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Senate GOP closes in on tax-cutting budget plan as ‘Big Six’ readies release of tax reform framework

Senate Budget Committee Republicans Bob Corker of Tennessee and Pat Toomey of Pennsylvania are said to have shaken hands this week on a tentative deal to include fiscal room for a net tax cut in the range of $1.5 trillion in a still-developing Senate budget resolution for fiscal year 2018; meanwhile, details of just what a tax code overhaul will look like remained unclear as members of the “Big Six” negotiating team prepared for the upcoming release of their promised tax reform outline.

Corker-Toomey deal aimed at unlocking ‘budget reconciliation’

Corker and Toomey reportedly were seen exiting the office of Senate Majority Leader Mitch McConnell, R-Ky., along with Budget Committee Chairman Mike Enzi, R-Wyo., on September 19. The subsequent handshake deal between the fiscal hawk (Corker) and avid tax-cutter (Toomey), was interpreted by some observers as a small breakthrough in congressional Republicans’ pursuit of a fiscal year 2018 budget resolution intended to carry subsequent tax legislation through the Senate on a filibuster-proof basis. (The Senate Budget Committee is charged with drafting the 2018 budget plan in that chamber.)
This would be done through the inclusion of so-called “budget reconciliation” instructions, which allow conforming legislation to be subsequently passed in both chambers of Congress with simple majority votes – a potentially powerful tool for Republicans who currently control 52 Senate seats. (Normally, legislation must garner a three-fifths majority – or 60 votes – in order to clear procedural hurdles in the Senate.)

The tentative deal, therefore, raises the specter of the Senate GOP drafting a budget plan that calls on the two congressional taxwriting panels – the Senate Finance Committee and the House Ways and Means Committee – to report legislation that reduces federal revenues by roughly $1.5 trillion (likely over the 10-year budget window covering fiscal years 2018 through 2027).

One piece of a bigger puzzle

It is important to note that the Corker-Toomey deal – even if it unites the Senate GOP on a revenue target for the fiscal 2018 budget resolution – is just one piece of a broader budget puzzle congressional Republicans must assemble if they are going to unlock the budget reconciliation process. The agreement will have to be formalized in a yet-to-be-scheduled mark-up by the Senate Budget Committee and then win approval on the Senate floor. Moreover, any budget resolution that clears the Senate will have to be negotiated against a separate resolution from the House. (Both the House and Senate must adopt an identical budget resolution to utilize reconciliation.)

House priorities may conflict: Republicans on the House Budget Committee, for their part, advanced a fiscal 2018 budget plan on July 19 that includes a broad set of reconciliation instructions aimed at expediting both revenue-neutral tax reform and significant spending cuts to entitlement programs. In total, the plan calls on 11 committees to report deficit-cutting legislation. (For prior coverage, see Tax News & Views, Vol. 18, No. 26, July 21, 2017.)

But that plan has not received a vote on the House floor and remains in legislative limbo as members of the conservative Freedom Caucus are demanding additional detail as to what tax reform will look like before they give their assent to a budget that seeks to expedite its passage. (More on that below.)

Agreeing on tax reform details a separate battle: And, of course, it is also true that agreement on a budget resolution with reconciliation instructions does not guarantee subsequent agreement on the legislation the instructions were intended to carry – as exemplified by congressional Republicans’ struggle to enact reconciliation legislation pursuant to the fiscal 2017 budget that would repeal and replace the Affordable Care Act. (See related coverage in this issue.)

In a similar vein, Sen. Corker on September 19 sought to differentiate his handshake deal with Sen. Toomey on a revenue target from the statutory changes that could be put forward later to hit that target.

"We're going to give the taxwriting committee some flexibility, and each of us know at the end of the day, we have our own vote at the end," Corker said.

Don't forget about the 'Byrd Rule': Another point worth noting is that the tentative Corker-Toomey deal – should it hold – would not absolve Republicans from having to deal with the so-called "Byrd Rule” restrictions on the reconciliation process, perhaps the most significant of which with respect to tax reform generally prohibits provisions that would increase the deficit in any year beyond the budget window (unless offset by other changes in the same legislative title).

In other words, a Corker-Toomey style revenue reconciliation instruction, if adopted, would free Republicans to pursue a net tax cut on a filibuster-proof basis, but they may have to consider sunsetting revenue-losing provisions or enacting other changes designed to offset their out-year costs.

Uncertainty around 'Big Six' tax reform outline continues

But even as the contours of a potential agreement on a budget resolution began to emerge in the Senate, “uncertainty” remained the watchword for the tax community – and for many lawmakers – as they await the release in the coming days of new GOP tax reform details from the so-called “Big Six” group of White House and congressional negotiators.
Release date not set: The outline is set for release sometime during the week of September 25. House Republican taxwriters plan to huddle to discuss details at a retreat with Ways and Means Committee Chairman Kevin Brady of Texas on September 24 and 25; President Trump is hosting conservative grassroots leaders to make his pitch over dinner on September 25; and House leaders have scheduled a conference-wide “summit” on tax reform away from the Capitol for much of the day September 27. But the Senate’s continued work on time-sensitive and high-profile health care legislation, as well as rumors of still-unresolved policy disagreements, mean the timing for a public unveiling at some point during the week remains unclear.

How detailed?: The Big Six – Brady, Senate Finance Committee Chairman Orrin Hatch, R-Utah, House Speaker Paul Ryan, R-Wis., Senate Majority Leader Mitch McConnell, Treasury Secretary Steven Mnuchin, and National Economic Council Director Gary Cohn – spent significant time during the August congressional recess working to develop a single consensus blueprint, and their comments earlier this month raised expectations that they would release a solid framework in September that would be finalized and turned into legislation by the taxwriting committees this fall. In more recent days, however, the prospects of the group providing substantial details seem to be lower.

Tax aides are now describing the anticipated product as "extremely high level," which is certain to frustrate those who have been waiting for specifics of a tax reform proposal that the administration and congressional Republicans continue to insist can be signed into law by the end of the 2017. (It also could stymie efforts to move a fiscal year 2018 budget resolution through the House if Freedom Caucus members determine that the release lacks the details they need in order to support the fiscal blueprint.)

While House Republicans published a tax reform blueprint last summer with specific proposals and tax rates, subsequent statements and documents issued this year – notably a one-page release by the Big Six in late July – have focused on “principles” rather than detailed policies.

Although members of the Big Six have hinted that their release will include specific tax rates, there are reports that it will not include many of the revenue-raising provisions necessary to offset the cost of tax cuts, a move that would bolster criticism that Republicans want to highlight the “candy” of tax reform while delaying discussion of the “vegetables.” But such a move also would keep a lid on the interest group opposition likely to accompany proposals to eliminate or pare back current incentives. The potential for drastic changes to provisions such as the state and local tax deduction, the mortgage interest deduction, and the deduction for net business interest expense have all drawn lobbying efforts this year that will only intensify if the proposals become official.

The latest breadcrumbs: For Big Six watchers collecting hints of what may be coming, this week brought small rewards. Building on recent statements by several key players, there are press reports that the negotiators will officially abandon President Trump’s target business tax rate of 15 percent, long considered by many analysts to be too low – read: costly – to be legislatively practical.

Similarly, there has been further emphasis this week on the idea that the wealthiest taxpayers should not benefit from reform, with the notion of lowering the tax rate for individuals in the top 39.6 percent bracket potentially off the table.

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Senate taxwriters discuss business tax reform, economic growth

The Senate Finance Committee continued the conversation on tax reform this week, speaking with panelists at a September 19 hearing about various ways to grow the economy by revamping the tax rules for businesses. Reducing the US statutory corporate rate seemed to be the winning answer for boosting competitiveness and spurring growth – something that Finance Committee Chairman Orrin Hatch, R-Utah, emphasized in his opening remarks. But what that lower rate could or should be remained an open question.
Rates

President Trump has stated repeatedly that the target corporate rate should be 15 percent, but few on the committee seemed to think that goal is achievable. (Chairman Hatch, for his part, commented recently that a 15 percent rate is unrealistic but he did not propose a target rate of his own during the hearing.) Much of the hearing’s discussion involved how to pay for such a dramatic rate cut, whether it could be permanent, and who would benefit most.

Donald Marron of the Urban Institute and Urban-Brookings Tax Policy Center, stated in his opening remarks that the lowest corporate rate possible under a revenue-neutral tax reform plan that repeals all current-law deductions, credits, and incentives would be 26 percent (the conclusion reached in a Tax Policy Center study released September 13).


Scott Hodge of the Tax Foundation encouraged a permanent reduction of the corporate tax rate to 20 percent, which he argued was achievable with the right tradeoffs (that is, repealing or limiting certain current-law incentives) and using dynamic scoring, which accounts for additional revenue resulting from higher growth generated by the tax law changes.

100 percent expensing

Yet others wondered if there other ways to boost growth than simply lowering the rates. In response to a question from Sen. Charles Grassley, R-Iowa, both Marron and Hodge argued that full expensing – that is, allowing businesses to write off 100 percent of a capital expenditure in the year of purchase rather than depreciating it according to a schedule – would be more effective than a rate cut at spurring growth because it would encourage new investment by businesses rather than simply reducing the taxes on their profits, which presumably have been earned already.

But Jeffrey DeBoer of The Real Estate Roundtable cautioned members that allowing expensing of structures (as was proposed in the House GOP blueprint for tax reform from 2016) could lead to a boom in construction that is not tied to demand. Instead, DeBoer cited a study from MIT that argued buildings should be depreciated over a 20-year period to more accurately reflect their so-called “useful life.” (Currently commercial real estate is depreciated over 39 years and residential real estate over 27.5 years.)

Limits on interest deductions

Grassley (among others) also asked whether limiting the ability to deduct net interest expenses was an acceptable tradeoff for lower rates and more generous expensing rules.

Hodge argued that eliminating this deduction would raise $1.2 trillion over the 10-year budget window and would be less painful than other options for generating that much revenue. He also noted that limiting the deductibility of interest could discourage earnings stripping.

Marron said the provision needs to be balanced against other options but does tend to create negative effective tax rates for certain types of investment. Nixing the net interest deduction is also widely seen as a way to equalize the tax treatment of debt and equity financing on new investment, he said. (In a later exchange with Finance Committee member Debbie Stabenow, D-Mich., however, Marron noted that small businesses generally are already able to fully expense certain capital expenditures under section 179 so taking away net interest deductibility to give them something they already have necessarily would leave them worse off.)

Overleveraging?: Chairman Hatch asked panelists if they thought the ability to deduct net interest leads to overleveraging of businesses.

Troy Lewis, former chairman of the Tax Executive Committee at the American Institute of Certified Public Accountants (AICPA), responded that equity financing is “simply not available” for many start-ups and small businesses and that limiting or eliminating the interest expense deduction would raise the cost of capital for these operations.

Jeffrey DeBoer argued that debt financing is a useful tool for businesses of all sizes and that businesses that have the ability to repay should be allowed to borrow. The issue of overleveraging, he said, should be addressed through regulations and not through the tax code.
Corporate integration

Hatch asked The Tax Foundation’s Scott Hodge whether corporate integration – that is, eliminating the double taxation that occurs when business activity is taxed twice, once at the entity level and again when money is paid out to shareholders in the form of capital gains or dividends – could serve as a “complement” to a corporate rate reduction in tax reform.

Hodge said integration would lower the effective tax rate for corporations as well as equalize the treatment of debt and equity, both of which he said would make the economy more efficient.

Hatch has been an outspoken advocate of corporate integration and has spent considerable time over the past few years developing a plan that would couple a dividends-paid deduction with a withholding tax on both interest and dividend payments, although he has not released a formal proposal. Senate taxwriter John Thune, R-S.D., told reporters after the hearing that a Finance Committee tax reform bill could include a “partial corporate integration” component.

Passthrough rates

Democrats on the taxwriting panel generally criticized proposals for steep reductions in the tax rate on passthrough businesses, which are currently taxed on the individual side of the code. (The Trump administration has proposed to tax passthroughs at 15 percent; the House GOP tax reform blueprint released last year calls for a 25 percent rate.)

Marron agreed with Wyden and Finance Committee member Claire McCaskill, D-Mo., that the administration’s proposed 15 percent rate on passthrough income would primarily benefit upper-income taxpayers since such business income is “concentrated at the high end.” He also told McCaskill that such a system would not promote new economic activity but would instead encourage recharacterization of old or current economic activity for tax-motivated reasons.

In response to a question from Chairman Hatch, the AICPA’s Troy Lewis argued that we should “encourage and not discourage the creation of passthrough entities.” He contended in his opening remarks that rules could be drafted to prohibit gaming and he encouraged codification of the “reasonable compensation” rules which are currently administered through the courts.

In his opening statement, Lewis also criticized a proposal being floated by the Trump administration that would deny preferential passthrough tax rates to service companies such as accounting and law firms.

Permanent v. temporary reform

A driving factor in what rates can be achieved in tax reform is whether or not they are permanent. Republicans hope to use budget reconciliation rules to pass tax reform with a simple majority in the Senate rather than the 60 votes normally required to overcome procedural hurdles in that chamber; but doing so requires the bill not add to the deficit outside the 10-year budget window. A substantially lower tax rate that would otherwise increase the deficit beyond the 10-year window could be left to sunset in the legislation in order to comply with budget rules. But witnesses and members (generally Democrats) cautioned against making short-term, deficit-financed rate cuts at the expense of long-term revenue.

Wyden analogized the growth from short-term cuts to a “sugar high” that might provide some immediate benefits followed by a crash leading to years of economic stagnation.
Sen. Ben Cardin, D-Md., likewise argued that deficit financing would be “one of the worst things we could do” and would be “an anchor on growth.”

Among the witnesses, Hodge also warned against short-term cuts, equating them to programs like “Cash for Clunkers” where economic activity accelerates into the near future but decreases in the long term.

In response to a question from Sen. Tom Carper, D-Del., Marron stated that deficit financing could lead to crowding out of investment in the future.

New revenue streams

Sens. Cardin, Carper, and McCaskill, along with Virginia Democrat Mark Warner, all noted that the corporate tax rates among US trading partners are as low as they are because those nations generate significant revenue through alternative sources such as consumption taxes.

"How do we expect to have competitive business rates if we don't harmonize with the international community as to the source of our revenues?" Cardin asked.

Cardin has proposed what he calls a progressive consumption tax that he argues would generate enough revenue to allow the business rate to be reduced to 17 percent. Hodge said that the Tax Foundation's modeling supports Cardin's claims about the potential for a consumption tax to raise revenue for a corporate rate reduction.

Marron told Cardin that the US should consider an alternative revenue stream such as a carbon tax, a value-added tax, or a destination-based cash flow tax (an idea included in the House GOP's tax reform blueprint in 2016 but dropped from the consensus statement on tax reform that a negotiating team of White House officials and congressional leaders released in July).

Next steps

Hatch reiterated at the hearing that the Finance Committee will produce its own tax reform legislation after evaluating all proposals in a "methodical and inclusive" manner and will not simply add details to the tax reform outline that the so-called "Big Six" tax reform negotiating team is expected to release in the coming days. (See related coverage in this issue.) He added that he also would prefer to move a bill with bipartisan support.

Hatch reportedly plans to hold an additional hearing – to address international tax reform – but no such hearing had been announced at press time.

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New PPACA repeal bill stumbles on its way to possible Senate floor vote

Senate Republican leaders this week made some headway in gathering support for new legislation that would dismantle major portions of the Patient Protection and Affordable Care Act of 2010 (PPACA) but retain most of the PPACA's revenue-raising tax provisions. A floor vote on the measure is possible the week of September 25, but there were significant doubts at press time over whether it has enough support to clear the chamber while it still enjoys fast-track budget reconciliation protections, which expire at the end of this month.

The bill (H.R. 1628), which was formally introduced on September 13 by Sen. Lindsey Graham, R-S.C., and Finance Committee member Bill Cassidy, R-La., is a Senate substitute amendment to PPACA repeal legislation that was narrowly approved by the House of Representatives in May. (For prior coverage of the House bill, see Tax News & Views, Vol. 18, No. 16, May 5, 2017.)

URL: http://newsletters.usdbriefs.com/2017/Tax/TNV/170505_1.html
PPACA benefits structure gone, most revenue provisions retained

In very broad terms, the Graham-Cassidy bill would dismantle the overall structure of the PPACA (including the expansion of the Medicaid program, tax credits to help lower-income individuals afford the cost of health insurance coverage, and cost-sharing reduction subsidies) in 2020, and replace it with block grants for states to use to administer their own respective health insurance plans.

The revenue stream for the block grants would be derived from many of the revenue provisions that currently fund the PPACA, such as the 3.8 percent net investment income tax and the 0.9 percent Medicare Hospital Insurance tax assessed on certain upper-income individuals, as well as corporate offsets such as the annual fee on health insurance providers, the fee on branded drug importers, limits on executive compensation for certain employees of covered insurance providers, and the excise tax on "Cadillac" group health insurance programs.

The Graham – Cassidy bill would effectively repeal the PPACA’s individual and employer mandates by reducing the penalties for noncompliance to zero retroactive to calendar year 2016, and would repeal the medical device excise tax effective for sales after December 31, 2017.

On the incentive side, the measure includes a number of provisions similar to those in the House-passed bill that would, among other things, liberalize the rules governing tax-preferred health savings accounts.

‘Preliminary’ CBO analysis pending

The Congressional Budget Office (CBO) announced September 18 that would release a “preliminary assessment” of the Graham-Cassidy bill early in the week of September 25 that would indicate whether the legislation meets the deficit reduction targets outlined in the fiscal year 2017 budget resolution instructions.

CBO cautioned, however, that the preliminary analysis will not include “point estimates of the effects on the deficit, health insurance coverage, or premiums.” Those details, CBO said, would not be available “for at least several weeks.”

Beat the clock

The Senate Finance Committee has scheduled a hearing on the proposal for September 25. And despite the lack of details from CBO regarding the bill’s impact on insurance coverage, premiums, and deficit levels, a Senate floor vote could come as early as September 27. The accelerated schedule is intended to allow the chamber to hold a vote on the measure while budget reconciliation protections that permit passage by a simple majority vote still apply.

The Senate parliamentarian recently held that the fast-track budget reconciliation protections for PPACA repeal-and-replacement legislation expire on September 30, along with the fiscal year 2017 budget resolution that included the reconciliation instruction authorizing the legislation. If the Senate does not act by September 30, the legislation would have to move under regular order and would be subject to the 60-vote threshold required to overcome procedural hurdles in that chamber.

No room for error

Republicans hold 52 seats in the Senate, and the chamber’s 46 Democrats plus the 2 Independents who caucus with them are expected to vote in lockstep against the measure. That means the GOP can afford only 2 defections and still scrape together the 50 votes they need to get the Graham-Cassidy bill across the finish line. (Vice President Mike Pence, who has been personally reaching out to senators to win support for the measure, would supply the fifty-first vote in the case of a tie.)

But even though the bill gained momentum within the conference during the week, the GOP’s ability to secure a majority appeared imperiled at press time. According to a whip list published in The Hill, Sen. Rand Paul, R-Ky., is a firm “no” vote, as is Sen. John McCain, R-Ariz., who famously helped sink efforts by Majority Leader Mitch McConnell, R-Ky., to move repeal-and-replacement legislation through the Senate in July.

URL: http://thehill.com/policy/healthcare/351341-the-hills-whip-list-republicans-try-again-on-obamacare-repeal

McCain declared in a statement released September 25 that Republicans “should not be content to pass health care legislation on a party-line basis” and that he “cannot in good conscience vote for the Graham-Cassidy proposal.”
Moreover, Republicans Susan Collins of Maine, and Lisa Murkowski of Alaska – both of whom joined McCain in voting against repeal-and-replacement bills in July – are among several senators who are currently listed as undecided. With no more room for error, the pressure will be on Senate Republican leaders and Vice President Pence to maintain a vigorous effort to convert “undecideds” to “yes” votes in the coming days.

Outlook in the House: Bill sponsor Lindsey Graham told reporters this week that if the measure does manage to clear the Senate, Speaker Paul Ryan, R-Wis., has indicated that it will get a favorable reception in the House.

“He told me: ‘You pass it there, we’ll pass it here,’” Graham said.

House Freedom Caucus Chairman Mark Meadows, R-S.C., suggested in a September 18 interview that conservatives – whose objections to an earlier iteration of PPACA repeal legislation contributed to Speaker Ryan’s decision to cancel a planned floor vote on that bill back in March – likely would support the Graham-Cassidy bill if it is approved in the Senate.

“It’s fundamentally our last chance to make a legislative fix to Obamacare, and if it doesn’t happen, then the chances of it happening in the future are slim to none. ...[S]o I fully expect that if it makes it out of the Senate, the pressure will be so great – from moderates to conservatives – to get it passed” in the House, he said.

Given the slim margins the Republicans enjoy in the House, however, there is no guarantee they will accept Graham-Cassidy, especially once a more robust CBO analysis is completed. It’s also worth noting that the House could not make any changes to a Senate-passed bill in this case, since doing so would send the measure back across the Capitol after the September 30 expiration of reconciliation protections, all but ensuring Senate Democrats could filibuster the measure.

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