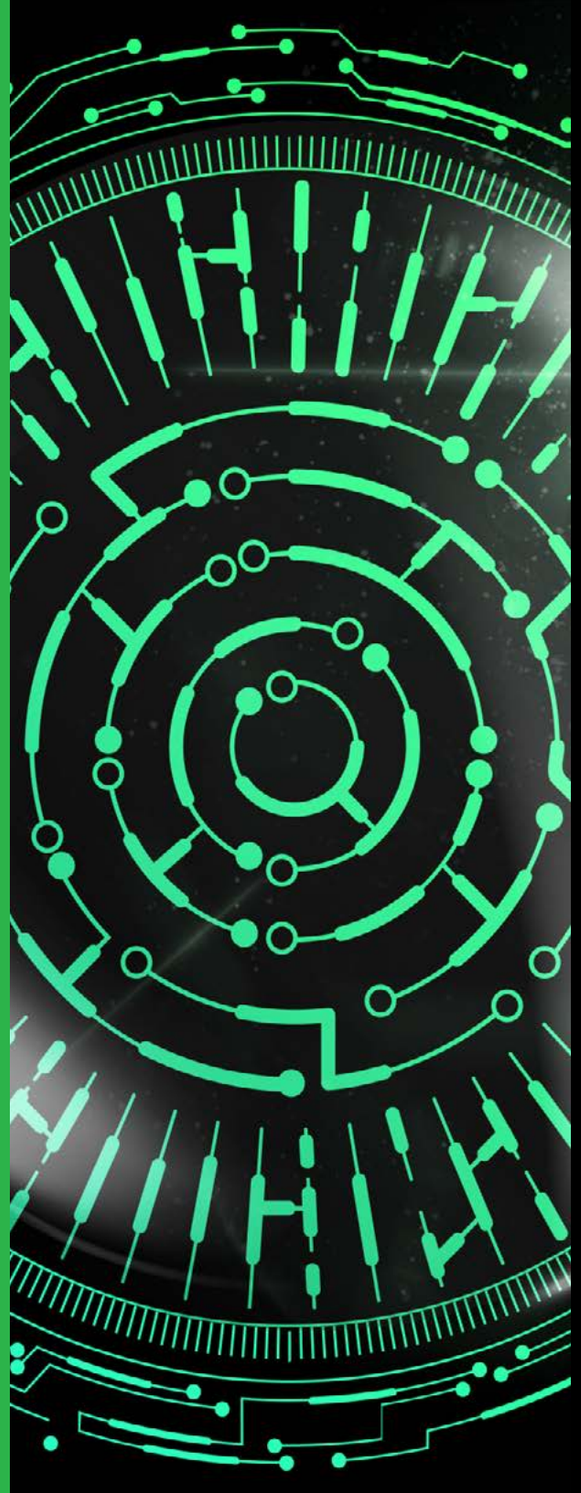
Tax policy update

Divided government isn't pretty

We are now more than six months into the first session of the 116th Congress, with the House under Democratic control and the Senate and White House in the hands of Republicans. Lawmakers have an IRS reform bill (H.R. 3151) that makes taxpayer-friendly changes in the areas of enforcement, appeals, and customer service; lays out a path for reorganizing the agency and modernizing its information technology infrastructure; and provides new protections for taxpayers who are victims of tax-related identity theft. But the lack of progress on other issues—such as extenders, retirement savings reform, and technical corrections to the 2017 Tax Act—reflects the realities of moving significant tax legislation in a divided government.



Extenders

There is support in both chambers for addressing some two dozen temporary tax deductions, credits, and incentives that expired in 2017 and 2018, along with a handful of others that are set to lapse at the end of this year. The list of so-called "extenders" provisions includes, among others, the New Markets Tax Credit, the Work Opportunity Tax Credit, credits for qualified fuel cell vehicles and two-wheeled plug-in vehicles, and the deduction for qualified tuition and related expenses.

The House Ways and Means Committee approved legislation (H.R. 3301) in June that would extend the bulk of the expired and expiring provisions through 2020. For their part, Senate Finance Committee Chairman Charles Grassley, R-IA, and ranking member Ron Wyden, D-OR, unveiled a proposal in late February that would renew the now-expired 2017 and 2018 extenders through the end of this year, however, that proposal has not yet been taken up by the full committee.

Assuming these two measures move through their respective chambers as currently drafted, the biggest threat to eventual House-Senate negotiations on a compromise bill will be disagreements over whether to offset the cost of renewing the temporary provisions. Republicans have traditionally argued that extensions of current law need not be paid for, and the Finance Committee proposal includes no offsetting revenue raisers. But Democrats on the House Ways and Means Committee, led by Chairman Richard Neal of Massachusetts, are insisting that extenders legislation should be fully offset, and they have included in their bill a provision that would accelerate by three years (to 2022) the scheduled expiration of the increased estate and gift tax exemption that was enacted in the 2017 Tax Act. The 2017 Tax Act provision, which basically doubled the prior-law estate tax exemption amount, is currently set to lapse at the end of 2025, along with other tax relief for individuals and pass-through entities.

Pensions and retirement savings

In May, the House overwhelmingly approved bipartisan legislation (H.R. 1994) that generally would make it easier for smaller businesses to offer tax-qualified retirement savings plans to their employees, encourage individuals to participate in retirement plans, and promote savings for certain nonretirement expenses. The measure—which is substantially similar to a bipartisan retirement savings bill that Senate Finance Committee leaders Charles Grassley and Ron Wyden unveiled earlier this spring—also includes revenue-raising provisions that, among other things, would in certain cases accelerate distributions of retirement account assets after an account holder's death.

The bill, as approved, also would repeal a change to the "kiddie tax" enacted in the 2017 Tax Act that requires unearned income of children to be taxed at the rate for estates and trusts rather than their parents' top marginal rates, as was the case under prior law. The provision in the House bill would reinstate the prior-law kiddie tax rules. Lawmakers added the kiddie tax provision to the retirement savings bill in the wake of news reports revealing that the 2017 Tax Act change, which was intended to discourage wealthy individuals from making tax-motivated transfers of investment income to their minor children, also ensnared unearned income received by children in less affluent families—for example, survivors' benefits paid to children of deceased active-duty military service members and first responders—leaving those families facing significantly higher tax rates on that income than they would have before the 2017 Tax Act was enacted.

Senate leaders had hoped to bring up the House-passed bill and approve it under expedited unanimous consent rules before the Memorial Day recess. But that plan was scuttled after various GOP senators raised objections to specific retirement security provisions, such as funding relief for pension plans sponsored by financially struggling community newspapers. It is currently unclear how Senate leaders intend to proceed. Finance Committee Chairman Grassley has indicated that they are exploring all options for getting the bill through the chamber, including convincing individual lawmakers to release their respective holds and then moving it under unanimous consent, attaching it to a must-pass legislative vehicle (such as one of the upcoming spending bills for fiscal year 2020), and bringing it to the Senate floor under an agreement that would allow for consideration of a limited number of amendments.

Technical corrections to the 2017 Tax Act

The kiddie tax issue that House lawmakers addressed in their retirement savings legislation is just one example out of dozens of emerging drafting errors and assorted technical glitches in the 2017 Tax Act that have led to unintended consequences for taxpayers. From a purely partisan standpoint, fixing those problems through what are known as "technical corrections" is among the most divisive issues facing the current Congress.

Advancing 2017 Tax Act technical corrections has been a top priority for congressional Republicans, who were responsible for drafting the underlying legislation and moving it under "budget reconciliation" protections that allowed it to clear the Senate with a simple majority vote rather than the three-fifths supermajority required to overcome procedural hurdles that normally arise in that chamber. In the waning days of the 115th Congress, then Ways and Means chairman Kevin Brady, R-TX, released draft technical corrections legislation that proposed modifications to dozens of 2017 Tax Act provisions as well as to other recently enacted tax laws.

But Democrats—who contend that they were shut out of the 2017 Tax Act drafting process and were given little opportunity to amend the legislation as it moved through the GOP-controlled Congress in 2017—have been reluctant to move a large technical corrections package. Indeed, since he took the Ways and Means gavel in the 116th Congress this past January, Democratic Chairman Richard Neal has maintained that technical corrections will have to wait until the panel holds hearings on the 2017 Tax Act and explores policy questions that he argues should have been considered as the law was being drafted and vetted in committee.

During the markup of the Ways and Means Committee's tax extenders bill in June, Chairman Neal dangled the prospect of legislative action on technical corrections sometime this year. But since then he has not elaborated on the timing or scope of a possible legislative package.

Looking ahead

The debate over these legislative issues is likely to extend into the fall. Over the longer term, as we continue to move closer to the 2020 election cycle, we also can expect increasing calls from the GOP to permanently extend the individual and pass-through provisions in the 2017 Tax Act. Democrats can be expected to oppose that effort, likely citing recent estimates from the Joint Committee on Taxation staff indicating that making these provisions permanent would cost nearly $920 billion over 10 years.[9] Moreover, we likely will hear continued calls from Democrats to scale back or eliminate some of the 2017 Tax Act provisions that they believe are disproportionately skewed to corporations and wealthy individuals. The proposed estate tax clawback (as described above) in the Ways and Means Committee extenders bill is just one example of the types of Democratic proposals that could emerge in the months ahead.

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[9] https://www.jct.gov/publications.html?func=startdown&id=5208.