In this issue:

Familiar divisions re-emerge as focus returns to tax reform

Congressional Republicans and the Trump administration have identified tax reform as their top legislative priority now that efforts to repeal and replace the Patient Protection and Affordable Care Act appear to be on hold for the time being; but questions remain as to whether GOP lawmakers and the White House agree on who will be controlling the process or on what a reformed tax code should look like.

House developments: Health care still casts a shadow

In the House, promises by Speaker Paul Ryan, R-Wis., and Ways and Means Committee Chairman Kevin Brady, R-Texas, to turn immediately to tax reform in the wake of Ryan's decision to pull the American Health Care Act (AHCA) – the GOP's proposal to repeal and replace major portions of President Obama's signature health care reform legislation – before what was likely to be an unsuccessful vote on the House floor March 24 proved to be easier said than done.

A meeting of the full House Republican Conference on March 28 to discuss tax policy instead turned into a post-mortem on health care, according to members and staff, as did another meeting the same day of the Ways and Means Republicans. The committee members intend to try again the week of April 3 to have that internal discussion.

Brady also hopes to reschedule a planned meeting with the committee's Democrats to search for common ground on tax reform, but while he has said he is open to their input, he continued his full-throated advocacy of the GOP-drafted tax reform blueprint this week. In several television appearances, he reiterated his belief that reform this year must be "bold," lowering the corporate rate enough to "leapfrog" past those of other nations – the blueprint proposes a corporate rate of 20 percent – and implementing a border-adjustment tax to encourage US-based production.

Consensus on border-adjustment tax remains elusive: The blueprint's proposed border-adjustment tax (also referred to as a destination-based cash flow tax) provides for a not-yet-specified mechanism that would serve to eliminate US tax on products, services, and intangibles exported abroad (regardless of their production location) and impose a 20 percent US tax on products, services, and intangibles imported into the US (also regardless of production location). It continues to be a divisive concept among lawmakers and businesses alike, even as Brady has said the committee will look at design and transition issues in drafting the provision.

"My sense is that border adjustability has become a given, that it will be part of the final tax reform plan," he said in a recent appearance on CNBC.

But rival advocacy coalitions representing export-heavy and import-heavy interests have been active on Capitol Hill over the past month, seeking to rally House and Senate members to their side, and there are a number of vocal skeptics of the proposal among Republicans in both chambers. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 7, Feb. 17, 2017; *Tax News & Views*, Vol. 18, No. 6, Feb. 10, 2017; and *Tax News & Views*, Vol. 18, No. 5, Feb. 3, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170217_1.html
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URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170203_1.html

Freedom Caucus weighs in: Adding another wrinkle to Chairman Brady's already bumpy path were comments this week by Rep. Mark Meadows, R-N.C., indicating that tax reform doesn't necessarily need to be revenue neutral, from his perspective. (Brady and Ryan have been advocating for a tax reform plan that is revenue neutral under "dynamic scoring" rules, which take into account certain macroeconomic feedback effects of tax and spending legislation on the economy and in turn on federal revenue levels.)

Meadows chairs the conservative House Freedom Caucus – whose staunch opposition to the AHCA contributed to Speaker Ryan's decision to cancel the planned March 24 House floor vote – and his statement likely reflects the view of some others among the roughly 35-member caucus. But congressional Republican leaders hope to move tax reform legislation under fast-track "budget reconciliation" rules, and a reconciliation bill that adds to the deficit outside the current budget window could hit a procedural wall in the Senate. (More on that below.)

White House: 'We're driving the train'

At the opposite end of Pennsylvania Avenue, meanwhile, White House Press Secretary Sean Spicer told reporters in his March 27 press briefing that the Trump administration now intends to take the lead in moving tax reform legislation.

"[O]bviously we're driving the train on this," Spicer said. "So, I mean, we're going to work with Congress on this. But I think the president, [has been] very clear – this is a huge priority for him and something that he feels very passionately about."

In an interview on Fox Business News earlier in the week, Ways and Means Chairman Brady urged the administration to use the House blueprint as its starting point for tax reform.

"We have so much in common with the Trump administration – it wouldn't make sense to have a separate bill from Secretary Mnuchin, a separate one from Gary Cohn, a third from whomever," he said.

But in an interview with *Politico* published March 31, Brady acknowledged that "[i]t's critically important for presidential leadership for [tax reform] to succeed, bringing the resources of the White House and the cabinet to this and coupling it with our effort here in the House and the Senate together, all of those are critical elements."

Administration won't adopt House blueprint as is, Mnuchin says: Treasury Secretary Steven Mnuchin likewise alluded to the administration's plans for a more assertive role in tax reform when he stated in a March 24 interview with *Axios* that the White House will not simply adopt the House GOP's tax reform blueprint in its current form.

On the blueprint's proposed border-adjustment tax, for example, Mnuchin noted that some elements of the proposal are "attractive," while other elements are "concerning."

When asked if there was a way to obviate the concerns of retailers and other import-dependent sectors that have objected to the proposal, Mnuchin suggested that there could be carve-outs for certain industries – a position that Ways and Means Chairman Brady has largely resisted to date. (Brady stated in his *Politico* interview, however, that House taxwriters currently are "engaging with members and with industry, especially those in import industries, about how best to design and phase [the border-adjustment tax] in.")

Asked whether a border-adjustment tax would be good for consumers, Mnuchin noted the argument advanced by some economists that currency fluctuations will occur and mitigate the effects of border adjustment. "If the currency moves," he explained, "then [consumers] should not be impacted." But he also noted that currency fluctuations would have "an impact for our exporters. So, it's a very complicated issue. We're looking at it carefully."

Mnuchin also said the administration would seek to tax "short-term" carried interest (the share of excess profits received by general partners in hedge funds and private equity), as ordinary income rather than as capital gains. While he acknowledged it was "absolutely possible" that changing these rules could cause real estate to be taxed differently, Mnuchin said the hedge funds were the main target of the administration's proposals.

"We'll look carefully at what the impact is to other areas so we don't disincentivize very important investment by pension funds, by state funds, by lots of other institutional investors, retail investors, into infrastructure," he said.

When asked whether the administration will formally propose a 15 percent corporate tax rate – something then-candidate Donald Trump called for during the presidential campaign – Mnuchin replied that it would be "premature" to cite a specific target rate.

"I would say we want to get a lot lower than we are now. And we're looking at a bunch of different options on that," he said.

Infrastructure in the mix?: Administration officials this week also floated the possibility of moving tax reform legislation and an infrastructure package simultaneously (although not necessarily in the same bill), possibly as a way to attract support from moderate Democrats.

There is certainly precedent for such an approach. In 2015, Democratic Sen. Charles Schumer of New York., who was then a member of the Finance Committee and now serves as Senate minority leader, worked with Republican Senate taxwriter Rob Portman of Ohio and then-House Ways and Means Committee Chairman Paul Ryan on a proposal to link deemed repatriation of untaxed offshore income with infrastructure spending, although that deal subsequently fell apart because of disagreements over the level of highway funding to be included in the package. It is unclear, however, whether many Democrats would embrace President Trump's approach to infrastructure, which, as currently understood involves providing tax incentives to promote the formation of public-private partnerships for building roads and bridges rather than direct federal funding of those projects.

Some Senate Republicans have appeared receptive to the idea, however. Finance Committee member John Thune of South Dakota told reporters March 28 that this approach could mean that infrastructure "might get more attention and be considered earlier than had previously been thought in the schedule."

For his part, Finance Committee Chairman Orrin Hatch, R-Utah, called the idea "an interesting concept" in comments to reporters on March 28; however Mississippi Republican Sen. Roger Wicker told reporters the same day that no such pairing of taxes and infrastructure had been discussed by anyone in the leadership meeting that had taken place the day before.

Sean Spicer addressed the issue at his March 28 press briefing, telling reporters that the administration wants to have options on the table but that the discussions remain very preliminary.

Tax reform and the deficit: In response to a question about whether the White House would consider moving tax cut legislation that adds to the deficit in the short term but expires at the end of the 10-year budget window (as opposed to a revenue-neutral tax reform bill), Spicer said at his March 27 press briefing that the administration's focus would be on "what's going to attract jobs, what's going to help us build, what's going to grow the economy."

"I think we're growing around – potentially, growing around 2.6, and the president really would like to see that growth right up in the high 3s, 4s, and 5s. And so there's a question about what part of tax reform, especially on the corporate side, will help us spur the economy and grow jobs," he said.

Ways and Means Chairman Brady appeared to reject the idea of a tax cut-only bill during his March 31 *Politico* interview.

"The rates alone, especially if they're temporary, won't do it," Brady said. "They won't make us more competitive, they will not grow the economy in a significant way. It would leave out perhaps our biggest challenge, which is to drag ourselves out of nearly last place among our global competitors and make us competitive for the twenty-first century, all that would be lost."

Trump briefed on tax reform options: President Trump met on March 30 with Mnuchin, National Economic Council (NEC) Director Gary Cohn, chief strategist Steve Bannon, adviser Jared Kushner, and others from the NEC and Treasury to discuss broad policy agendas, including overviews of the House tax reform blueprint as well as former Ways and Means Chairman Dave Camp's 2014 tax reform legislation.

Spicer told reporters after the meeting that the administration's economic team "is weighing the best option to develop a plan that will provide significant middle-class tax relief and make American businesses more competitive" and that the White House is "at the first stages of this process, beginning to engage with members of Congress, policy groups, business leaders, industry, constituents from around the country, and other stakeholders."

When asked about the potential timeline for tax reform, Spicer replied that "you're talking several months."

AHCA's stumble, tax reform, and reconciliation – is there a connection?

As lawmakers and the administration sort out questions around the substance of tax reform, questions also remain about the process for moving tax reform legislation through the House and Senate. Congressional Republicans had been attempting to move their health care reform legislation pursuant to a budget reconciliation instruction included in the fiscal year 2017 budget resolution adopted by Congress last year. (Reconciliation provides for a fast-track procedure that allows legislation that complies with the given instructions and certain other procedural and budgetary rules to be approved in both chambers with simple majority votes. That makes it a potentially powerful tool for Republicans, who control 52 seats in the Senate, where 60 votes are normally required to advance legislation under regular order.)

Recycle FY 2017 reconciliation instructions?: The reconciliation instruction in the FY 2017 budget agreement called on the Ways and Means and Energy and Commerce committees in the House and the Finance and Health, Education, Labor, and Pensions committees in the Senate to each report legislation that would reduce the deficit by $1 billion over the next decade. (Budget resolutions, and reconciliation instructions, cannot stipulate specific policies to be reported by committees, but it was understood that legislation reported pursuant to that instruction would deal with dismantling the Patient Protection and Affordable Care Act.)

But the recent decision by House Republican leaders to shelve the AHCA has led some observers to speculate that congressional Republicans may attempt to repurpose the fiscal 2017 reconciliation instruction for tax reform rather than health-related legislation. It is important to remember, however, that in order to move tax reform legislation pursuant to that instruction in a way that is protected from a Democratic filibuster it still must meet the requirements of the instruction – in this case, reducing the deficit by $1 billion over the next 10 years. In practical terms, that would equate to "revenue-neutral" tax reform – *i.e.*, broadening the tax base by dialing back current-law deductions, credits, and other incentives in order to finance reductions in tax rates – something that lawmakers have struggled to make progress on for the last several years.

A new reconciliation instruction under FY 2018 budget resolution?: Other observers, however, have speculated that, given the political difficulties inherent in revenue-neutral tax reform, congressional Republicans may desire to move "tax relief" legislation – meaning net tax cuts, partially or entirely divorced from base-broadening. Given Democratic support is also unlikely in this scenario, congressional Republicans would need to modify the FY 2017 budget resolution or adopt another one – likely for fiscal year 2018 – that includes a reconciliation instruction specifically calling for reductions in federal revenues.

But this path also presents the practical challenge of getting the most conservative Republicans – namely, the Freedom Caucus – to agree with more moderate Republicans on what a 10-year budget blueprint should look like. (In order to utilize the budget reconciliation process, the House and Senate must agree on a budget resolution that includes the instructions.) This could be particularly challenging this year, given President Trump campaigned on a platform of protecting Social Security and Medicare from cuts, and increasing infrastructure spending – policies that are generally not consistent with the goal of many Republicans of supporting a budget that balances within a decade. (Concerns of fiscal hawks were likely exacerbated this week by the Congressional Budget Office's release of its *2017 Long-Term Budget Outlook*, which found that federal debt held by the public is currently at 77 of gross domestic product – its highest level since World War II. The reports concludes that "[i]f current laws generally remained unchanged…growing budget deficits would boost that debt sharply over the next 30 years; it would reach 150 percent of [gross domestic product] in 2047.")
URL: https://www.cbo.gov/publication/52480

Adopting a fiscal 2018 budget resolution before action is completed on the fiscal 2017 reconciliation instructions would also likely cancel the ability of congressional Republicans to both repeal and replace the Affordable Care Act and enact tax reform on separate tracks in a way that is protected from filibuster, since it is generally interpreted that there can only be one set of "live" reconciliation instructions at a given time.

Either way, Byrd Rule restrictions apply: No matter which path Republican leaders pursue, an eventual tax reform bill that is moved under reconciliation will be subject to the so-called "Byrd Rules" – named after the late Sen. Robert Byrd, D-W.Va. – which prohibit legislation that would increase the deficit in any year beyond the budget window (typically 10 years) and block provisions that are deemed to have no effect on the federal budget, or whose effect is "merely incidental" to the underlying policy.

These two budgetary restrictions on the reconciliation process have been codified into law and apply on a provision-by-provision basis. They are enforced through points of order, which can be waived in the Senate with a three-fifths majority (that is, generally 60 votes); but because Democrats are not currently expected to lend substantial support to Republican-led tax reform efforts, compliance with these rules is in essence a prerequisite for passage of a tax code overhaul.

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