matter but has drawn opposition from taxpayers who want the decision reversed.

Miscellaneous Issues: The IRS issued **Revenue Procedure 2019-12**, which provides **safe harbors under Code section 162** for payments made by C corporations or specified passthroughs "to or for the use of an organization described in section 170(c) if the C corporation or specified pass-through entity receives or expects to receive a state or local tax [SALT] credit in return for such payment," according to the IRS.

The IRS issued **Notice 2019-11, which waives the tax penalty under Code section 6654 for the underpayment of estimated income tax** for certain individuals who are required to make 2018 payments by January 15, 2019. The IRS said it would not penalize individuals who paid at least 85 percent of the required 90 percent that was imposed under the TCJA.

The **IRS issued informal guidance on excess business loss limitations and net operating losses (NOLs)** that reflects changes made by the TCJA. The guidance on excess business loss limitations defines an "excess business loss," provides information about what losses can be included in the calculation, and explains how disallowed business losses are treated. The guidance on NOLs explains the new rule that does not allow NOL carrybacks, gives guidance on deduction calculations, and discusses exceptions.

Other Guidance

The IRS issued **final comprehensive regulations to implement the centralized audit regime for partnerships**. The final rules cover partnerships for taxable years beginning in 2018 and those with tax years ending after August 12, 2018. The IRS also stated that the rules cover partnerships "that make the election to apply the centralized partnership audit regime to partnership taxable years beginning on or after November 2, 2015, and before January 1, 2018." The IRS issued **Notice 2019-6**, which announces that the agency will propose regulations that will set out **special enforcement guidelines for partnership audits** under Code section 6241(11).

Michael Desmond was re-nominated to be the IRS Chief Counsel. His confirmation was held up in the Senate last year by Senator Menendez (D-NJ) over the issue of the TCJA cap on state and local tax deductions, and the Senator has indicated he is willing to block the nomination again this year.

International Issues

Brexit: The U.K. Parliament overwhelmingly rejected the government's draft agreement for leaving the European Union on January 15th by a margin of 230 MPs, throwing the Brexit plans into crisis and raising questions about whether the March 29 departure date can still be met. The range of possible outcomes broadly includes no deal, a "managed" no deal, a second referendum, a General Election – or a second vote of some kind, perhaps after a renegotiation phase with Europe.

European tax unanimity requirement: The **European Commission (EC) launched a debate on reforming decision-making for areas of the EU taxation policy, which currently requires unanimity among Member States**. The EC Communication recommends a roadmap for a progressive and targeted transition to qualified majority voting (QMV) under the ordinary legislative procedure in certain areas of shared EU taxation policy, as is already the case with most other EU policy areas. The EC is not proposing any changes to the rights of Member States to set personal or corporate tax rates as they see fit. The EC asks that the EU leaders, the EU Parliament, and other stakeholders assess the possibility of a gradual, four-step progression towards decision-making based on QMV with the suggestion that Steps 3 and 4 be developed by the end of 2025.

Digital Services Taxation/OECD announcement: The OECD announced on January 29th that it is working toward a **consensus plan to taxing digital commerce** as part of the BEPS initiative. A Policy Note on the issue outlines a path forward with the goal of reaching a consensus by the end of 2020. Renewed international discussions will focus on two central pillars identified in the Policy Note, which was released after the Inclusive Framework's January 23-24 meeting, which included 264 delegates from 95 member jurisdictions and 12 observer organizations.

The **first pillar will focus on how the existing rules that divide up the right to tax the income of multinational enterprises among jurisdictions**, including traditional transfer pricing rules and the arm's length principle, could be modified to take into account the changes that digitalization has brought to the world economy. The **second pillar aims to resolve remaining BEPS issues** and will explore two sets of interlocking rules designed to give jurisdictions a remedy in cases where income is subject to no or only very low taxation.

A consultation document will be issued in mid-February, and a public consultation meeting will be held on March 13-14th in Paris as part of the meeting of the Task Force on the Digital Economy. An elaboration of a detailed program of work will be considered at the Inclusive Framework meeting in May and presented to the G20 Finance Ministers meeting in June with the intended target completion date of the end of 2020.

EU Rules to Limit Corporate Tax Avoidance—Now in Force: Legally binding rules that were first proposed in 2016, known as **ATAD (Anti-Tax Avoidance Directive)**, came into force on January 1, 2019, and require all EU member countries to apply **new anti-abuse measures** that target the main forms of tax avoidance practiced by large global companies. Additional rules on hybrid mismatches will come into force on January 1, 2020.