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## Outlook still murky as Senate leaders unveil revised health care draft that retains PPACA upper-income taxes

A second draft of legislation unveiled July 13 by Senate Republican leaders aimed at repealing and replacing major elements of the Patient Protection and Affordable Care Act of 2010 (PPACA) would keep in place certain PPACA taxes on high-income households and funnel the savings into other priorities such as shoring up the so-called “state stabilization funds” and providing additional money to treat opioid abuse; but its outlook remains unclear due to persisting policy disagreements between moderate and conservative Republicans.

### Net investment income, additional Medicare taxes retained

The latest iteration of the bill – formally known as the Better Care Reconciliation Act of 2017 (BCRA) – would retain the 3.8 percent net investment income tax on certain unearned income of households with adjusted gross income (AGI) over $250,000 ($200,000 for single filers), as well as the additional 0.9 percent Medicare hospital insurance tax on wages over $250,000 for joint filers ($200,000 for single filers).
**URL:** https://www.budget.senate.gov/imo/media/doc/BetterCareJuly13.2017.pdf

The first draft of the Senate bill, released on June 22, would have repealed the net investment income tax retroactively to the beginning of 2017, while deferring repeal of the additional Medicare tax to taxable years beginning in 2023 and beyond. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 22, June 23, 2017.) The PPACA repeal-

and-replace bill passed by the House of Representatives in May followed the same approach on those two taxes. (For prior coverage of the House-passed bill, see *Tax News & Views*, Vol. 18, No. 16, May 5, 2017.)
**URL:** http://newsletters.usdbriefs.com/2017/Tax/TNV/170623_1.html
**URL:** http://newsletters.usdbriefs.com/2017/Tax/TNV/170505_1.html

Unlike the previous Senate bill, the latest draft would also keep in place a current-law provision that limits the deductibility of remuneration paid to officers, directors, employees, and service providers of covered health insurance providers to $500,000 per person per year. (The original Senate draft and the House-passed measure would repeal that limitation retroactively to the beginning of 2017.)

The Joint Committee on Taxation staff has estimated that repealing these three provisions as proposed in the House bill and the original Senate draft would reduce federal receipts by $231 billion over 10 years.
**URL:** https://www.jct.gov/publications.html?func=startdown&id=5000

**Other PPACA tax repeals look familiar:** Aside from these modifications, other provisions that would repeal PPACA taxes – and the effective dates of those proposed repeals – remain unchanged from the previous version of the Senate bill. These proposals include repealing the annual fees on US health insurance providers and manufacturers and importers of branded drugs, as well as the 2.3 excise tax on manufacturers and importers of certain medical devices.

Like the previous Senate bill, the revised measure also proposes to further delay the effective date of the so-called "Cadillac" tax on high-cost employer-provided health plans from 2020 to 2026.

On the individual side, the bill continues to call for nixing PPACA limitations on HSAs, and returning the floor for the itemized deduction for medical expenses to its pre-PPACA level of 7.5 percent of AGI, as well as repealing the 10 percent excise tax on indoor tanning services.

**Individual, employer mandates still neutered:** The latest Senate bill continues to call for the effective repeal of the PPACA individual and employer mandates by reducing the penalty for noncompliance to zero for months after December 31, 2015.

However, recognizing the need to encourage younger and healthier individuals to purchase or maintain coverage in order to facilitate a functioning market, the plan would require insurers to impose a six-month waiting period before coverage can take effect in the case of individuals who purchase nongroup health insurance if they had a gap in coverage of more than 63 days during the past year.

**HSA enhancements also left intact:** The new draft also leaves unchanged several proposals in the previous bill designed to expand access to and increase the flexibility of HSAs – tax-preferred savings accounts which, when used in conjunction with a high-deductible health plan, allow individuals to pay for qualifying out-of-pocket health care expenses with tax-free dollars – including increasing the maximum HSA contribution limit to the combined amount of the plan's deductible and out-of-pocket contribution requirement, allowing both spouses to make catch-up contributions to the same HSA, and implementing a grace period during which certain expenses incurred after a taxpayer purchases an eligible high-deductible insurance plan but before the taxpayer establishes an HSA would be treated as eligible expenses under the HSA.

### Changes designed to woo moderates, conservatives

The initial Senate bill came under heavy fire from Democrats, and unsettled some moderate Republicans, due to the perception that it would cut taxes on high-income households at the same time that it proposed major reductions in federal Medicaid spending (by phasing-out the PPACA's Medicaid expansion and making other reforms) and less generous premium assistance tax credits to help low- and moderate income households pay for coverage in the individual market. But it also drew criticism from conservative Republicans, who felt that the draft retained too many elements of the PPACA and thus did not amount to a true repeal.

**For moderates:** An analysis of that earlier bill by the Congressional Budget Office (CBO) estimated that the legislation would have resulted in 22 million fewer Americans with health coverage within a decade. That helps explain why the latest iteration of the bill appears to take the savings generated by retaining the PPACA taxes on high-income

households and redirects them into other priorities designed to provide for greater coverage and lower out-of-pocket costs than the original draft. For example, the revised bill includes provisions that would:
**URL:** https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/52849-hr1628senate.pdf

- Allow individuals to receive a premium assistance tax credit if they enroll in a lower-premium ("catastrophic") plan so long as other eligibility requirements are met, which is not otherwise allowed under the PPACA. (Note that the other reforms to the premium assistance tax credit regime, including lowering the income threshold that determines which individuals are eligible for the credits and changing the benchmark plan referenced in the credit calculation, appear unchanged from the previous draft.)
- Provide additional funds to states and/or insurers to help cover high-risk individuals, reduce out-of-pocket costs, and combat the opioid epidemic.

**For conservatives:** The latest bill also includes controversial language pushed by conservative Sen. Ted Cruz, R-Texas, that would permit insurers to sell low-cost, unregulated health plans provided they also make available at least one plan that complies with PPACA requirements (as to cost, coverage, etc.). Moderates and health insurers worry this could lead to lower premiums for the young and healthy who opt for those bare-bones plans but higher premiums for sicker and older individuals who want the benefits and coverage of PPACA-compliant plans.

The revised bill includes another provision backed by Cruz that would allow individuals, beginning in 2018, to pay premiums for a high-deductible health plan with HSA funds (provided those expenses exceed amounts that are otherwise creditable, deductible, or excludible under other specified provisions of the tax code).

**But is it enough?**

Senate Majority Leader Mitch McConnell, R-Ky., has stated that he intends to hold a vote the week of July 17 on a motion to bring the bill to the floor for debate. McConnell scrapped plans to move on his original draft in late June after it became clear that he lacked the votes he needed to clinch a motion to proceed; but despite the subsequent changes meant to bridge the gap between conservatives and moderates, it remains uncertain whether he can cobble together a majority to advance the new proposal.

With 52 Republicans in the Senate, McConnell can only afford to lose two votes. (All 48 Senate Democrats are expected to oppose the bill. If only two Republicans defect and leave the chamber divided at 50-50, Vice President Mike Pence would step in to break the tie.)

**Count Paul out:** Republican Sen. Rand Paul of Kentucky, who saw the changes a day before the latest draft was released, told reporters he still cannot support the bill.

"From what I can tell so far, it looks a lot like the old bill except it spends more money and taxes more," Paul said. "I cannot support the bill as is."

**Cruz in – for now:** Ted Cruz, who opposed the original draft, has changed sides now that his amendment to allow low-cost plans (with stipulations) has been incorporated, but his amendment may end up driving away some moderate Republicans. And there's one additional complication: the amendment language is entirely contained within Title III of the draft, which is bracketed, leaving some to wonder whether its inclusion is merely tentative and whether it will be found to comply with budget reconciliation rules that disallow provisions that have no budgetary effect or whose effect on the budget is merely incidental.

**Moderates still concerned about Medicaid:** Several moderate Republicans objected to the cuts to Medicaid in the original draft of the BCRA. But the latest draft leaves those Medicaid cuts in place, which could make it more difficult for McConnell to draw any wavering moderates into the fold.

Republican Sens. Lisa Murkowski of Alaska and Susan Collins of Maine have been very vocal about the need for Medicaid spending, arguing that the PPACA did not affect the baseline of the Medicaid program, so a repeal bill should not either. Both have argued that separate legislation or amendments would be better vehicles to handle the level of Medicaid spending.

"The ACA allowed for Medicaid expansion. The ACA didn't address traditional Medicaid. …Why do we not focus on the urgency of the concerns with the ACA?" Murkowski told reporters after a closed-door meeting on July 12.

Sen. Rob Portman, R-Ohio, who also represents a state which expanded Medicaid under the PPACA, released a noncommittal statement in which he promised to “review the text of this new legislation…and…the analysis from the Congressional Budget Office when it becomes available.”

Even those members who back Sen. Cruz’s amendment still worry about Medicaid. Sen. Jeff Flake, R-Ariz., for example, said he supports the Cruz language but added that “[t]here is a lot of concern in Arizona on the Medicaid side. …This amendment does not affect the Medicaid side at all.”

**Graham, Cassidy planning an alternative:** In another sign of fractures within the GOP, Sens. Lindsay Graham, R-S.C., and Bill Cassidy, R-La., debuted their own proposal just before McConnell was scheduled to release the updated BCRA. Graham said he would vote yes on the procedural motion to open debate on McConnell’s revised proposal but added that he would continue working on his own plan, which is designed to be less harsh on states that expanded Medicaid under the PPACA.

**CBO score expected soon**

A revenue score from the CBO showing the revised bill’s impact on the budget deficit and on insurance coverage levels could help determine whether current Republican fence-sitters ultimately land in the “yes” or “no” camp.

The CBO estimate could be released as soon as July 17, but some uncertainty remains as to exactly what provisions will be scored. Due to the changes made and its complicated nature, the Cruz amendment may be scored separately, meaning the CBO could provide one score for the draft with the Title III language and one without. Senate Majority Whip John Cornyn, R-Texas, echoed this uncertainty in comments to reporters.

“We are expecting a CBO score, but I can’t tell you exactly what the format will be,” Cornyn said. “The…Cruz amendment will be scored.”

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## Ways and Means mulling small-business exception to proposed repeal of interest expense deduction, Roskam says

House taxwriters are exploring ways to create an exception for small businesses to a proposal in the House Republican tax reform blueprint that would repeal the current-law deduction for net interest expenses, Ways and Means Tax Policy Subcommittee Chairman Peter Roskam, R-Ill., said July 13. Roskam spoke at a Tax Policy Subcommittee hearing on how tax reform can promote the growth of small businesses and create new jobs.

The blueprint, which House Speaker Paul Ryan, R-Wis., and Ways and Means Chairman Kevin Brady, R-Texas, released in June of last year, would, among other things, repeal the net interest expense deduction in exchange for a provision allowing full expensing of business investments in year one.

Small-business owners who spoke at the hearing supported the proposal for immediate expensing, arguing that it would give them access to cash that they can then use to expand their operations. But Scott VanderWal, a third-generation farmer from South Dakota, told the panel that businesses that lack access to capital – like farms and ranches – depend on debt financing to purchase land and buildings, vehicles and equipment, and production inputs.

“If my family can’t deduct interest it will make it more expensive for our farm business to borrow money or could restrict the amount of money we can borrow. If our farm debt load becomes too great, the long-term viability of our business operation will be called into question,” he said in his opening statement.

The notion of providing a small-business carve-out to the proposed repeal of the interest expense deduction rules had some bipartisan support at the hearing. Tax Policy Subcommittee ranking Democrat Lloyd Doggett of Texas noted that 100 percent depreciation would be a “radical” change to the tax code given that small businesses can already expense up to $500,000 a year under section 179. But he agreed with VanderWal that small businesses need the interest expense deduction and contended that it would be "problematic" for lawmakers to repeal the deduction outright.

**Passthroughs**

There was less bipartisan accord on the issue of how to tax passthrough entities. Under the House GOP tax reform blueprint, passthroughs would be subject to a top tax rate of 25 percent. Roskam noted in his opening statement that "[t]he Ways and Means Committee has been hard at work figuring out the fairest way to define business income so that companies are taxed fairly." (The blueprint states, without further elaboration, that passthrough entities would pay – or be treated as having paid – reasonable compensation to owner-operators, which would be deductible by the business and subject to tax at graduated rates for families and individuals.)

But several Democrats on the panel – including Doggett, John Larson of Connecticut, Loretta Sanchez of California, and Mike Thompson of California – expressed concern that the proposal in the blueprint would do little to benefit "mom and pop" businesses and would instead create "loopholes" for large passthrough entities and wealthy individuals.

Chey-Ching Huang of the Center on Budget and Policy Priorities, who was invited to testify by the subcommittee's Democrats, argued in her opening statement that the 25 percent passthrough rate proposed in the blueprint and the 15 percent rate proposed by the Trump administration "would mostly help wealthy filers – such as hedge fund managers, investment bankers, and real estate investors – as well as high-earners who engage in tax avoidance by converting their salaries to passthrough income." She also noted that many owners of traditional small businesses are already being taxed at the lower end of the individual income tax rate spectrum.

Republican taxwriters such as Pat Tiberi of Ohio and Jackie Walorski of Indiana countered that the Democrats' focus on tax benefits flowing to the wealthiest taxpayers was a distraction and that a rate cut for passthroughs is an example of how tax reform can support taxpayers who take risks by starting a small business.

"What I hear today…is that a passthrough rate cut raises all ships. And with all ships raised, that's how we get the most efficient, accurate increase in money and productivity in the lower- and middle-income [sectors] in this country," Walorski said.

**Border-adjustability**

Republican taxwriter Tom Rice of South Carolina spoke out in favor of the blueprint's proposed border-adjustment tax, which generally would impose a 20 percent tax on goods and services imported into the US and impose no tax on US exports. The lack of a border-adjustment tax in the US, he argued, puts small businesses at a disadvantage in relation to their foreign competitors who operate in countries that impose such a levy.

Responding to a question from Rice, Rebecca Boenigk of Neutral Posture, Inc., a Texas-based manufacturer of ergonomic seating products, stated that a US border tax had the potential to make her business more competitive in foreign markets. But she also noted that certain parts that she needs to manufacture her products are not currently available in the US and that a border tax would need to be phased in over a number of years to give the US supply chain a chance to catch up.

**Permanent tax reform**

Several subcommittee Republicans – notably Roskam, Tiberi, and Kristi Noem of South Dakota – emphasized the importance of providing greater certainty to small businesses by enacting permanent tax reform. (Some of the more conservative elements of the congressional GOP have argued that a simpler bill focusing largely on tax cuts might be more easily achieved than comprehensive reform. But a tax cut package, without significant accompanying revenue offsets, would have to be temporary in order to meet the budget reconciliation rules that Republicans are currently planning to use for tax reform, which preclude legislation that increases the deficit beyond the budget window.)

The business owners who testified at the hearing generally agreed. VanderWal told the panel that "[f]rom unpredictable commodity and product markets to fluctuating input prices, from uncontrollable weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. …Farmers and ranchers need a permanent tax code that recognizes the financial challenges they face."

Boenigk likewise contended that "[i]f Washington is serious about strengthening the American economy, it is time to enact a plan that will level the playing field for American businesses by encouraging investments and job creation. Piecemeal efforts won't get us where we need to go. We need comprehensive, permanent tax reform, and we need it now."

**Next up: Tax reform's impact on individuals and families**

Roskam announced earlier this week that the Tax Policy Subcommittee's next hearing – addressing how tax reform can "reduce the burdens on American families and individuals, and deliver economic growth that creates jobs and improves the quality of life of all Americans" – will be held on July 19 at 2:00 p.m. A witness list was not available at press time.

**Senate developments: Hatch pushes lower corporate tax rate**

On the other side of the Capitol, Senate Finance Committee Chairman Orrin Hatch, R-Utah, reiterated in a July 12 floor speech that "lowering the US corporate tax rate from one of the highest in the world to one of the lowest is a top priority" in congressional tax reform efforts.

"A reduced corporate tax rate would allow American companies to compete with their international counterparts on a more level playing field. A reduced corporate tax rate would mean that fewer businesses would move offshore, taking their jobs and investments elsewhere. A reduced corporate tax rate would incentivize more new companies to set up shop in the US, and lead more established companies to invest their capital and hire workers here, rather than in lower-tax jurisdictions found in places like Canada, the UK, Ireland, or elsewhere," he said.

The Finance Committee has not put forward a tax reform proposal (or detailed outline) of its own, although Hatch recently announced that he has tapped several Republican Finance Committee members to take the lead on developing proposals that focus on overhauling discrete elements of the tax code. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 23, June 30, 2017.)
**URL:** http://newsletters.usdbriefs.com/2017/Tax/TNV/170630_2.html

**Former Treasury officials to weigh in at upcoming tax reform hearing:** Hatch's speech came just one day after he announced that his panel will hear from four former Treasury assistant secretaries for tax policy at an upcoming hearing to examine "how Congress can reform the tax code to help promote economic growth, spur new job creation, and increase America's competitiveness." Witnesses at the hearing, which is set for 9:00 a.m. on July 18, include Mark Mazur (who held the tax policy post at Treasury from 2012-2017), Pamela Olson (2002-2004), Eric Solomon (2006-2009), and Jonathan Talisman (2000-2001).

Treasury's Office of Tax Policy plays a key role in developing tax legislative proposals – including tax reform – and implementing any tax legislation that is enacted into law. Hatch explained in a news release that "[b]y bringing together former Treasury Department assistant secretaries for tax policy, our committee will gain a better understanding of not only the challenges we face with a comprehensive tax overhaul, but also the significant benefits meaningful reforms would bring to the American people."

**Kautter nomination hearing follows:** Senate taxwriters will follow up the tax reform session with a separate hearing to consider President Trump's nomination of David Kautter to serve as Treasury's next assistant secretary for tax policy. That hearing is scheduled for 11:00 a.m., also on July 18.

Kautter currently heads the Washington National Tax practice for RSM US LLP. He has previously served as the managing director of the Kogod Tax Center and executive-in-residence at the Kogod School of Business at American University and as a partner at Ernst and Young.

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