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No consensus on highway funding sources at Ways and Means, Finance hearings

Two separate hearings in Congress this week did little to clear the murky waters around long-term funding options for the federal Highway Trust Fund (HTF). While the potential for using a package of international tax reforms has been increasingly discussed in recent weeks as a source of revenue for infrastructure, such a proposal was mentioned only in passing during a House Ways and Means Committee hearing on June 17 (though it will be the sole focus of an upcoming Ways and Means subcommittee hearing) and was raised but not explored in depth at a Senate Finance Committee hearing on June 18.

Spending authority for the HTF has been maintained under a series of short-term extensions, the latest of which is set to expire on July 31. Although there is broad agreement that a six-year highway bill would be optimal for planning and certainty, a long-term fix would require additional trust fund receipts beyond those projected under current law. The Congressional Budget Office (CBO) recently estimated that lawmakers would need to find an additional $85-90 billion to pay for a six-year bill.
URL: http://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/SanderLevinHTFLetter.pdf

International reform

At the Ways and Means Committee hearing, taxwriter Kevin Brady, R-Texas, declared himself "skeptical" that tax reform is the solution to funding the HTF and said he believes revenue raised from changes to the tax code should be used to pay for broader tax reform, not spending. Committee member Charles Boustany, R-La., who is working on an international tax reform framework for House leaders to consider, recently made a similar argument.

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In addition to a deemed repatriation tax, elements that have been mentioned as potentially part of a broader Ways and Means international tax package include repeal of deferral, a minimum tax on future foreign earnings, an "innovation box" that would provide a lower tax rate for income from patents and certain other intellectual property, and a shift from the United States' worldwide system of taxation towards a territorial regime for taxing foreign-source income. (See separate coverage in this issue for additional discussion of the Ways and Means Committee's plans to pursue an international tax reform package this year.)

Shortly after the Ways and Means hearing concluded, Select Revenue Measures Subcommittee Chairman David Reichert, R-Wash., announced that his panel would hold its own hearing on June 24 specifically to address the taxation of the repatriated foreign-source earnings of US multinationals as a funding mechanism for a multi-year highway bill. A witness list for the hearing was not available at press time.

At the Finance Committee hearing, members including Sherrod Brown, D-Ohio; Ben Cardin, D-Md.; Mike Crapo, R-Idaho; and Mark Warner, D-Va., all noted that both deemed repatriation and a broader international tax package have been floated as a potential revenue source for highway spending, although none of them discussed these proposals in detail. The most significant exchange on the topic came when Brown asked former Transportation Secretary Ray LaHood, who was an invited witness at the hearing, about the merits of using revenue from deemed repatriation for the HTF. LaHood replied that he would expect such a move to meet resistance from some in the business community but that it would be worthwhile for Congress to discuss it and for the Joint Committee on Taxation to issue a revenue score.

Several times during the hearing, Chairman Hatch noted that repatriation would create a revenue loss and so was not a feasible option for HTF revenue; but he appeared to be referring to a voluntary repatriation "holiday" rather than to a mandatory deemed repatriation plan.

Other revenue options

Taxwriters also disagreed on other potential revenue options for the HTF. Ways and Means Committee Chairman Paul Ryan, R-Wis., set the tone in his opening statement by definitively stating that the committee would not raise the federal tax on gasoline and diesel fuel, even though some of his colleagues from both parties and many outside experts advocate this as the preferred revenue source.

At the Finance Committee hearing, Hatch noted in his opening remarks that he does not believe a large increase in the gas tax can be enacted. (The CBO has estimated that the tax would need to be raised by about 10 cents per gallon to meet the projected HTF shortfall over the next 10 years.) And while many members of both chambers have decried the possibility of another short-term extension of highway funding rather than a multi-year bill, Ryan declared that he sees another general funds transfer this summer as "unavoidable."
URL: http://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50298-TransportationTestimony.pdf

Witnesses at the hearings – who, in addition to former Transportation Secretary LaHood, included president of the American Trucking Association and former Kansas Gov. Bill Graves,

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CBO officials, and think tank policy analysts – discussed a variety of other options for long-term funding, including mileage-based user fees, financing mechanisms such as Build America bonds and municipal bonds, devolving infrastructure responsibility to the states, public-private partnerships, and raising money from oil drilling rights on some federal lands. However, they noted that these methods would generally take time to implement and/or scale up and so were not immediate solutions.

— Storme Sixeas
Tax Policy Group
Deloitte Tax LLP

International tax reform, extenders, top near-term agenda for Ways and Means, Ryan says

House Ways and Means Committee Chairman Paul Ryan, R-Wis., indicated June 16 that his panel will focus in the near term on proposals to overhaul the tax rules for US multinationals and extend expired tax provisions, but that broader corporate and individual tax reform will most likely have to wait until after a new president takes office in 2017.

Piecemeal reform

In remarks at *The Wall Street Journal* CFO Network annual meeting in Washington, Ryan acknowledged that comprehensive tax reform is not an option for Congress this year because the Obama administration does not support the GOP's call for lowering rates for upper-income individuals. But he reiterated his plans to pursue international tax reform this year as a bridge to comprehensive legislation in the future.

International: Ryan confirmed that House taxwriters are currently working behind the scenes on an international-only reform plan that may include an "innovation box" that would provide for a lower tax rate on income from patents and certain other intellectual property. He characterized the innovation box as "a way of, for the moment, having lower tax rates to help keep that income here and making our system a little more competitive if only on an incremental basis toward getting to comprehensive [tax reform] later on."

Ryan and other Ways and Means Committee members have also recently floated international tax reform legislation that includes a "deemed repatriation" tax on foreign-source income of US multinationals as a possible revenue source for the rapidly dwindling Highway Trust Fund. (The full Ways and Means Committee held a hearing on highway funding on June 17 and the Senate Finance Committee held its own hearing a day later, but the idea of using international reform to pay for infrastructure spending did not generate extensive discussion. See separate coverage in this edition for details. The Ways and Means Select Revenue Measures Subcommittee will hold a hearing focused on the issue on June 24.)

Business-only plan appears unlikely: Ryan also noted at the *Wall Street Journal* event that a business-only plan that would lower the corporate tax rate – something that he had suggested earlier this year as a possible "down payment" on comprehensive reform – was

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unlikely to advance because lawmakers would be unable to also provide a rate cut for passthrough entities, who pay taxes through the individual side of the code.

"We were concerned about exacerbating the disparity," he said.

The treatment of passthrough entities in business-only tax reform emerged as a sore point between congressional taxwriting leaders and the small-business community this spring when Ryan and Senate Finance Committee Chairman Orrin Hatch, R-Utah, sent a letter to members of the Coalition for Fair Effective Tax Rates seeking "ideas on how to reduce the effective tax rate [for small businesses] without reducing the statutory rates in a manner that will make small business more competitive and better able to invest, grow, hire, and increase wages for their employees."

The group replied in a letter to Ryan and Hatch that it could not support a business-focused tax reform plan that did not also lower marginal tax rates for individual filers, stating that "no combination of credits, deductions, or exclusions will bring about tax rate parity and produce a fair, simple, transparent and pro-growth tax code." (For prior coverage, see *Tax News & Views*, Vol. 16, No. 13, April 17, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150417_3.html

Extenders in the fall

Ryan told the *Journal* audience that the Ways and Means Committee intends to address expired tax deductions, credits, and incentives "as early as possible in the fall" to avoid a repeat of last year's legislative process in which "taxpayers had to wait until December 11 to find out if these provisions were being extended." He also emphasized that some temporary tax provisions, such as the research and experimentation credit and enhanced section 179 expensing, should be extended permanently.

The House has already passed legislation to make several extenders permanent – including the research credit – as a way to lay the groundwork for broader tax reform in the future. But it is unclear whether those bills will be taken up in the Senate, and the White House has routinely threatened to veto the measures because they do not include revenue offsets.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

House approves medical device excise tax repeal

The House of Representatives voted 280-140 on June 17 to repeal the 2.3 percent excise tax on medical devices that was enacted in 2010 and implemented in 2013 as part of the Patient Protection and Affordable Care Act.

The Protect Medical Innovation Act of 2015 (H.R. 160), which was sponsored by House taxwriter Erik Paulsen, R-Minn., and approved in the Ways and Means Committee earlier this month, would be effective for sales in calendar quarters beginning after the date of enactment.

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The measure includes no revenue offsets and the Joint Committee on Taxation staff estimates it would reduce federal receipts by $24.4 billion over 10 years.
URL: https://www.jct.gov/publications.html?func=startdown&id=4792

No Republicans voted against the bill and 46 Democrats broke ranks to vote in favor of passage.

Senate plans unclear

How the measure will fare on the other side of Capitol Hill is currently unclear. Senate Finance Committee Chairman Orrin Hatch, R-Utah, introduced similar legislation – the Medical Device Access and Innovation Protection Act (S. 149) – in January, but has not yet indicated when he intends to hold a mark-up. Legislation to repeal the medical device excise tax did not advance in the Senate during the 113th Congress when the chamber was under Democratic control, although several nonbinding votes in recent years have shown broad bipartisan support in the Senate for such proposals.

White House veto threat

The Obama administration, as expected, has promised to veto the legislation if it reaches the White House, arguing in a June 15 statement of administration policy that it would "finance a permanent and costly tax break for [the] industry without improving the health system or helping middle-class Americans."
URL: https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr160r_20150615.pdf

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

House panel approves 'mobile workforce' legislation

The House Judiciary Committee voted 23-4 on June 17 to approve legislation that would impose federal standards on when a state may tax nonresident employees who travel to that state to perform work and require employers to implement state income tax withholding and reporting with respect to wages or other remuneration earned by such employees.

The Mobile Workforce State Income Tax Simplification Act (H.R. 2315), which was introduced last month by Judiciary Committee member Mike Bishop, R-Mich., would limit state taxation of wages or other remuneration of any employee who performs duties in more than one state to:

- The state of the employee's residence and
- The state(s) in which the employee is "present and performing employment duties for more than thirty days during the calendar year in which the wages or remuneration is earned."

These same standards would apply to an employer's state income tax withholding and reporting requirements.

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For purposes of determining the application of employer penalties related to a state's withholding and reporting requirements, the legislation provides that in the absence of certain instances of fraud or collusion an employer may generally rely on an employee's determination of the time he or she will spend in each state during the year. This would apply unless the employer maintains a "time and attendance system" that records and tracks where employees perform their daily duties, in which case such system would be used to determine the number of days an employee works in each state. An employer is considered to maintain a "time and attendance system" if: (1) each employee is required to contemporaneously record his or her work location for every day worked outside of his or her primary employment state, and (2) the system permits the employer to allocate each employee's wages among states in which such employee performs employment duties.

The legislation generally defines "employee" according to the definition used in the applicable state where the employee performs his or her duties. However, professional athletes, professional entertainers, and certain public figures would not be included in the definition of "employee." The legislation also provides that an employee would be deemed to work a "day" in the state where he or she performs the most duties for the day, not including travel time. However, if an employee performs duties in his or her resident state and only one nonresident state during a particular day, the employee would be considered to perform more employment duties in the nonresident state for that day.

If enacted, the measure would be effective on January 1 of the second year that begins after the date of enactment.

Next steps

House leaders have not yet indicated when the measure will come up for a floor vote.

An identical companion measure (S. 386) was introduced in the Senate in February by Finance Committee member John Thune, R-S.D. Finance Committee Chairman Orrin Hatch, R-Utah, has not so far announced plans to mark up that legislation.

Taxpayer considerations

In light of ongoing state audit activity in this area, taxpayers should consider whether their current employment tax reporting, withholding, and compliance processes are up-to-date as well as whether they are prepared for the possibility of federal legislation in this area.

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

CBO report reiterates long-term federal budget challenges

A June 16 report by the Congressional Budget Office (CBO) detailing the federal government's fiscal challenges over the next 25 years warns that projected revenue increases will be

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outstripped by a concurrent rise in outlays attributable mainly to growing Social Security and Medicare payouts, rising health care expenses, and increasing debt service costs due to higher interest rates.

CBO, Congress's nonpartisan budget scorekeeper, issues its Long-Term Budget Outlook annually. The report is distinct from what is known on Capitol Hill as the "baseline" – CBO's 10-year budget projections which are used as the yardstick for measuring the fiscal impact of congressional tax and spending proposals.
URL: http://www.cbo.gov/publication/50250

Revenue-spending mismatch to widen over time

CBO's latest long-term outlook predicts that, even absent action by Congress, federal revenues will gradually rise over the next 25 years, from 17.7 percent of gross domestic product (GDP) in fiscal year 2015 to 19.4 percent of GDP in fiscal year 2040 – an ascent driven primarily by so-called "bracket creep," or the tendency of revenues to increase as wage gains outpace the inflation index to which the personal income tax brackets are tied. The so-called "Cadillac tax" on high-cost employment-based health plans scheduled to take effect in 2018 pursuant to the 2010 health reform law, as well as increasing withdrawals by Baby Boomers from tax-deferred retirement accounts, will also contribute to the rising-revenue phenomenon, according to CBO.

However, these revenue gains will be outstripped by a concurrent rise in outlays attributable mainly to the growing ranks of Baby Boomers becoming eligible for Social Security and Medicare, rising health care expenses, and increasing debt service costs due to higher interest rates. Between fiscal years 2015 and 2040, CBO predicts federal spending will rise from 20.5 percent of GDP to 25.3 percent of GDP.

As a result of these dynamics, CBO estimates the annual budget deficit will more than double from about 2.7 percent of GDP today to almost 6 percent of the economy in 2040. Over the same time span, the federal debt held by the public (i.e., debt not held in government trust funds) is projected to rise from 74 percent of GDP to 103 percent of GDP. (Over the past 50 years, the publicly held debt has averaged about 38 percent of GDP.)

Actual fiscal outlook may be even bleaker

As is customary with all CBO budget projections utilized by Congress, the primary figures included in the Long-Term Budget Outlook are based upon the assumption that current laws will not change – for example, that expired and expiring tax cuts will not be renewed and scheduled spending cuts will transpire as prescribed in statute.

However, under an alternative set of budget projections – dubbed by CBO as the "alternative fiscal scenario" – the budget outlook is considerably worse. That scenario assumes that expired and expiring tax provisions (including the so-called "tax extenders" which most recently lapsed at the end of 2014) are instead renewed for the next 10 years and that scheduled "sequester" cuts to discretionary spending are not allowed to transpire.

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Under a budget scenario that includes these policy assumptions, by 2040 the annual budget deficit would swell to more than 12 percent of GDP, and the publicly held debt would reach 156 percent of the economy.

Difficult choices ahead

In written testimony delivered to the Senate Budget Committee in connection with a June 17 hearing on the government's long-term fiscal outlook, CBO Director Keith Hall noted that if lawmakers sought to stabilize the publicly held debt at 74 percent of GDP for the next 25 years they would have to either raise revenue or cut noninterest spending by 1.1 percent of GDP per year – an amount equivalent to $210 billion in 2016 alone.
URL: http://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/50178-2015_LTBO_Testimony.pdf

If instead lawmakers sought to reduce the publicly held debt by 2040 to its 50-year average of 38 percent of GDP, the requisite revenue increases or noninterest spending cuts would rise to 2.6 percent of GDP per year, or $480 billion in 2016 alone.

CBO also noted that as daunting as those figures seem, the challenge becomes even more difficult the longer Congress waits to enact policies designed to address this imbalance.

— Alex Brosseau
Tax Policy Group
Deloitte Tax LLP

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