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Higher target corporate rate floated as Congress tees up tax reform conference

The House and Senate this week held separate votes to authorize the start of conference negotiations to reconcile their competing versions of the Tax Cuts and Jobs Act (H.R. 1) – and one of the chief items up for discussion could involve whether to set the top corporate tax rate at 22 percent instead of the 20 percent originally targeted by congressional Republicans.

Both the House- and Senate-approved versions of H.R. 1 call for reducing the corporate rate to 20 percent from its current level of 35 percent, although the House provision would be effective beginning in 2018 while the Senate would delay enactment of the rate cut until 2019. But President Trump – who campaigned for the White House on a plan to cut the corporate tax rate to 15 percent – mentioned the idea of a 22 percent rate in comments to reporters on December 3. And according to a December 6 report in *Politico*, Senate Finance Committee Republican Pat Toomey of Pennsylvania and National Economic Council Director Gary Cohn told attendees at a private meeting of the Business Roundtable that the top rate conceivably could wind up at 22 percent in the final conference agreement because of revenue concerns.

Toomey told *Politico* outside of the meeting that a 22 percent rate "is not likely to happen" but acknowledged that some of the fixes and enhancements that lawmakers are seeking for the legislation would require additional revenue and "we've got to figure out how to do that."

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For his part, Senate Majority Leader Mitch McConnell, R-Ky., has said he would prefer for the proposed rate to remain at 20 percent to boost global competitiveness.

House Ways and Means Chairman Kevin Brady, R-Texas, who will chair the conference negotiations, told reporters December 7 that he is "focused on 20" percent.

"I really think that's our competitive rate, so we're going to go into conference with that," he said.

Shopping list

If negotiators were to incorporate a 2 percentage point bump in the proposed corporate rate into the conference agreement, it would free up roughly $200 billion in revenue that would give Republican leaders wiggle room to make some modifications and still keep the 10-year cost of the final package within the parameters of the fiscal year 2018 congressional budget resolution – that is, a net tax cut of no more than $1.5 trillion – as well as budget reconciliation rules that prohibit the legislation from increasing federal deficits outside the 10-year budget window. According to estimates from the Joint Committee on Taxation (JCT) staff, the House-passed legislation would reduce federal receipts by $1.44 trillion between 2018 and 2027 (JCX-54-17) while the Senate measure would spike the deficit by 1.45 trillion over the same period (JCX-63-17).
URL: https://www.jct.gov/publications.html?func=startdown&id=5034
URL: https://www.jct.gov/publications.html?func=startdown&id=5047

The list of revenue-gobbling changes that lawmakers would like to see incorporated into an eventual conference agreement has been making its way around Capitol Hill since the Senate finalized its proposal last week and could continue to grow in the coming days.

Eliminating corporate AMT: The House-approved bill would repeal the alternative minimum tax (AMT) for corporations and individuals. The version of H.R. 1 that was reported out of the Finance Committee and brought to the Senate floor likewise would have repealed both taxes, but they were reinstated in a manager's amendment unveiled late on December 1. (The corporate AMT was brought back in its current form; the individual AMT was revived with modifications.)

The reappearance of the corporate AMT in the Senate bill was particularly upsetting to many Republicans in the House – as well as certain business groups – who had hoped to be rid of the provision.

Moreover, the proposed retention of the corporate AMT, which is levied at 20 percent rate on an alternate tax base, has also led to concerns about unintended policy consequences, chiefly revolving around the fact that the proposed statutory corporate rate is also 20 percent, which would make the AMT the default corporate tax system for many corporations and would limit their ability to claim many tax benefits – including, most notably, the research and development credit.

Concerns also have been raised about the AMT's effects on various international provisions. The operation of the Senate's base erosion rules would require alternative tax base calculations that could be mooted by the AMT, which could render certain taxpayers unable to take advantage of some of the benefits of the bill, including the participation exemption (the mechanism that would move the US from a worldwide system toward a territorial-style system) and reduced rates on global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII). Instead, taxpayers could be left with tax on worldwide income plus an additional worldwide tax due to the other base erosion provisions, including GILTI, FDII, and base erosion and anti-avoidance taxes (BEAT).

Ways and Means Chairman Brady told reporters December 7 that the AMT provisions in the Senate bill "are costly to taxpayers, both family and business. They increase complexity, and on the business side they actually undermine many of the pro-growth aspects of the new tax code. …It's not something the House wants to retain in there."

Expanding access to SALT deductions: The issue of whether or not to retain current-law deductions for state and local taxes (SALT) on income and real property had threatened to stall tax reform legislation in the House until GOP leaders reached a compromise with Republicans from high-tax states (like New York, New Jersey, and California) to retain a deduction of up to $10,000 for state and local property taxes, while still eliminating the deduction for state and local income and sales taxes. The Senate originally intended to repeal the SALT deduction outright, but the

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version of H.R. 1 that cleared the chamber includes an amendment from Maine Republican Susan Collins that incorporates the House provision.

But House Ways and Means Chairman Brady said December 6 that he was open to examining ways to retool the provision to allow for the deduction of some state and local income tax – for example, by allowing a $10,000 SALT deduction for income or property taxes. Senate Majority Leader McConnell likewise said December 6 that he is amendable to allowing taxpayers to "pick which state and local tax [they] want to deduct" – something he called "a kind of reasonable idea."

Retaining the medical expense deduction: The House bill would repeal a current-law provision that generally allows taxpayers to deduct unreimbursed medical expenses in excess of 10 percent of adjusted gross income (AGI) or 7.5 percent of AGI for those age 65 and older. The Senate bill would retain the deduction but lower the floor for claiming it to 7.5 percent of AGI for all taxpayers for 2017 and 2018.

Ways and Means Chairman Brady told reporters December 6 that he was "willing to preserve specific protections for people facing large medical bills," and although he stopped short of endorsing the Senate provision, he noted that the Senate bill "does good work in this area."

Enhancing the child tax credit: Florida Republican Sen. Marco Rubio attempted unsuccessfully during floor debate on the Senate version of H.R. 1 to add an amendment that would raise the corporate tax rate by less than 1 percentage point to offset the cost of an expanded child tax credit. (His amendment was subject to a point of order and fell far short of the 60 votes needed to overcome it.) But whispers of a potential 22 percent rate have prompted Rubio to revive his push to get an expanded child credit into the conference agreement.

"If they raise the corporate income tax rate to 22 and they don't use some portion of it to help increase the refundability of the child tax credit, I'm going to have a big problem," he told reporters December 6.

Other potential conference sticking points

Conference committee negotiators could face other potentially nettlesome policy issues as they attempt to forge a compromise agreement.

Treatment of passthroughs: One notable difference between the two bills is the way they treat income earned by passthrough entities. The House sets a top marginal rate at 25 percent on qualifying passthrough business profits, with an assumed 70/30 split between wages and business profits, while the Senate measure proposes a 23 percent deduction for business profits, limited to 50 percent of W-2 wages. Both would have certain exemptions for small businesses.

Some argue that the Senate's approach is more equitable, as the marginal rate cap in the House bill would chiefly benefit those taxpayers with income above the 25 percent bracket. (Under the House bill, the next highest bracket would be 35 percent, which would begin at $260,000 for married filers and $200,000 for single filers.) The House bill does include a special 9 percent rate that would be available to certain small businesses, however. There are additional concerns to work out in conference over rules to prevent income shifting and gaming by taxpayers seeking to recharacterize wage income as more lightly taxed business income.

Individual tax rates: The House bill would condense the current seven brackets into four but retain the top marginal rate of 39.6 percent and increase the income threshold for that rate to $1 million ($500,000 for single filers). The House also contains a so-called "bubble rate" on some income over $1.2 million ($1 million for single filers) – essentially a clawback of the 12 percent rate that millionaires would pay on their first $90,000 ($45,000 if single) of gross income. It operates by levying a 6 percent additional tax on income over $1.2 million ($1 million for singles) until that amount is repaid.

The Senate bill has no such bubble rate and also does not retain the top marginal rate, but reduces it just over a point to 38.5 percent; moreover, the proposed rate reductions would expire and revert to current law after 2025. The Senate also retains the current seven brackets.

Mortgage interest deduction: The Senate bill retains the current-law deduction for interest on up to $1 million of home loans for up to two residences but eliminates a current-law deduction on home equity loan interest. The House

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bill, on the other hand, disallows the deduction for second homes and home equity loans and reduces the overall cap on loan principal for newly acquired primary residences to $500,000. This lower cap has drawn criticism from members of Congress hailing from states with high property values and calls for changing it in conference are likely to continue.

Affordable Care Act: The Senate bill would reduce to zero the penalty for individuals for failing to purchase health insurance that was enacted in the Patient Protection and Affordable Care Act of 2010. Sen. Susan Collins, R-Maine, has expressed concerns about the impact of that change and indicated she only supported the bill because of a commitment by Senate Majority Leader McConnell to move separate nontax legislation sponsored by Republican Sen. Lamar Alexander of Tennessee and Democratic Sen. Patty Murray of Washington, intended to stabilize the individual health insurance markets. However, House Speaker Paul Ryan, R-Wis., indicated he was not part of any such commitment, and several leading conservatives in the House cast doubt on whether such a bill was likely to pass the House. The failure to act on Alexander-Murray could endanger Sen. Collins' vote on an eventual conference agreement.

Side-by-side

A detailed report outlining similarities and differences between the two bills is available from the JCT staff.
URL: https://www.jct.gov/publications.html?func=startdown&id=5048

Conference roster

The H.R. 1 conference committee is comprised of a mix of Republicans and Democrats representing the congressional panels with jurisdiction over the legislation – namely, the Ways and Means, Budget, Natural Resources, and Energy and Commerce committees in the House, and the Finance, Budget, Energy and Natural Resources, and Health, Education, Labor, and Pensions (HELP) committees in the Senate.

Republican House members named to the conference committee this week include Ways and Means Committee Chairman Kevin Brady (who, as already noted, is chairing the conference negotiations), along with taxwriters Devin Nunes of California, Peter Roskam of Illinois, Diane Black of Tennessee (who also chairs the House Budget Committee), and Kristi Noem of South Dakota; Natural Resources Committee Chairman Rob Bishop of Utah and Natural Resources Committee member Don Young of Alaska; and Energy and Commerce Committee members Fred Upton of Michigan and John Shimkus of Illinois.

House Democrats at the negotiating table include Ways and Means ranking member Richard Neal of Massachusetts and taxwriters Sander Levin of Michigan and Lloyd Doggett of Texas; Natural Resources Committee member Raul Grijalva of Arizona; and Energy and Commerce Committee member Kathy Castor of Florida.

Republican conferees from the Senate include Finance Committee Chairman Orrin Hatch of Utah and taxwriters Mike Enzi of Wyoming, John Cornyn of Texas, John Thune of South Dakota, Rob Portman of Ohio, and Tim Scott of South Carolina; and Energy and Natural Resources Committee Chairman Lisa Murkowski of Alaska.

Hatch, Enzi, Murkowski, and Scott also serve on the Senate HELP Committee. Enzi also chairs the Senate Budget Committee.

They will be joined by Senate Finance Committee ranking Democrat Ron Wyden of Oregon (who also sits on the Energy and Natural Resources Committee and the Budget Committee), Bernie Sanders of Vermont (ranking member of the Budget Committee and member of the Energy and Natural Resources and HELP committees), Patty Murray of Washington (ranking member of the HELP Committee and member of the Budget Committee), Maria Cantwell of Washington (ranking member of the Energy and Natural Resources Committee and member of the Finance Committee), Debbie Stabenow of Michigan (member of the Finance, Energy and Natural Resources, and Budget committees), Bob Menendez of New Jersey (member of the Finance Committee) and Tom Carper of Delaware (member of the Finance Committee).

What's next...

The conference committee is required to have at least one public meeting, which had not been scheduled as of press time but is likely to take place early in the week of December 11. The conference process allows for additional open

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meetings to discuss specific provisions but observers suggest that is unlikely to be the case for this legislation and that final details probably will be hashed out in a series of closed-door sessions.

Once an agreement is reached, it will need to be submitted to the JCT for a new revenue score and voted on in the House and Senate. Lawmakers currently hope that the process will be completed by December 22.

Extenders moving on a separate track?

Also this week, even as lawmakers mounted an all-out push to finalize tax reform and get H.R. 1 to the president's desk before Christmas, some Senate Republicans are also hoping to move a second, smaller tax bill this year to address provisions that expired at the end of 2016.

The 2015 year-end tax bill, the PATH Act, extended a number of tax provisions for various periods – some permanently, some for five years, and some just through 2016. At the time, Ways and Means Chairman Brady said that House taxwriters made deliberate decisions about which provisions were being allowed to expire and noted that he hoped the bill would end the need for annual "tax extenders" legislation. However, many Senate taxwriters have characterized some of the now-expired incentives as "inadvertently excluded" from the 2015 bill and have been pushing to revisit them since.

In that vein, Senate Finance Committee member John Thune, R-S.D., said December 4 that the Senate intends to revive many of energy-related incentives – such the investment tax credits under section 48 for combined heat and power property, fuel cell property, small wind property, and geothermal property – along with other miscellaneous provisions. With some members advocating for such a package to be attached to a must-pass government funding bill expected before Christmas, these expired incentives could be in the heart of year-end legislative discussions.

Chairman Brady this week made clear his view on a separate bill to deal with these, saying, "I don't like the extenders. It's horrible policy and process."

That said, though, he added that no decisions have been made and that lawmakers will need to discuss the possibility.

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Congress clears two-week funding bill, temporarily averts government shutdown

In back-to-back votes December 7, the House and Senate both cleared a two-week stop-gap appropriations measure known as a continuing resolution, or "CR", effectively keeping general government operations running through December 22. (Fiscal year 2018 appropriations covering defense and nondefense programs had previously been scheduled to lapse after December 8 under a previously passed CR.) The bill passed the House on a largely partisan 235-193 vote and cleared the Senate shortly thereafter on a more bipartisan 81-14 tally.

Next one not so easy?: Republican leaders hope to use this two-week fiscal window to wrap up the conference committee and complete legislative action on tax reform. But in addition to that, the strategy is also premised on passage of another CR – possibly into January – designed to buy time for the drafting and enactment of a broader "omnibus" appropriations package that provides partial relief from the statutory spending caps known as the "sequester" for the remainder of fiscal year 2018, and possibly fiscal year 2019 as well. GOP leaders and the president are currently negotiating the high-level outlines of such a package with Senate Minority Leader Charles Schumer, D-N.Y., and House Minority Leader Nancy Pelosi, D-Calif. (Appropriations legislation cannot move under budget reconciliation and thus by definition requires Democratic support in the Senate to garner the three-fifths majority needed to break a filibuster.)

Passage of the next CR into 2018, however, promises to be more politically fraught and in theory could lead to a Christmastime government shutdown. House conservatives, for their part, are pressing Speaker Paul Ryan, R-Wis., on a strategy that would lift the sequester caps on defense appropriations for the remainder of fiscal 2018 while funding

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nondefense accounts essentially at current levels – a vision that holds virtually no chance of success in the Senate, where Democrats are demanding parity between any increases in defense and nondefense accounts. Many Democrats, meanwhile, are demanding a legislative fix for the so-called "Dreamer" population – that is, individuals brought into the country illegally as children – in conjunction with year-end funding legislation, following the president's decision to rescind so-called "DACA" (Deferred Action for Childhood Arrivals) protections for such individuals beginning early next year.

Also in play in the appropriations talks is funding for the president's proposed border wall, as well as a bipartisan bill negotiated by Senate Health, Education, Labor, and Pensions Committee Chairman Lamar Alexander, R-Tenn., and ranking member Patty Murray, D-Wash., that would temporarily fund so-called Cost Sharing Reduction (CSR) payments to health insurers (that are designed to defray their costs of covering low-income individuals under the Patient Protection and Affordable Care Act) which the president recently announced the government would no longer make.

The Alexander-Murray bill is also a flashpoint in the tax debate, with Sen. Susan Collins, R-Maine, having conditioned her support for the Senate tax reform bill in part on a promise from Senate Majority Leader Mitch McConnell, R-Ky., that it would be taken up prior to year-end. (Collins is concerned that the Senate tax reform bill, which guts the Affordable Care Act's individual mandate, could lead to premium increases, but believes concurrent passage of the Alexander-Murray bill may help mute those effects.) However, whether Senate Democrats would support Alexander-Murray in the context of a broader legislative effort by the GOP to nix the individual mandate, and whether House Republicans would lend enough support to pass it (Speaker Ryan has indicated Sen. McConnell's promise to Sen. Collins does not apply in his chamber), remain open questions.

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