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Government shutdown likely as short-term funding bill appears headed for failure in the Senate

With the threat of a government shutdown looming, House Republicans this week approved a short-term continuing resolution (CR) that would fund government operations through mid-February; but it appeared unlikely at press time that the measure would clear the Senate before the current CR expires at midnight on January 19.

In addition to keeping the government open through February 16, the House-passed bill includes temporary suspensions of three tax provisions from the Patient Protection and Affordable Care Act (PPACA) – the medical device excise tax, the so-called "Cadillac tax" on high-cost employer-provided health care plans, and the annual fee imposed on health insurers – and a six-year reauthorization of the Children's Health Insurance Program (CHIP).

The delayed implementation of the PPACA taxes and reauthorization of the popular and bipartisan CHIP program were added to the latest CR by congressional Republican leaders in large part to win over two different groups of lawmakers: those who were frustrated by the lack of a longer-term bill resolving government funding for the remainder of the fiscal year and those who were intent on addressing the status of the individuals brought into the country illegally as children following the president's decision to rescind so-called "DACA" (Deferred Action for Childhood Arrivals) protections as of March 5 of this year. Congressional Democrats had originally demanded a DACA fix as a condition for supporting the funding bill. The addition of the PPACA and CHIP provisions proved to be enough for Republicans to muster the majority they needed to get the bill through the House, where it passed by a vote of 230-197 on January 18.

But at press time, the situation was more precarious in the Senate, where Republicans hold only 51 seats and 60 votes are required to overcome procedural hurdles before the bill can go to the floor for final passage. There currently appear to be enough Senate Democrats who will vote against a funding agreement that does not resolve the DACA issue to block the bill there.

But the problems also extend across the aisle. According to a whip list in *The Hill*, two Senate Republicans – Lindsey Graham of South Carolina, and Rand Paul of Kentucky – have publicly stated they would oppose the bill, and two others – Jeff Flake of Arizona and Mike Lee of Utah – have not indicated how they intend to vote. Moreover, Republican Sen. John McCain of Arizona is recovering from cancer treatments in his home state and will be unavailable to cast a vote.

PPACA provisions

In addition to funding government operations for roughly another month, the CR as passed by the House would:

- Suspend the 2.3-percent excise tax imposed on the sale of medical devices, effective for calendar years 2018 and 2019. There have been efforts to fully repeal the tax since it came into force in 2013, and the levy was suspended for 2016 and 2017 under the Protecting Americans from Tax Hikes (PATH)/Consolidated Appropriations Act, which was enacted in December of 2015.
- Delay the implementation of the Cadillac tax until 2022 rather than 2020. (The tax was originally set to take effect in 2018, but was delayed until 2020 under the PATH Act.)
- Suspend the annual fee imposed on health insurers for calendar year 2019. (The PATH Act suspended this fee for calendar year 2017.)

Finger-pointing

On multiple occasions January 18, President Trump accused Congressional Democrats of seeking a government shutdown to distract from the recent passage of Republican tax legislation.

"The tax cuts and tax reform have not been working well for the Democrats," the president told reporters before a Pennsylvania event at which he touted the new tax law. "I really believe the Democrats would like to see a shutdown in order to get off that subject."

But Senate Minority Leader Charles Schumer, D-N.Y., offered a different assessment in remarks on the Senate floor.

"Ideally, we'd all roll up our sleeves and try to reach an agreement on all of the issues we need to solve. We could easily sit down and find a cosmic agreement that would get the majority of support on both sides, in both houses, and keep the government open," he said.

Implications for the IRS

For the Internal Revenue Service, a government shutdown could be especially problematic as the agency is working to quickly implement and provide guidance on the new tax law, and also preparing for the start of the 2017 tax filing on January 29. Only a small fraction of the IRS workforce would be able to work during a shutdown. A November 2017 plan designated about 13 percent of the agency's total staff as exempt from furloughs resulting from a lapse in funding, but that was during nonfiling season, and a different plan would likely be implemented during filing season.

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No immediate need for tax reform technical corrections, Mnuchin says

Treasury Secretary Steven Mnuchin said January 12 that he does not expect any immediate action on technical corrections to the major tax legislation that Congress approved and President Trump signed into law late last year.

In a Q&A with David Rubenstein of the Economic Club of Washington, Mnuchin said that many of the questions arising from the new law (P.L. 115-97) will be addressed by a significant increase in regulatory guidance from Treasury, noting that roughly 80 sections of the legislation require the Secretary to promulgate regulations. Still, he said that issues may arise that would require a technical corrections bill, and he acknowledged that such a bill would need Democratic support to move through Congress. Technical corrections, which generally aim to clarify congressional intent, have no revenue score and therefore cannot move under fast-track reconciliation protections, which allow certain legislation to pass the Senate with a simple majority rather than the three-fifths majority typically required to clear procedural hurdles in that chamber. (The Byrd Rule prohibits the Senate from advancing reconciliation bills with provisions that have no budget effect or only an incidental budget effect.) Since Republicans control only 51 Senate seats, they would need at least nine Democrats to reach the 60 votes required to overcome a filibuster.

“The good news,” according to Mnuchin, “is there’s nothing that we’ve identified so far that we think is particularly problematic, that we think we’d need a technical correction.”

Skepticism on SALT workarounds

When asked about one of the more controversial aspects of the new law – the $10,000 limitation on deductions for state and local taxes (SALT) paid by individuals – Mnuchin said he believes the legislation strikes “the right balance” between those in Congress who argued that the prior-law SALT deduction was a federal subsidy to high-tax states that should be repealed and those who argued that repealing the deduction outright would be unduly burdensome to taxpayers living in high-cost, high-tax jurisdictions. And while the $10,000 cap may seem low to some, Mnuchin said, it is a meaningful amount to a large portion of the country.

Mnuchin dismissed the claim that capping the deduction was politically calculated to hit the “blue” states harder than “red” states.

“I don’t think that’s the case at all. No one said this is a political issue. It was an economic issue,” he said.

Mnuchin appeared skeptical of a proposal being floated in California that would allow residents to skirt the new limitation on the SALT deduction by characterizing payments of certain state and local taxes as payments to state-sponsored charitable agencies, calling it “one of the funniest things I have possibly heard.” Although he said he would need to see the specific legislative language before ruling out such a proposal, he remarked that “most people understand the concept of a charitable deduction. That is voluntary, that goes to help people. It is different from the high cost of real estate taxes…“

Repatriation

Mnuchin was also asked why the new law does not impose any requirements on what multinational corporations do with the income that they repatriate from offshore. (The law imposes a deemed repatriation tax on previously untaxed foreign-source income of US multinationals as a transition to the new participation-exemption regime, but it does not require corporations to actually bring money back to the US or specify what they may or may not do with the repatriated funds.)

Mnuchin said negotiators crafting the tax package considered placing conditions on the use of repatriated funds but ultimately decided to leave corporations in charge of deciding how to spend the money they bring back.

“Certain industries, people make capital investments; certain industries, people should return money to workers. …Let the companies allocate that capital and we believe 70 percent of that will flow back to workers,” he said.

Paying for implementation

Mnuchin acknowledged that implementing the new law would be a large undertaking. When asked whether the implementation would require beefing up the IRS budget, he said Treasury is "speaking with Congress about getting additional funding…and we would expect that we would hire a significant number of people." When asked if there would be additional spending on audits, Mnuchin said that new technologies are being developed and implemented that could help to automate audits and close the tax gap (the difference between the amount of taxes owed to the government and the amount actually collected).

According to a recently released report from National Taxpayer Advocate Nina Olson, the IRS would need $495 million in additional funding to fully implement the new law, much of which would be used for hiring new employees and upgrading systems. Republicans on the Hill seem divided over whether the Service should be given more funds to implement the new law. Senate Finance Committee member John Thune, R-S.D., and House Budget Committee member Dave Brat, R-Va., both told reporters early last week they were open to increasing the IRS budget. Senate Finance Committee Orrin Hatch, R-Utah, when asked for a comment after the release of Olson's report, said he wants to make sure the agency has the resources it needs, but would only commit to reviewing the IRS's request for additional funds. House Ways and Means Chairman Kevin Brady, R-Texas, has previously argued the IRS would need to justify its request for additional funding before Congress boosts the agency's appropriations.
URL: https://www.irs.gov/newsroom/national-taxpayer-advocate-delivers-annual-report-to-congress-discusses-tax-reform-implementation-and-unveils-purple-book

While hiring and funding decisions are still pending, Mnuchin indicated that changes to the status quo at the IRS can be expected as a result of the tax reform law.

"This touches every single aspect of the IRS from technology to processes to forms," he said.

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IRS announces penalty relief for medical device tax payments, passport restrictions on 'seriously delinquent' taxpayers

The Internal Revenue Service announced this week that it will provide penalty relief for certain taxpayers who fail to make required deposits for the 2.3 percent excise tax on sales of medical devices and will begin implementing a program with the State Department that will impose passport restrictions on "seriously delinquent" taxpayers."

Medical device tax

The medical device excise tax was enacted in the Patient Protection and Affordable Care Act of 2010 and was suspended for sales in 2016 and 2017 under the Protecting Americans from Tax Hikes/Consolidated Appropriations Act, which was signed into law in December of 2015. Unless Congress extends the moratorium, the tax is effective for sales in 2018 and taxpayers subject to the levy are required to make their first semimonthly deposit for 2018 by January 29. (A provision that would suspend the tax for calendar years 2018 and 2019 is included in the short-term government funding bill that is currently stalled in Congress. See separate coverage in this issue for details.)

Because there is only a short interval between the end of the moratorium and the due date of the first deposit, the Service announced in Notice 2018-10 that it will not impose penalties under section 6656 for the first three quarters of 2018 on a taxpayer that fails to make the required deposits "provided that the taxpayer demonstrates a good faith attempt to comply with [the requirement]…and that the failure was not due to willful neglect." Beginning in the fourth quarter of 2018, "a taxpayer may avoid penalties if it makes an affirmative showing that the failure to deposit is due to reasonable cause and not due to willful neglect," the notice states.
URL: https://www.irs.gov/pub/irs-drop/n-18-10.pdf

Passport restrictions

In other developments, the Service announced that it will begin working with the State Department this month to implement a taxpayer compliance measure enacted in 2015 that will prevent certain individuals from obtaining, renewing, or keeping a passport if they owe significant amounts of unpaid federal taxes.
URL: https://www.irs.gov/newsroom/irs-urges-travelers-requiring-passports-to-pay-their-back-taxes-or-enter-into-payment-agreements-people-owing-51000-or-more-covered

The passport restrictions were enacted in the Fixing America's Surface Transportation (FAST) Act, a $305 billion infrastructure spending package that became law in late 2015. Among its revenue provisions, the FAST Act requires the IRS to notify the State Department of taxpayers that the Service has identified as having "seriously delinquent tax debts," defined as more than $51,000 in back taxes, penalties, and interest for which the IRS has filed a Notice of Federal Tax Lien and the period to challenge it has expired and the IRS has issued a levy. The State Department is required to deny applications for new passports or passport renewals by these individuals and may in some cases revoke existing passports. The restrictions are intended to help close what's known as the "tax gap" – that is, the difference between the amount of taxes owed to the federal government and the amount actually collected – and are expected to increase federal receipts by roughly $400 million over 10 years, according to an estimate from the Joint Committee on Taxation staff.

The Service explained that affected taxpayers can avoid having the IRS notify the State Department of their delinquent status by paying their debt in full or by making timely payments under an approved installment agreement, an accepted offer in compromise, or a settlement agreement with the Justice Department. The process also will not apply if a taxpayer has requested or has a pending collection due process appeal with a levy, or if collection of the tax debt is suspended because a taxpayer has made an innocent spouse election or requested innocent spouse relief.

Taxpayers who will *not* be subject to passport restrictions include those who are in bankruptcy, have been identified by the IRS as a victim of tax-related identity theft, have accounts that the IRS has determined are not collectible due to hardship, are located in a federally declared disaster area, have a request pending with the IRS for an installment agreement, have a pending offer in compromise with the IRS, or have an IRS-accepted adjustment that will satisfy the debt in full, the Service said.

Certain protections also will apply to members of the armed forces with a seriously delinquent tax debt who are serving in a combat zone.

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Supreme Court to address collection of online sales taxes

Taking on an issue that has vexed Congress for years, the Supreme Court announced on January 12 that it will consider a case addressing whether states can require online retailers to collect and remit sales and use taxes when selling into the state, even if the company lacks a physical presence in the state. The case the justices agreed to hear is an appeal by the state of South Dakota, which is seeking to overturn a 1992 decision by the Court – in the case of *Quill Corp. v. North Dakota* – that limits states' ability to require sales tax collection from remote sellers.

The defendants in the South Dakota case – *Wayfair Inc.*, *Overstock.com Inc.*, and *Newegg Inc.* – argue that Congress, rather than the Supreme Court, should determine how sales tax should be collected for online sales. However, lawmakers have long been divided on the issue, and, while multiple bills have been developed to address it and the Senate passed legislation in 2013 that would have allowed states to impose collection requirements on retailers without a state presence, nothing has made it as far as the House floor. (For prior coverage of the Senate-approved legislation, see *Tax News & Views*, Vol. 14, No. 21, May 10, 2013.)
URL: http://newsletters.usdbriefs.com/2013/Tax/TNV/130510_2.html

Applauding the High Court's decision to take on the issue were bricks-and-mortar retailers, who argue that the current policy puts them at a competitive disadvantage when compared to their online rivals. The governments of 35 other states also advocated for the South Dakota case to be heard, saying their inability to require sales tax collection by online sellers is creating huge tax gaps and limiting state budgets. Strictly speaking, taxpayers are required to calculate and pay state sales and use tax on their online purchases in cases where the online retailer does not collect it at the time of sale, but it is difficult for states to monitor these transactions and collect the taxes due.

The Supreme Court could hear oral arguments in the case as soon as April, which should lead to a decision announced by the end of June.

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