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House panel clears budget that would expedite tax reform – but GOP divisions cloud its future

On a party-line vote on July 19, Republicans on the House Budget Committee advanced a long-awaited fiscal year 2018 budget resolution that includes a broad set of reconciliation instructions aimed at expediting both revenue-neutral tax reform and significant cuts to entitlement programs, but familiar divisions within the GOP – particularly as to spending policy – cast doubt on its viability on the House floor should it be brought to a vote.

Contours of the plan

The budget blueprint for upcoming fiscal year 2018 – which begins on October 1 – is the product of months of haggling between the committee's chair, Rep. Diane Black, R-Tenn., and the panel's other Republican members. In broad terms, it resembles other GOP fiscal plans put forward in recent years and calls for bringing the federal budget into balance within the 10-year budget window through major reductions in spending on entitlement programs (such as Medicare, Medicaid, and food stamps), nondefense appropriations (offset in part by increases in defense spending), and reduced debt service costs.

The budget also factors in $1.8 trillion in additional “dynamic” savings over 10 years as a result of faster projected economic growth, and devotes $1.5 trillion of that total to deficit reduction, with the remainder earmarked to help finance tax reform (suggesting implicitly, that under conventional – or “static” – scoring, the budget’s vision of tax reform would result in a net tax reduction of $300 billion).

American Health Care Act – and its tax cuts – included: The budget assumes enactment of the American Health Care Act (AHCA) – the bill passed by the House during May aimed at repealing and replacing key aspects of the Patient Protection and Affordable Care Act of 2010 – including its call for repeal of the 3.8 percent net investment income tax, the additional 0.9 percent Medicare hospital insurance tax, and the medical device excise tax, among other taxes and fees. (For prior coverage of the tax changes included in the AHCA, see *Tax News & Views*, Vol. 17. No. 16, May 5, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170505_1.html

As a result of this assumption, the revenue levels in the budget are roughly $1.1 trillion lower over the next decade when compared to projections made by the nonpartisan Congressional Budget Office (CBO) in January 2017 on the basis of current law.

Whether those proposed tax cuts ever go into effect, however, remains highly uncertain as Senate Republicans struggle to coalesce around their own health care legislation. (See related coverage in this issue for additional details.)

Nonbinding tax reform recommendations: Although it is not binding on congressional taxwriters, the budget resolution also includes a policy statement on tax reform citing budget writers’ perceived flaws with the current tax system and enumerating a handful of proposed remedies. Those suggested changes – which are very high-level in nature – include lowering tax rates for individuals and corporations, repealing the alternative minimum tax, transitioning to a territorial system for taxing foreign-source business income of US multinationals, and simplifying the tax code.

Threatened GOP border-adjustment tax amendment causes flare-up: Near the end of a marathon mark-up session in which Republicans successfully batted away more than two dozen Democratic amendments – some on tax issues, such as expanding Earned Income Tax Credit and reducing tax expenditures for top income earners – Republican Rep. Mark Sanford of South Carolina attempted to offer a change to the budget resolution effectively aimed at blocking any inclusion of a border-adjustment tax regime in a future tax reform plan. (The border-adjustment tax proposal included in the House GOP tax reform blueprint and supported by Speaker Paul Ryan, R-Wis., and Ways and Means Committee Chairman Kevin Brady, R-Texas, generally would impose a 20 percent tax on goods and services imported into the US and impose no tax on US exports. It has proven highly controversial, both within the business community and among congressional Republicans.)

“I’m not saying there’s a guarantee of a [border-adjustment tax] going forward, but increasingly, what I’ve seen over the last couple of days, puts it in that direction,” Sanford said. “That puts myself and others on this committee in a bad spot.”

Sanford ultimately stood down and did not offer his amendment after a lengthy exchange with Chairman Black in which she emphasized an earlier agreement with Democrats that members of the committee’s Republican majority would not offer amendments to the budget.

Reconciliation: Fast-track tax reform tied to entitlement cuts

The budget plan would also make good on Republican promises to establish a fast-track process – that is, “budget reconciliation” – to move subsequent tax reform legislation. Provided strict parliamentary and procedural rules are met, legislation moved under budget reconciliation can pass both chambers with a simple majority vote – a potentially powerful tool for Republicans who control 52 seats in the Senate, where 60 votes (a three-fifths majority) are normally required to advance legislation under regular order.

However, the reconciliation instructions included in the blueprint call for a much broader suite of policy changes than just tax reform. Eleven House committees are charged under the plan with reporting legislation by October 6, 2017, that would reduce the deficit by a total of at least $203 billion over the next decade. (The October 6 deadline is generally understood to be nonbinding from a parliamentary perspective.) In that way, the budget would establish an expedited legislative process to achieve a portion of the several trillion dollars in total savings called for in the plan.

The Ways and Means Committee, for its part, would be tasked with producing legislative changes achieving at least $52 billion in deficit reduction. Although those budgetary savings could theoretically come from tax changes, the policy document accompanying the budget resolution stresses the view of budget writers that (1) tax reform should be revenue-neutral (after taking into account a portion of the plan's projected "dynamic" savings, as discussed above) and (2) the committee's deficit reduction target should be met through changes to spending programs within its jurisdiction such as Supplemental Security Income, Temporary Assistance for Needy Families, and unemployment insurance.

Similarly, the House Agriculture and Judiciary committees would be charged with reporting bills that cut the deficit by at least $10 billion and $45 billion, respectively. Again, those savings could come from any program in the committees' jurisdictions, but budget writers telegraphed their view that the savings should be generated within the Supplemental Nutrition Assistance Program (food stamps) in the case of the Agriculture Committee and from medical malpractice reform in the case of the Judiciary Committee.

Because each committee receiving a reconciliation instruction must meet its savings goal in order for the bundled legislation to receive expedited treatment on the floors of the House and Senate, this approach – if implemented – could complicate the path for tax reform by essentially making it contingent upon other lawmakers coalescing around unrelated (and sometimes controversial) spending cuts.

GOP moderates, conservatives defect in advance

That concern was being expressed by some moderate Republicans not on the Budget Committee even before the panel began marking up its blueprint.

"I have serious concerns about the budget in its current form," said Rep. Charlie Dent, R-Pa. "The focus of this budget should be on reconciliation instructions for tax reform. Trying to use mandatory savings in the same reconciliation instructions is going to make tax reform much harder, not easier. Anybody with a pair of eyes can see this."

Meanwhile, many conservative Republicans, including most members of the House Freedom Caucus, believe the $203 billion in reconciled spending cuts does not go far enough, and that the budget should seek to expedite passage of a greater portion of the plan's overall savings.

Other conservatives are smarting over the relatively secretive process under which Republican leaders have attempted to draft PPACA repeal-and-replace legislation – which is also moving under budget reconciliation – and are angling to influence the shape of any tax reform reconciliation bill on the front end.

"We've done this before – where you pass a budget for reconciliation to deal with a big issue. We saw how that played out over the past seven months," said Freedom Caucus member Rep. Jim Jordan, R-Ohio.

"Fool me once, shame on you, fool me twice, shame on me. I just want to know more about what tax reform looks like before we open the gate," Jordan explained.

Another divide exists between Republicans who sit on the House Appropriations Committee and those who do not, with appropriators generally of the view that the cuts to nondefense accounts called for in the plan – roughly $1.3 trillion over the next decade – are unrealistically steep and would prevent them from writing appropriations bills that could ever become law.

A significant number of these lawmakers have argued to Speaker Ryan that Republicans should begin bipartisan negotiations with Democrats to ease the statutory caps on appropriations known as the "sequester" which are set to return in full force on October 1. (Two bipartisan deals have been struck in recent years that raised the spending caps for fiscal years 2014 through 2017.)

All of these dynamics are coalescing to cast a great deal of uncertainty on the budget plan's prospects on the House floor, should it be brought to a vote. While Speaker Ryan can lose 22 Republican votes and still pass legislation with GOP-only support, more than that number have publicly expressed reservations about the current blueprint.

Radio silence from the Senate

The Senate Budget Committee, for its part, has been silent on its plans for a fiscal 2018 budget resolution and Majority Leader Mitch McConnell, R-Ky., has not discussed a budget blueprint as being part of the chamber's legislative agenda this summer.

If no fiscal 2018 budget, then what?

Even if House and Senate Republicans cannot agree on a new budget resolution for fiscal 2018, there are at least two other pathways by which the GOP could – at least theoretically – seek to move tax legislation on a filibuster-proof basis.

Co-opt fiscal 2017 instructions: One option would be to co-opt the fiscal 2017 reconciliation instructions currently being used to move health care-related legislation and use them to move tax legislation instead. The nature of those instructions – which require 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 reduces the deficit by at least $1 billion over the next decade – would essentially require the taxwriting committees to produce revenue-neutral tax reform. (A "tax relief" bill would not be allowable under these nominal deficit reduction instructions.)

This option, however, would require Republicans to officially give up on their hopes of repealing and replacing the PPACA – at least for the time being – and could also run into a roadblock in the Senate if that chamber's parliamentarian should rule that the fiscal 2017 reconciliation instructions lose their privilege after September 30 when fiscal year 2017 comes to an end – an issue that is presently unclear.

'Shell' budget: Another option would be for Republicans to adopt a "shell" budget resolution for fiscal 2018 that ignores broader budget policy, includes only placeholder numbers, and is shuttled through Congress solely for the purpose of setting up the reconciliation process. This is the approach congressional Republicans took in January 2017 with an eye toward swiftly dismantling the PPACA.

This option faces its own set of challenges, though, as Speaker Ryan promised at the time the fiscal 2017 budget was adopted that there would not be another shell budget later in the year – a vow many House conservatives took to heart.

"The shell budget on health care produced no results, so why do we think a shell budget on tax reform is going to produce results?" said Rep. Mark Meadows, R-N.C., the chairman of the Freedom Caucus on July 20. "The speaker assured us when we voted for one shell budget that we wouldn't have to vote for another."

— Alex Brosseau
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Uncertainty abounds as Senate eyes procedural vote on PPACA repeal legislation

Senate Republican leaders indicated this week that the chamber could hold a procedural vote early in the week of July 24 on whether to begin debate on legislation to repeal the Patient Protection and Affordable Care Act of 2010 (PPACA). But at press time it was unclear whether lawmakers would be voting to take up the retooled repeal-and-replacement package that Majority Leader Mitch McConnell, R-Ky., unveiled just days ago or an alternative repeal-only bill with a two-year delayed effective date. Also unclear was whether Republican leaders would be able to scrape together a majority within their own caucus to begin debate on either measure.

Grim outlook for Better Care 2.0

McConnell had hoped to hold a procedural vote this week on the updated version of his Better Care Reconciliation Act (BCRA) which he unveiled on July 13 after an earlier iteration drew criticism from conservative Republicans, who believed that the measure left too much of the PPACA intact, and from moderate Republicans, who argued that it

would cut taxes on high-income households at the same time that it proposed major reductions in federal Medicaid spending. (For details on McConnell's initial version of the BCRA, see *Tax News & Views*, Vol. 18, No. 22, June 23, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170623_1.html

But in a sign of just how tough it would be to line up enough supporters to guarantee success, McConnell had to scuttle any action on the revised bill after learning that Arizona Republican Sen. John McCain had been sidelined by emergency surgery and would not be available to cast a vote. (McCain's subsequent diagnosis of brain cancer means that he could be away from Capitol Hill for the foreseeable future. It also means that in the near term the GOP, for all practical purposes, will control only 51 Senate seats to the Democrats' 48, and that McConnell can afford only 1 Republican defection and still ensure a majority on any difficult vote.)

In drafting his revised bill, McConnell attempted to win over moderates by retaining certain PPACA taxes on high-income households – notably, the 3.8 percent net investment income tax and the additional 0.9 percent Medicare hospital insurance tax – and funneling the savings into other priorities such as shoring up the so-called "state stabilization funds" and providing additional money to treat opioid abuse. To appeal to conservatives, McConnell included 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. (For details on the revised version of the BCRA, see *Tax News & Views*, Vol. 18, No. 25, July 14, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170714_1.html

Those changes appeared insufficient to satisfy holdouts, however. By the start of the week, two Republican senators – Rand Paul of Kentucky and Susan Collins of Maine – had already announced that they would not support a motion to proceed on the bill and a number of others were expressing reservations. Things got worse for McConnell late on July 17 when conservative Republican Sens. Mike Lee of Utah and Jerry Moran of Kansas announced that they would not support the measure, bringing the number of official "no" votes to four – enough to defeat a motion to begin debate.

Equally grim prognosis for repeal-only alternative

The dismal outlook for the BCRA led McConnell to announce that the Senate would instead vote on a repeal-only measure similar to one the chamber approved in 2015 that would strike the major provisions of the PPACA but would not take effect for two years, giving lawmakers time to develop a separate replacement plan from scratch in the interim. (Republicans would have to work with Democrats to develop and pass the replacement measure since it presumably would not move under budget reconciliation protections.)

The alternative measure – the Obamacare Repeal Reconciliation Act of 2017 – would neuter the PPACA's individual and employer mandates by reducing the current-law penalties to zero retroactive to December 31, 2015, repeal many of the PPACA's taxes on businesses and individuals retroactive to the end of 2016, and eliminate most others beginning in 2018.
URL: https://www.budget.senate.gov/imo/media/doc/REPEAL7.19.17.pdf

Like the revamped BCRA, the repeal-only measure would retain the PPACA's excise tax on certain high-cost, employer-provided "Cadillac" health insurance plans but delay implantation of the tax until 2026 (from 2020 under current law). It also would retain the PPACA's "economic substance" doctrine, which generally requires taxpayers to show that a transaction changed their economic position in a meaningful way apart from the federal income tax effects and that they had a substantial nontax business purpose for entering into a transaction.

But McConnell's fallback plan quickly fell apart when 3 Republicans – Susan Collins, Shelley Moore Capito of West Virginia, and Lisa Murkowski of Alaska – announced on July 18 that they would not support a repeal-only bill, once again raising the prospect of a failed vote. Press reports citing unnamed Republican sources indicated that several other GOP lawmakers were likely "no" votes but had not announced their positions publicly.

White House weighs in

Amid talk that the Senate would simply abandon efforts to move either bill, President Trump initially suggested that he would be willing to follow suit and allow the PPACA to collapse under its own weight.

"I think we're probably in that position where we'll let Obamacare fail," he told reporters on July 18. "We're not going to own it. I'm not going to own it. I can tell you the Republicans are not going to own it. We'll let Obamacare fail and then the Democrats are going to come to us."

By the next day, however, the president changed course and invited the entire Senate Republican Caucus to a White House lunch during which he urged them to vote on a repeal-and-replacement package – or at the very least, vote to repeal the current law.

"We can repeal, but we should repeal and replace," he said. He also called on Senate leaders to cancel their August recess and stay in Washington until the issue was resolved. (McConnell announced last week that he would delay the start of the recess until the week of August 14 to give lawmakers more time to work on health care and other legislative priorities, and to process more of Trump's nominees for administration posts.)

Also at Trump's urging, a group of moderate and conservative holdouts held a late-evening meeting on July 19 to see if they could negotiate concessions on a repeal-and-replace package that they thought could clinch a majority on the Senate floor. But those talks do not appear to have resulted in a deal – or even the framework for a deal.

CBO releases revenue scores

The nonpartisan Congressional Budget Office (CBO), meanwhile, weighed in this week with revenue estimates for the revised BCRA and the repeal-only alternative – and the results, particularly as they relate to insurance coverage levels, appear unlikely to drive any fence-sitting moderates into the "yes" camp for either bill.

According to the CBO's estimates, the revised version of the BCRA would reduce federal deficits by $420 billion from 2017-2026, with the largest savings coming from a reduction in total federal spending for Medicaid. The number of individuals without health insurance would increase by 15 million in 2018 and by 22 million in 2026, relative to current law, the CBO said. (The estimate does *not* include the Cruz amendment to allow insurance companies to offer bare-bones insurance plans.)
URL: https://www.cbo.gov/publication/52941

The repeal-only package would decrease deficits by $473 billion from 2017-2026 and increase the number of uninsured individuals by 17 million in 2018 relative to current law and 32 million by 2026.
URL: https://www.cbo.gov/publication/52939

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Finance Committee approves Kautter for tax policy slot at Treasury

The Senate Finance Committee on July 20 unanimously approved President Trump's nomination of David Kautter to serve as assistant secretary for tax policy at the Treasury Department.

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. If confirmed by the full Senate, he is expected to play a key role in the ongoing discussions around Republicans' tax reform plans this year.

Tax reform positions

Kautter told Senate taxwriters during a July 18 hearing to consider his nomination that he believes "everything should be on the table" as lawmakers seek to revamp the tax code, but he did show some signs of potential dissention from the White House around a few specific tax provisions.

Revenue neutrality: In his prepared testimony and in answering questions from members of the committee, Kautter spoke of the need for revenue-neutral, comprehensive reform that would both improve international business competitiveness and provide simplicity. He also said that his focus is on a middle-income tax cut that maintains progressivity – although he emphasized that he was "not in a position to promise" that there would be no net tax cut for the wealthy.

House Speaker Paul Ryan, R-Wis., and Ways and Means Committee Chairman Kevin Brady, R-Texas, have called for revenue-neutral tax reform under "dynamic scoring" rules, which take into account certain macroeconomic feedback effects of tax and spending legislation.

But some Republicans have been less wedded to such a constraint. Finance Committee Chairman Orrin Hatch, R-Utah, for example, has stated that he is "not so sure that it's absolutely critical that [tax reform] be revenue neutral." (For prior coverage, see *Tax News & Views*, Vol. 18, No. 18, May 19, 2017.) For his part, President Trump, who has sent mixed signals on this issue, indicated in an interview with *The Economist* in May that he could accept a tax reform plan that adds to the deficit in the short term because the plan would pay for itself through increased economic growth. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 17, May 12, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170519_2.html
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170512_1.html

Full expensing v. interest expense deduction: Kautter noted that different types of businesses have different preferences in tax reform, highlighting as one example that more capital-intensive companies may value the ability to fully expense new equipment, while this may not be a priority for others.

The House Republican tax reform blueprint released in June of 2016 proposes implementing full expensing, while eliminating the current deduction for net business interest – a trade-off that has not been universally embraced. President Trump, others in the administration, and some congressional Republicans have pushed back on the House proposal – as have segments of the business community – and this is believed to be one of the remaining outstanding items of discussion among negotiators.

Kautter said that he recognized the distortions that some believe the interest deduction creates but added that he does not think eliminating the provision "as a simple, across-the-board change" would be wise.

Passthroughs: On another thorny issue, the treatment of passthrough business entities, Kautter's views appeared to be in line with the House proposal, which calls for a 20 percent tax rate for C corporations and 25 percent for passthroughs.

"I think there has to be a realization that C corporations have two levels of tax, and passthroughs only have one," Kautter said.

President Trump has proposed a single rate – 15 percent – across all types of businesses.

Individual provisions: Responding to questions about specific tax expenditures for individuals, including the mortgage interest deduction, the charitable giving deduction, and the deduction for state and local income tax payments, Kautter consistently noted that each should be viewed as part of the entire proposal when it is released, and not in isolation.

"I think as part of tax reform we should look at every individual provision in the Internal Revenue Code, and I think what we do should be viewed as a comprehensive package, so I think every provision of the code should be on the table, and components of the tax reform package are interdependent," he said.

The Trump administration has called for repealing all current-law tax incentives *except* for those tied to the mortgage interest payments, charitable giving, and retirement savings. The House Republican blueprint would retain the deductions for mortgage interest and charitable giving and eliminate most others. Both would trade the elimination of current-law incentives for a significant increase in the standard deduction

Senate vote next

Kautter's nomination now awaits a vote by the full Senate. The Senate vote had not been scheduled at press time.

— Storme Sixeas
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Senate Finance Committee consults former tax policy chiefs on tax reform

In a hearing on July 18, members of the Senate Finance Committee sought to keep the tax reform ball rolling by soliciting advice from tax policy professionals from previous administrations. The committee invited four of the most recent Treasury assistant secretaries for tax policy to provide their thoughts on what principles should guide the discussion going forward.

Corporate integration

Potentially breathing new life into an idea discussed often in 2016, several witnesses discussed the use of corporate integration to alleviate some problems with the current system.

Finance Committee member Rob Portman, R-Ohio, asked the panel of witnesses about the deductibility of interest expenses and how this has influenced the tax code's preference for debt over equity.

Two panelists, Pamela Olson (who served as assistant secretary for tax policy from 2002-2004) and Jonathan Talisman (who served in that role from 2000-2001), said that corporate integration would be more effective at addressing Portman's concerns than a limitation on interest deductions, which could have harmful consequences on smaller businesses who cannot raise capital in equity markets.

Corporate integration would eliminate the double taxation that occurs when business activity is taxed twice, once at the entity level and again when money is earned by shareholders or paid out to them in the form of capital gains or dividends. Finance Committee Chairman Orrin Hatch, R-Utah, has been an outspoken advocate of corporate integration and has spent considerable time over the past few years developing a proposal that would couple a dividends-paid deduction with a withholding tax on both interest and dividend payments. (A formal proposal or detailed outline has not yet been released, however.)

Passthrough issues

Finance Committee ranking Democrat Ron Wyden of Oregon criticized the Trump administration's proposal to lower the tax rate for passthrough entities to 15 percent, contending that it "could create a massive new tax shelter" by tempting passthrough owners to recharacterize wage income as more lightly taxed business income.

Talisman agreed that the proposal, if enacted, could be costly and prone to abuse and that Congress would need to develop rules for segregating service income from capital income. He also suggested that Congress could provide tax relief to owners of passthrough entities through a payroll tax credit rather than a rate cut.

Finance Committee member John Thune, R-S.D., commented that revamping the passthrough tax system would require the adoption of special rules to promote parity with the tax treatment of corporations, prevent abuse, and still be administrable.

Talisman and Olson agreed that developing anti-abuse rules would be essential. Eric Solomon, who served as assistant Treasury secretary for tax policy from 2006-2009, commented that Congress would need to create "baskets" of income that would flow through at the lower tax rate and also would need to develop a formula to calculate the compensation component.

Can base-broadening lower the rate?

Witnesses and committee members alike appeared skeptical over whether it would be possible through base-broadening alone to lower the US corporate tax rate to a level that would make it truly competitive with the tax rates of US trading partners. Finance Committee member Mark Warner, D-Va., noted that as a general rule every 1-percentage-point reduction in the corporate rate requires $100 billion in revenue (over 10 years) to be revenue neutral. Thus, moving from the current rate of 35 percent to 15 percent (the target set by the Trump administration) would require roughly $2 trillion in new offsetting revenue.

However, Mark Mazur, who served as assistant secretary for tax policy from 2012 to 2017, cautioned that rate reduction becomes more expensive as the rate goes lower, meaning a 20 point reduction could cost even more than $2 trillion.

Additional revenue sources?: Warner commented that he is in favor of a much lower corporate rate but wondered whether there are enough corporate tax expenditures that could be sacrificed to get the rate as low as the Trump administration wants. Noting that many of our foreign competitors with low tax rates also manage to raise "dramatically" more revenue than the US, Warner asked the witnesses whether Congress should consider looking for new sources of revenue in addition to identifying an array of potential base broadeners.

Mazur replied that "if you want to look like another country with a low corporate rate, you need another tax source. You can't just broaden the base and lower the rate."

Olson and Solomon agreed that lawmakers should do as much as possible to reduce the rate through base broadening and then consider the possibility of new revenue sources. Talisman commented that adding a new revenue source to the tax code would require a bipartisan approach to tax reform since lawmakers would have to sell the idea to the public.

One option discussed by several members in both parties is the addition of a consumption tax, likely similar in structure to a value added tax. Sen. Johnny Isakson, R-Ga., asked the panelists to weigh in on consumption taxes. Sen. Ben Cardin, D-Md., urged the committee to consider his prior proposal for what he calls a progressive consumption tax.

Olson agreed that consumption taxes could be added to a "portfolio of taxes" to allow the corporate rate to be more competitive. Mazur agreed that many of our trading partners use consumption taxes to reduce other taxes, but said doing the same thing in the US could be politically difficult.

One of the arguments against consumption taxes is that they are regressive, meaning they fall harder on those making less money, because those individuals consume a larger portion of their income than people at the top. In response to a question from Sen. Bill Cassidy, R-La., Olson stated that regressivity could be addressed by increasing the Earned Income Tax Credit or removing more people from income tax rolls (presumably by increasing the standard deduction). She also added that economists believe the consumption tax base to be better for economic growth.

State and local tax deduction

On the individual side of the tax code, one of the more controversial base broadeners in the administration's tax reform "principles" (released on April 26) and the House Republican tax reform blueprint (released in June of last year) is a proposal to eliminate the deduction for state and local taxes paid.

Finance Committee Democrats Robert Casey of Pennsylvania and Robert Menendez of New Jersey spoke against removing this deduction.

Talisman said that the deduction was enacted to relieve double taxation and that repealing it would be tantamount to imposing "an unfunded mandate" on states. He also compared it to the foreign tax credit, which operates in a similar fashion for income already taxed by another jurisdiction outside the US, and pointed out the foreign tax credit is not labeled as a tax expenditure while the state and local deduction is.

Olson and Solomon noted that all tax expenditures need to be on the table as part of tax reform but added that Congress should examine each one in the context of a tax simplification effort and determine whether the benefits a particular expenditure provides outweigh the complexity it adds to the tax code.

Going forward

In his opening remarks, Hatch alluded to some procedural issues facing the committee going forward. One large issue will be whether the Congress moves forward in a bipartisan effort to permanently reform the code or uses instead opts for a rate cut that likely would have to be temporary to comply with budget reconciliation rules.

In response to questions from Sen. Claire McCaskill, D-Mo., the witnesses generally agreed that it would not make sense to make significant structural changes to the tax code unless those changes are permanent.

Several Democratic taxwriters spoke out against moving tax reform under reconciliation, which they said essentially shuts the minority out of the process, and criticized the fact that the White House and GOP congressional leaders appear to be bypassing the committee process and developing a tax reform plan behind closed doors.

McCaskill asked Chairman Hatch if the Finance Committee will hold a hearing once a specific tax reform plan has been unveiled.

"I would like to but I don't know," Hatch said.

— Jacob Puhl
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Former Ways and Means chair cautions against retroactivity in tax reform

Former House Ways and Means Committee Chairman Bill Archer, R-Texas, on July 19 cautioned current taxwriters against enacting retroactive provisions for revenue reasons as they proceed with tax reform legislation this year.

Archer, who chaired the House taxwriting panel from 1995-2001, made his comments at a Ways and Means Tax Policy Subcommittee hearing on how tax reform can benefit individuals and families. Specifically, he noted that one of the "major failings" of the 1986 tax reform act was the inclusion of "major changes" that took effect retroactively.

Those 1986 Act provisions, which Archer did not specify but which appear to be the repeal of the passive activity loss rules under section 469, "undermined the value of real estate in the country and brought about the demise of thousands and thousands of savings and loans, which cost the federal government well over $125 billion to correct. That was avoidable if you simply made the change prospective," he said.

Simple, permanent reform preferred

In his opening remarks at the hearing, subcommittee Chairman Peter Roskam, R-Ill., described problems with the current tax code and some of the proposed solutions in the House GOP tax reform blueprint released June 24, 2016. Major simplification initiatives for families include consolidating childcare and dependent care credits as well as doubling the standard deduction, which could eliminate the need to itemize for as many as 95 percent of filers. Additionally, the blueprint would reduce the current seven income tax brackets to three and provide a lower top marginal rate.

Subcommittee member Kenny Marchant, R-Texas, pointed to the alternative minimum tax (AMT) as one of the primary sources of complexity in the current code. Former Ways and Means Committee Chairman Archer agreed, saying the AMT makes no sense and adds needless complexity.

Rep. George Holding, R-N.C., likewise said he believes the AMT is unfair in addition to being complicated, and that this complexity has increased reliance on tax preparation professionals.

Bernard F. McKay of the Council for Electronic Revenue Communication Advancement discussed how electronic filing has helped families spend less time filing their taxes. In his prepared testimony, he said that the language used in the tax code needs to be simple enough for ordinary people to understand.

In response to a question from Rep. Carlos Curbelo, R-Fla., on taxpayers' growing reliance on professional tax preparers and tax preparation software, McKay said he believes the annual "ritual" of going through the family finances is beneficial, but that Congress can still streamline the code to help make the process less painful.

Helping the middle class

While there was consensus that the code as written has too many carve-outs and needs to be simplified, there was disagreement over how best to help the middle class. Archer argued against using tax credits to make social changes, saying they create unnecessary complexity. But Eric Rodriguez of UnidosUS argued the opposite, commenting in response to a question from Rep. Linda Sanchez, D-Calif., that current-law provisions like the Earned Income Tax Credit and child tax credit do more than any other programs to help families get out of poverty and join the middle class.

Some Democrats argued that Republican tax reform proposals would pay for tax relief for upper-income individuals by cutting spending for government programs that benefit low- and middle-income families.

Rep. Suzan DelBene, D-Wash., said the relatively small tax cuts for middle-income families in the House GOP blueprint and the Trump administration's tax reform principles cannot make up for the lost services. Subcommittee ranking member Lloyd Doggett, D-Texas, likewise expressed concern that programs promoting education, job training, and health care could suffer if tax reform focuses primarily on the wealthiest Americans.

Retirement savings incentives (still) needed

Jania Stout of Fiduciary Plan Advisors discussed the importance of retaining current retirement incentives, arguing that eliminating or significantly modifying them could cause lasting problems. She cited statistics showing how individuals with access to workplace retirement savings plans save at higher rates compared to those whose workplaces do not offer such vehicles.

Rep. Dave Reichert, R-Wash., asked Stout for her opinion of legislation he has introduced with Ways and Means member Ron Kind, D-Wis., that would allow unrelated small businesses to pool their retirement plans. Stout replied that any provision that makes it easier for employers to offer and administer plans will boost employee participation.

Rep. Pat Tiberi, R-Ohio, noting that Stout's written testimony cautioned against equating consolidation of retirement plans with simplification, asked why it is important for the tax code to incentivize different types of retirement plans. Stout replied that each different type of plan was created to address the needs of specific types of employers, and that consolidation could leave people with fewer choices in retirement savings.

Stout also explained that caps on retirement contributions could lead fewer employers to offer retirement plans as they reduce interest in participation.

Rep. Doggett contended that current-law retirement incentives are primarily skewed to the wealthy and stated that Congress needs to develop plans more specifically targeted to the middle class.

Unidos's Eric Rodriguez agreed with Doggett that current-law retirement incentives primarily benefit those who already participate in retirement savings plans and do little to bring in new savers – primarily those at the lower end of the income spectrum. He also cautioned against what he called the proliferation of "Roth"-style retirement plans that permit individuals to make contributions with after-tax funds and receive distributions tax-free during retirement. This "Rothification" of the retirement system, as he called it, could lead to an explosion of tax expenditures that would "squeeze" the federal budget in future years.

Permanence, bipartisanship

Several subcommittee members asked Archer to discuss his view on the importance of enacting permanent tax reform.

In response to a question from Dave Reichert, Archer emphasized that taxpayers need certainty and should not have to worry about dramatic, unanticipated changes to the tax code.

Archer repeated the argument about certainty when asked by Rep. Kristi Noem, R-S.D., about the wisdom of enacting temporary tax “extenders” provisions. He explained that all tax provisions will eventually need to be modified in some way, and it may make sense for some targeted provisions to have a limited shelf life. What does not make sense, however, is to enact temporary provisions strictly for revenue reasons, he said.

In response to a question from Suzan Del Bene, Archer was unequivocal on the need for bipartisanship in tax reform.

“Both parties should be a part of it, otherwise it seems to me it’s not going to be as long lasting as it should be,” he said.

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