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Brady outlines path forward for tax reform, Trump seeks Democratic support

As congressional Republican leaders and the Trump administration continued to talk up their tax reform agenda, House Ways and Means Committee Chairman Kevin Brady, R-Texas, revealed this week that the so-called "Big Six" tax reform negotiators will share an outline of their plan with taxwriters later this month and the White House stepped up its efforts to win support from "red state" Democrats.

Outline on the way

At one of several recent meetings on tax reform with House Republicans, Brady on September 13 laid out a schedule for his colleagues that includes release to rank-and-file members the week of September 25 of a document outlining the direction that tax reform will take. That will be followed by House passage of a fiscal year 2018 budget resolution by mid-October, and then a legislative mark-up by the Ways and Means Committee.

The Big Six – Brady, Senate Finance Committee Chairman Orrin Hatch, R-Utah, Senate Majority Leader Mitch McConnell, R-Ky., House Speaker Paul Ryan, R-Wis., Treasury Secretary Steven Mnuchin, and Economic Council Director Gary Cohn – have been working all summer to develop a single consensus blueprint for tax reform, hoping to avoid the intra-party disagreements that arose during the health care debate earlier this year. Members of the Big Six have said they intend to provide Congress with a proposed outline – what Brady described to reporters on September

13 as “a consensus document with the core elements of big, bold tax reform” – and then rely on the taxwriting committees to finalize the legislation. It is unclear exactly what level of detail will be left to Congress, but expectations are that the outline will include the basic components and then allow taxwriters to move some of the various “levers” of policy in order to determine precise tax rates, enactment dates, transition rules, and other specifics.

“The whole point of all of this is the House, the Senate, and the White House are starting from the same page and the same outline, and taxwriters are going to take it from there,” said Ryan at a House meeting on September 13.

While the taxwriting committees may be starting from the same point, however, Hatch made it clear on September 14 that the Senate Finance Committee will not necessarily reach the same conclusions as its House counterpart.

“Any forthcoming documents may be viewed as guidance or potential signposts for drafting legislation, but at the end of the day, my goal is to produce a bill that can get through this committee.” he said during a hearing on individual tax reform, adding, “[a]nyone with any experience with the Senate Finance Committee knows that we are not anyone’s rubber stamp.” (See separate coverage in this issue for additional details on the Finance Committee hearing.)

Hints and innuendo

Details of the Big Six’s tax plan remain scarce, but negotiators did drop some breadcrumbs this week on their thinking about a couple of issues – while also making it evident that there are still big decisions outstanding.

Corporate rate: President Trump, Treasury Secretary Mnuchin, and White House Legislative Affairs Director Marc Short, all said this week that the administration’s goal is still a 15 percent tax rate for businesses, but at separate events both Mnuchin and Short acknowledged that this might prove unattainable. (Congressional leaders have previously made similar comments, while noting that they are targeting a rate as low as possible.) Mnuchin said September 14 that the forthcoming outline from the Big Six will include a specific corporate rate proposal.

Passthrough rates: Short also said that he is committed to bringing the rate for passthrough entities (which currently are taxed on the individual side of the tax code) into line with the corporate rate, but Mnuchin specified that passthrough service companies, such as accounting and law firms, will not be included in such a provision.

“If you earn money that’s clearly income – if you’re an accountant firm and that’s clearly income – you’ll be taxed at income rates – you won’t be taxed at passthrough rates,” Mnuchin said at a CNBC event on September 12. “If you’re a business that’s creating manufacturing jobs you’re going to get the benefit of that rate because that’s going to be passed through to help create jobs and better wages.”

Ways and Means Chairman Brady has said that negotiators have not yet made a final determination on the treatment of passthroughs.

Retroactivity: Mnuchin also said that negotiators are considering making the tax package retroactive to the beginning of 2017. This could have a significant impact on individual taxpayers – a fact not lost on members of Congress facing re-election in 2018 – but some analysts argue that retroactive policy, especially if enacted in the last quarter of the year, is not beneficial for the economy because businesses won’t suddenly make new hiring or investment decisions this year that would spur growth.

“Retroactive tax cuts are one of the absolute worst tax reforms one can pass,” said Maya MacGuineas, president of the nonpartisan Committee for a Responsible Federal Budget. “They do nothing to change incentives and can have very negative effects if deficit financed. Policymakers should focus on how to offset the cost of the tax cuts they want to enact, not providing tax cuts to incentivize people to do things they have already done.”

Expensing limits, interest expense deductions: Comments from various officials in recent weeks suggest that tax reform negotiators intend to scale back a proposal in the 2016 House Republican tax reform blueprint that called for 100 percent expensing in year one of most tangible and intangible assets (which the nonpartisan Tax Foundation has estimated would cost the government $2.2 trillion in lost revenue over 10 years on a static basis). Negotiators have begun referring to “unprecedented expensing” instead, signaling something more generous than current policy known as bonus depreciation but short of immediate full expensing.

Marc Short made that point even more explicitly in comments at a September 12 event sponsored by the *Christian Science Monitor*.

“On the expensing front, we do not believe expensing should be prioritized at the expense of rates. We’re more interested in prioritizing lower rates,” he said.

Ways and Means Chairman Brady also indicated in remarks at an event sponsored by *Politico* September 14 that limitations on the deduction for net interest expenses – a proposal that has frequently been paired with more generous expensing limits – also will be addressed in the forthcoming outline from the Big Six. He indicated that the provision will include some carve-outs to address the concerns of certain sectors that do not have access to capital markets.

“We will continue to work toward some changes, but in a way that creates certainty and helps us grow the economy in a big way,” he said.

Rates for upper-income individuals: President Trump this week muddied the waters on the issue of individual tax rates when he repeated a talking point on September 13 that the tax package will be focused on relief for the middle class and will not benefit the wealthiest taxpayers, but then added a new twist by appearing to suggest that the top rate could increase.

“The wealthy will be pretty much where they are. If we can do that, we’d like it,” the president said. “If they have to go higher, they’ll go higher, frankly.”

However, this does not necessarily comport with the House Republican’s 2016 tax reform blueprint or the president’s own proposals offered during his campaign or included in the statement of tax reform principles the administration released earlier this year, which have been unofficially estimated to result in lower tax bills for upper-income individuals. While Republicans have advocated scaling back or repealing some current tax incentives – such as the deductions for mortgage interest and state and local taxes – that some say disproportionately benefit wealthy households, they have also proposed cutting the top income tax rate and the rate on investment income, and repealing the estate tax and the alternative minimum tax, all of which would tend to benefit higher-income taxpayers.

Budget resolution: Chicken or egg?

Most Republicans believe tax reform will have to be done using the fast-track budget reconciliation process that allows for passage in the Senate by a simple majority rather than the three-fifths majority typically required to overcome procedural hurdles in that chamber; but for that to happen, the House and Senate must first agree to an FY 2018 budget resolution that includes reconciliation instructions authorizing a tax reform package.

The House Budget Committee passed its version of a budget resolution in late July; but a vote by the full House has been held up by members of the conservative House Freedom Caucus who are demanding to see details of the tax reform proposal first.

“We will guarantee that we have enough information before we vote for the budget,” Freedom Caucus Chairman Mark Meadows, R-N.C., told reporters September 13.

Conversely, Ways and Means Chairman Brady says the taxwriters need the budget resolution and its revenue targets in order to determine the details of a tax reform bill. A Republican headcount on the budget resolution right after Labor Day showed there were not enough votes for passage. (The Freedom Caucus includes roughly three dozen members – enough to sink the proposed budget resolution if they were to join the chamber’s Democrats in voting against the measure.) But Budget Committee Chairwoman Diane Black, R-Tenn., is pushing leadership to bring it to the floor regardless and essentially dare conservatives to oppose the vehicle for tax reform. (The House is scheduled to be out of session for a district work period the week of September 18, so the earliest possible timing for a floor vote on the budget resolution would be the week of September 25.)

On the other side of the Capitol, Treasury Secretary Mnuchin and Economic Council Director Cohn met with members of the Senate Budget Committee on September 12 to try and jumpstart the process there. According to Sen. John Thune, R-S.D., who sits on both the Budget and Finance committees, Senate Republicans are considering whether to do a “full-blown” budget like that passed by the House committee or a slimmed-down “shell” version – similar to the one used to pass the FY 2017 reconciliation instructions for the health care bill – that would simply serve as a vehicle for fast-track tax reform. The latter option is likely to face strong opposition in the House, especially from more conservative members eager to show their support for policy changes that would put the country on a path to having a balanced budget in 10 years.

Wooing the Democrats

While tax reform done using reconciliation would theoretically preclude the need for any Democratic support, the Trump administration has been making overtures to Senate Democrats that it sees as potential swing votes. Marc Short, the White House legislative affairs director, said this week that the failure this year to repeal and replace the Affordable Care Act demonstrated that Republican support in the Senate is “not reliable” and prompted the administration to open dialogue with Democrats.

As part of that initiative, Trump invited Democratic Sens. Joe Donnelly of Indiana, Joe Manchin of West Virginia, and Heidi Heitkamp of North Dakota (along with Republican Sens. Hatch, John Cornyn of Texas, Ron Johnson of Wisconsin, and Pat Toomey of Pennsylvania) to discuss tax reform at a White House dinner on September 12. Donnelly, Manchin, and Heitkamp are the only three Democratic senators who did not sign on to a recent letter that laid out the party’s conditions for moving bipartisan tax reform legislation. All three are running for re-election next year in states where President Trump won in 2016 by sizeable majorities, and were the only Democrats who crossed the aisle to vote for Trump-nominated Supreme Court Justice Neil Gorsuch in April.
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170804_1suppA.pdf

None of the three sits on the Finance Committee – and that panel’s ranking Democrat, Oregon Sen. Ron Wyden, commented this week that he has yet to hear from the president on tax reform and that “an awful lot of time has been frittered away” by not including his party in discussions.

Additional outreach planned: The administration’s outreach is not a one-shot effort. Last week, Trump also gave a speech in North Dakota to pitch tax reform and included Heitkamp on the Air Force One flight to the event and on the platform for his remarks. (For prior coverage, see *Tax News & Views*, Vol. 18, No. 30, Sep. 8, 2017.) Moreover, Vice President Mike Pence, who is from Indiana, has plans to visit his home state at least three times over the next month to talk tax reform and ramp up the pressure on Donnelly.
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170908_1.html

In the coming weeks, the president also plans to hold as many as 13 outside-the-Beltway rallies to continue making the case for reform – once again focusing on states that he carried last year and are represented by a Democratic senator facing a competitive re-election race in 2018.

But the president this week also sent signals that he does not necessarily consider bipartisanship as essential to the tax reform process. In a September 13 meeting with the Problem Solvers Caucus in the House, which includes members of both parties, Trump reportedly told attendees that he wants to give bipartisanship on tax reform “a shot.” But he quickly added, “…if it works out, great. And if it doesn’t work out great, hopefully we’ll be able to do it anyway, as Republicans, ok?”

Republican leaders weigh in: For their part, congressional Republicans have made references to welcoming input on tax reform for their colleagues in the minority but have generally expressed skepticism that that they will receive much, if any, Democratic support.

“It most likely will get done through reconciliation,” Thune said following the September 12 bipartisan dinner at the White House. “It would be great if it gets done with Democrat votes, but I don’t know how you get eight Democrats to vote for something.”

Ways and Means Chairman Brady likewise said at an event sponsored by *Politico* September 14 that “there’s common ground” for Democrats and Republicans to build on when it comes to reforming the tax code. But he also pointed to President Trump’s recent outreach efforts as a cautionary tale for Republicans.

“If Republicans aren’t willing to unite and deliver on tax reform, he’ll find someone else,” Brady said.

— Storme Sixeas
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Witnesses urge Senate taxwriters to drop ‘Rothification’ as tax reform revenue source

Witnesses and lawmakers representing both sides of the aisle at a September 14 Senate Finance Committee hearing on individual tax reform were skeptical of proposals aimed at raising revenue for a tax code overhaul by limiting future defined contribution retirement plan offerings to “Roth”-only accounts.

Revenue stream or timing gimmick?

Under current law, participants in defined contribution plans generally can choose between traditional 401(k) and individual retirement accounts – in which contributions are made with pre-tax funds, earnings accumulate tax deferred, and tax is imposed only as amounts are withdrawn during retirement – and so-called “Roth” style accounts, in which contributions are made with after-tax funds and distributions are paid out tax-free during retirement. (Roth accounts are named for former Finance Committee Chairman William Roth, R-Del.)

White House and congressional negotiators mulling an outline of a tax code overhaul are reportedly considering a transition to a Roth-only system that would raise revenue in the near term to help offset the cost of lower rates and other tax priorities.

At the Finance Committee hearing, some Democratic taxwriters – including Tom Carper of Delaware, Sherrod Brown of Ohio, and Ben Cardin of Maryland – argued that ‘Rothification’ and similar timing changes that are imposed strictly for revenue reasons could destabilize the retirement system.

According to Brown, the proposal “would take away freedom from American families to choose the retirement savings plan that works best for them and force everyone into a Roth account, slapping taxes on middle class families.” He added that Democrats would not support a transition to a Roth-only retirement plan system to pay for rate cuts for upper-income individuals. (Brown and several other Finance Committee Democrats also argued against the proposal in a September 14 letter to the so-called “Big Six” congressional leaders and administration officials who are currently developing a consensus blueprint on tax reform.)
URL: https://www.brown.senate.gov/newsroom/press/release/senators-draw-line-on-tax-reform-workers-retirement-savings-will-not-bankroll-corporate-tax-cuts

Among the witnesses, Lily Batchelder of New York University School of Law – and a one-time tax aide to former Finance Committee Chairman Max Baucus, D-Mont. – called this proposal a “timing gimmick” that would generate revenue in the short term as contributions are made but would reduce revenue in the future as funds are withdrawn tax-free in retirement. She also cautioned that this is a dramatic change in policy and said reducing choices could cause problems because “different families have different incentives whether they should select to save on a Roth basis or on a traditional basis.”

Across the aisle, Finance Committee member Rob Portman, R-Ohio, questioned the advisability of Rothification from the standpoint of its effect on long-term revenue and its potential impact on savings behavior. Portman cited statistics suggesting that relatively few individuals opt for Roth-style accounts under current law and asked witnesses whether a shift to a Roth-only system would reduce individual retirement savings rates.

Alex Brill of the American Enterprise Institute – and a former Republican staff member of the House Ways and Means Committee – agreed with Portman that real-world evidence suggests fewer individuals prefer Roth plans, but he added that it would be difficult to determine how mandatory Rothification would affect future savings rates. (In response to an earlier question from Carper, he also said he agreed with Batchelder’s concern about the potential long-term revenue impact of such a proposal.)

Batchelder told Portman that if Congress wanted to pursue such a policy it should have the Joint Committee on Taxation model the potential long-term impact on retirement savings rates.

Mortgage interest, state and local tax deductions

Opinions broke along more traditional party lines as lawmakers discussed other potential revenue raising provisions such as reducing or eliminating the deductions for mortgage interest and for state and local taxes.

Progressive change?: Finance Committee Chairman Orrin Hatch, R-Utah, asked witnesses whether repealing the deduction for state and local taxes would promote progressivity in the tax code.

Batchelder – who argued in her opening testimony that tax reform should at a minimum retain the same level of progressivity as the current tax code – replied that the answer depended on how the resulting revenue was used. She said current proposals from the administration and the House Republican tax reform blueprint would use that revenue to reduce rates for upper-income individuals and passthrough owners – a result that would not be progressive. On the other hand, using that revenue to expand the earned income tax credit and the child tax credit would promote progressivity, she said.

Brill said that repealing the deduction would be progressive "in isolation" and could raise up to $1.4 trillion in revenue during the 10-year budget window.

Iona Harrison of the National Association of Realtors (NAR) suggested that repealing the deduction would be regressive, noting in her opening statement that "70 percent of the value of real property tax deductions in 2014 went to taxpayers with incomes of less than $200,000, and 53 percent of those claiming the itemized deduction for real estate taxes that year earned less than $100,000." She also noted to Hatch that individuals continue to pay property taxes even after they have paid off their mortgages and are no longer able to deduct mortgage interest.

Unfair subsidy?: Republican taxwriter Pat Toomey of Pennsylvania argued that the state and local tax deduction creates a system under which low-tax states subsidize high-tax states. But Democrats defended the deduction. Ben Cardin of Maryland argued it would violate the principles of federalism to tax the income already taxed by the states and Maria Cantwell of Washington said that repealing the deduction would be "wrong-headed."

Among the witnesses, Alex Brill of the AEI agreed with Toomey that the deduction unfairly subsidizes individuals in high-tax states at the expense of those in low-tax jurisdictions.

In her opening statement, the NAR's Iona Harrison rejected the subsidy argument by comparing the deduction to the foreign tax credit.

"Interestingly, few if any suggest that the far more generous credit for taxes paid to a foreign government subsidizes spending by those nations," she said.

Mortgage interest: The mortgage interest deduction also sparked some debate. Seen by many as a pathway to building wealth, the deduction is also criticized for subsidizing more expensive home purchases (up to $1 million in total loan principal on a primary residence and a qualifying second home).

Finance Committee members Dean Heller, R-Nev., and Debbie Stabenow, D-Mich., argued that the deduction is an important wealth-building tool for the middle class.

Harrison agreed with that position and noted in her opening statement that capping the mortgage interest deduction would create undue burdens to lower- and middle-class taxpayers who live in high-cost areas. In response to a question from Heller, she contended the transfer of real property is an economic driver and that that limiting the deduction for mortgage interest (and for state and local taxes) would impede wealth building through home ownership.

Democratic Sen. Claire McCaskill of Missouri appeared more skeptical of the long-term benefits of the deduction and asked Harrison if she was aware of any studies that address whether eliminating or limiting the mortgage interest deduction would cause existing home owners to consider renting their next property rather than purchasing it when making the decision to move.

Harris replied that she was not aware of any such studies and stated that the deduction was added to the code to promote home ownership generally, not simply to encourage first-time buyers to get into the housing market.

Passthrough issues

At several points during the hearing, Finance Committee ranking Democrat Ron Wyden of Oregon criticized a Trump administration proposal to lower the rate on passthrough entities to 15 percent, stating that such a proposal was ripe for abuse by certain wealthy passthrough owners seeking to recharacterize wage income as more lightly taxed business income. (The administration has said that it intends to offer anti-abuse rules to prevent such a result, but has so far provided no details on what those rules might look like.)

Lily Batchelder, responding to a question from Sen. Debbie Stabenow, D-Mich., about how lawmakers can avoid unintended consequences in tax reform, cautioned that the administration's passthrough proposal would create "a giant new loophole in the tax code" that would cost the government an estimated $2 trillion. Between 30 and 50 percent of that amount, she claimed, would result from individuals "avoiding taxes" by recharacterizing income. She argued that the proposal would benefit "sophisticated taxpayers that can access fancy tax advice" but would do nothing for the bulk of small-business taxpayers who are already taxed in the lower rate brackets.

Retroactive tax code changes

Sen. Johnny Isakson, R-Ga., cautioned against making retroactive changes to the tax code such as the repeal of the passive activity loss rules in the Tax Reform Act of 1986. (Former House Ways and Means Committee Chairman Bill Archer, R-Texas, made a similar argument when he appeared as a witness at a Ways and Means hearing on tax reform in July. For prior coverage, see *Tax News & Views*, Vol. 18, No. 26, July 21, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170721_5.html

Brill agreed that these types of decisions need to be made carefully and added that the prospect of significant tax law changes being enacted retroactively could stifle entrepreneurship in the future.

Other discussions

Ramesh Ponnuru of the American Enterprise Institute, argued in his opening remarks that the child tax credit should be expanded to lift more families out of poverty.

Members from both sides raised questions regarding improving the child tax credit. Sen. Michael Bennet, D-Colo., asked if there was a way to make it more beneficial. Ponnuru suggested reducing the threshold for phase-in and making the credit refundable against payroll taxes as well as income taxes.

Other ideas for strengthening the middle class included increasing education credits and expanding the earned income tax credit.

In response to questioning from Sen. Robert Casey, D-Pa., Batchelder advocated for expanding the number of refundable credits, as households earning less than the standard deduction and personal exemptions, arguably the most vulnerable households, are ineligible for nonrefundable credits.

IRS budget

In a discussion about raising revenue to fund government operations, Sen. Carper criticized efforts by Congress in recent years to cut the Internal Revenue Service's operating budget – particularly in the areas of technology and enforcement – arguing that investing in these priorities can pay off in the form of more efficient customer service and increased revenue collections.

Batchelder called for "substantially increasing" the IRS budget and noted that funding enforcement operations is "an easy way to collect revenue from people who legally owe it."

In a related development, the House on September 14 voted 211-198 to approve a fiscal year 2018 appropriations bill (H.R. 3354) that would, among other things reduce IRS funding by more than $140 million over fiscal year 2017 levels. That measure now heads to the Senate for consideration.

Going forward

In an effort to assuage concerns among some committee members that tax reform is being negotiated without them, Hatch assured the panel that they would have time to review and consider any proposal released by the Big Six – that is, Hatch, Ways and Means Committee Chairman Kevin Brady, R-Texas, House Speaker Paul Ryan, R-Wis., Senate Majority Leader Mitch McConnell, R-Ky., Treasury Secretary Steven Mnuchin, and White House National Economic Director Gary Cohn. (The group is expected to unveil its outline of a tax reform proposal later this month. See separate coverage in this issue for details.)

Hatch said he does not intend for the Finance Committee to simply "rubber stamp" the Big Six plan and added that any legislation that moves through the committee will reflect the consensus view of the panel. He added that he would prefer for tax reform to be a bipartisan exercise but said he would not abandon plans to move tax reform under budget reconciliation protections as a precondition for gaining Democratic cooperation.

Next up: Business tax reform

Hatch announced this week that the committee's next tax reform hearing will focus on "ways to improve the US tax code's business provisions and create a healthier economic environment that will encourage job creators to invest in the United States and increase their competitiveness in the global market." The hearing is set for September 19 at 10:00 a.m.

Witnesses will include Scott Hodge of the Tax Foundation, Donald Marron of the Urban Institute & Urban-Brookings Tax Policy Center, Troy Lewis, former chairman of the American Institute of Certified Public Accountants, and Jeffrey DeBoer of The Real Estate Roundtable.

— Jacob Puhl
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Tax relief package for Harvey, Irma victims in the works, Brady says

House Ways and Means Committee Chairman Kevin Brady, R-Texas, said this week that his panel intends to expedite legislation aimed at providing tax relief for businesses and individuals affected by Hurricanes Harvey and Irma.

Although few details are currently available, Brady – whose own district felt the impact of Hurricane Harvey – recently told reporters the package is likely to include temporary provisions that would waive certain penalties for hurricane victims who need emergency access to funds in their qualified retirement plans, relax current-law rules for deducting casualty losses, and expand charitable-giving incentives to encourage donations for hurricane-related disaster relief. Taxwriters are "consulting with our members and our communities now" and will "tailor" the provisions of an eventual tax package "to our communities and their needs going forward," he said.

Brady told reporters September 12 that House Speaker Paul Ryan, R-Wis., would like to see the legislation clear Ways and Means by the end of this month. The tax provisions could be attached to the next disaster-relief spending package to move through Congress, Brady said. (President Trump signed legislation on September 8 that makes a $15 billion down payment on relief for victims of Hurricane Harvey and suspends the statutory debt limit and extends government funding through December 8 of this year. For prior coverage, see *Tax News & Views*, Vol. 18, No. 30, Sep. 8, 2017.)
URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170908_1.html

According to Brady, action on a disaster-relief tax bill will not alter the Ways and Means Committee's schedule for working on tax reform legislation. (See separate coverage in this issue for the latest developments on tax reform.)

"It does take some time because we want to make sure we get the [disaster-relief] tax provisions right. But we are continuing to stay on the timetable on tax [reform]," he said.

— Michael DeHoff
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