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Two-year budget agreement with significant tax package becomes law

Congress this week approved and President Trump signed a two-year agreement that sets top-line defense and nondefense spending levels for two years, extends dozens of expired temporary tax provisions, provides tax relief for victims of last fall's natural disasters, and tweaks certain provisions in the tax reform legislation (P.L. 115-97) that was enacted at the end of 2017.

The Joint Committee on Taxation staff estimates that the tax provisions will reduce federal receipts by nearly $17.5 billion between 2018 and 2027.
URL: https://www.jct.gov/publications.html?func=startdown&id=5061

The Bipartisan Budget Act of 2018 cleared the Senate early on February 9 by a vote of 73-26 and was approved in the House just a few hours later by a vote of 240-186. (The Senate approved the bill as a substitute amendment to a narrower budget measure that the House had passed on February 6. That measure was then sent back to the House for another vote.)

The President Trump quickly signed the budget agreement into law, spurred on by the fact that parts of the government were forced to temporarily shut down due to a lapse in funding that started at 11:59 p.m. on February 8.

Contours of the budget deal

The legislative agreement was announced on February 7 by Senate Majority Leader Mitch McConnell, R-Ky., and Senate Minority Leader Charles Schumer, D-N.Y. Similar to two previous bipartisan budget deals enacted in 2013 and 2015, the bill's primary focus is to lift the statutory caps that were placed on defense and domestic appropriations by the Budget Control Act of 2011 for two years – in this case, for the remainder of fiscal year 2018 and for fiscal year 2019 which begins on October 1.

To that end, the deal allows for increased appropriations of roughly $300 billion over that period, split between increases of $80 billion for defense accounts and $63 billion for domestic accounts in fiscal 2018, and $85 billion for defense and $68 billion for domestic in fiscal 2019 – increases that far outstrip those included in the prior bipartisan deals.

Continuing resolution buys time to draft appropriations bill: It is important to note that this aspect of the bill only lifts the statutory spending caps. Congressional appropriators will now have to draft, and Congress will have to pass, appropriations legislation that distributes the funds at a programmatic level. To buy time for that process, the deal also includes what's known as a "continuing resolution" (CR) that extends government funding at prior levels through March 23. (The government had previously been operating on a CR that expired after February 8.)

In pitching the deal, McConnell and Schumer noted that they agreed between themselves to work with appropriators to secure funding increases in several discrete areas, including for infrastructure ($20 billion over the two-year period), child care programs ($5.8 billion), and combatting opioid abuse ($6 billion). The leaders also noted they would work to provide "adequate funding" for the Internal Revenue Service for tax administration, though a specific dollar amount was not mentioned.

Debt limit suspension period extended: Significantly, the deal takes off the table a potential near-term political skirmish by suspending the federal debt limit until March 1, 2019, at which time the dollar amount of the statutory limit will be increased for debt issued by Treasury in the intervening months. The previous debt limit suspension period had lapsed on December 8, 2017; but, as has become customary in recent years, the Treasury Department had been implementing so-called "extraordinary measures" that provided headroom under the new limit. Treasury Secretary Steven Mnuchin recently indicated to Congress, however, that that headroom would vanish in the next several weeks.

'Mandatory sequester' extended: The deal extends the application of what is known on Capitol Hill as the "mandatory sequester" – an aspect of the Budget Control Act, separate from the discretionary spending caps, that trims spending on certain nonexempt mandatory spending programs and other nonappropriations federal outlays, including a handful of outlays attributable to tax-related items such as the election under tax code section 168(k)(4) – which allows a refund of alternative minimum tax credits in lieu of claiming bonus depreciation – and Build America Bonds payments. (It has been speculated that refunds of corporate AMT credits under the recent tax reform law – *i.e.*, "new" tax code section 53(e) – also could be subject to the mandatory sequester, although that outcome is not yet certain.)

Although the Budget Control Act's statutory caps on discretionary spending are in law through fiscal year 2021, the mandatory sequester – enacted at the same time – has been extended a handful of times in order to generate savings within the 10-year budget window to help pay for other legislative priorities. It had previously been scheduled to expire after fiscal year 2025, but the Bipartisan Budget Act of 2018 extends it through fiscal 2027.

This provision is one of a handful of policies included in the deal designed to offset a portion of the budgetary cost of the discretionary spending increases. Others include selling oil from the Strategic Petroleum Reserve, extending certain Customs users fees and fees related to aviation security and immigration, and increasing Medicare premiums for high-income beneficiaries.

Last train?: In addition to these provisions – as well as the package of tax extenders and disaster relief tax provisions discussed below – the package also extends funding for the Children's Health Insurance Program for four additional years through 2028 (a six-year extension recently had been enacted), reauthorizes the Community Health Centers program, extends a handful of provisions known as the "health extenders," provides tens of billions of dollars in emergency disaster aid related to last year's natural disasters, and lays the groundwork for two bipartisan, bicameral "Joint Select Committees" intended to make legislative recommendations by November 30, 2018, to reform the budget and appropriations process and improve the solvency of multiemployer pension plans.

The sweeping nature of the Bipartisan Budget Act of 2018 has some observers wondering if it could be one of the last major legislative efforts (outside the appropriations legislation now due by March 23) prior to the mid-term elections in November.

Orphaned energy provisions and other tax extenders

On the tax side, the budget agreement extends a number of temporary tax deductions, credits, and incentives that expired at the end of 2016 – most notably, the "orphaned" commercial and residential investment tax credits (ITCs) for certain energy property, which were not renewed under the Protecting Americans from Tax Hikes (PATH) Act in 2015.

Commercial ITC: The agreement extends the expired section 48 energy ITCs to harmonize the expiration dates and phase-down schedules for these credits based on the current beginning-of-construction rules applicable to solar electric generation property. The agreement provides that the 30 percent ITC for fiber-optic solar energy, qualified fuel cell, and qualified small wind energy property is available for property for which construction begins before 2020 and is then phased down for property for which construction begins before 2022 (26 percent if construction begins in 2020 and 22 percent if construction begins in 2021). No ITC is available for property for which construction begins after 2021 or which is placed in service after December 31, 2023. Additionally, the 10 percent ITC for qualified microturbine property, combined heat and power system property, and thermal energy property is made available for property for which construction begins before 2022.

Residential ITC: The agreement also extends the section 25D orphaned residential ITC for individuals placing qualifying fuel cell property, small wind energy property, and geothermal heat pump property into service by December 31, 2021. It applies the same phase-out period and applicable credit percentage for these technologies that are available to qualifying solar property in section 25D (a 26 percent credit for property placed in service during 2020 and 22 percent for property placed in service during 2021). This provision is effective for property placed in service after December 31, 2016.

Other energy provisions: The agreement extends, generally only through the end of 2017, a number of other expired energy provisions such as the section 45 production tax credit, the credit for new energy-efficient homes, credits for fuel cell and plug-in electric vehicles, and incentives for biodiesel and renewable diesel fuels.

Business, economic development, individual incentives: Other provisions extended through 2017 under the agreement include:

- Business incentives, such as three-year depreciation for race horses two years old or younger, the seven-year recovery period for motorsports entertainment complexes, and special expensing rules for certain film, television, and live theatrical productions;
- Economic development incentives such as the authorization for qualified zone academy bonds, empowerment zone incentives, and the deduction for income attributable to economic development in Puerto Rico; and
- Individual incentives such as the deduction for qualified tuition and related expenses and the gross income exclusion for discharge of indebtedness on a principal residence.

A complete list of provisions extended under the budget agreement is available from Deloitte Tax LLP.
URL: http://newsletters.usdbriefs.com/2018/Tax/TNV/180126_1_suppA.pdf

Future extenders on borrowed time?: The enactment of the tax extenders package in the budget agreement comes just days after senior House taxwriters told reporters that all the expired provisions need a thorough vetting to determine which, if any, are worth reviving. Rep. Vern Buchanan, R-Fla., the new chair of the House Ways and Means Tax Policy Subcommittee, said he is planning a hearing "in the near future" at which advocates for the various temporary tax breaks will have to justify their continuation.

Ways and Means Committee Chairman Kevin Brady, R-Texas, echoed Buchanan's sentiment, saying that the rationale of each expired provision should be re-evaluated "in a post-tax reform world." Since the passage of the PATH Act in December 2015, which made numerous tax provisions permanent and extended others for varying short-term periods, Brady has been adamant that taxwriters should evaluate the remaining extenders and decide which should be made permanent and which should be expunged from the tax code.

Senators have disagreed, however, pushing for the comprehensive package of extensions now bundled with the budget agreement. Senate Finance Committee Chairman Orrin Hatch of Utah introduced extenders legislation as a stand-alone bill in December, and Senate taxwriters have made it clear in recent weeks that they were seeking a must-pass vehicle to carry the package.

"If it's part of a broader package that includes a lot of the things we need to get done, then hopefully it'll be enough to get it through the House," Sen. John Thune, R-Texas, a member of the Senate Finance Committee told reporters earlier this week.

In its February 8 Statement of Administration Policy on the budget agreement, the White House appeared to side with House taxwriters, noting that "the [a]dministration is concerned with future extensions of special interest tax deductions and benefits in the wake of tax cuts and reforms that were enacted in December 2017."
URL: https://www.whitehouse.gov/wp-content/uploads/2017/11/saphr1892s_20180208.pdf

A list of all the provisions that have expired or will expire between 2016 and 2027 – including a number of individual provisions enacted in the 2017 tax reform legislation – is available from the Joint Committee on Taxation staff.
URL: https://www.jct.gov/publications.html?func=startdown&id=5057

Wildfire tax relief

As approved, the agreement provides targeted, temporary tax relief to individuals and businesses affected by wildfires that struck California last fall.

Employee retention incentives: The budget agreement includes a temporary tax credit for 40 percent of wages (up to $6,000 per employee) paid by an eligible employer to an employee from a designated disaster area.

The provision is effective for wages paid or incurred beginning October 8, 2017. The credit is available through January 1, 2018, for all affected employers.

Access to retirement funds: The measure makes it easier for wildfire victims to gain emergency access to funds in qualified retirement plans by:

- Waiving the 10 percent early withdrawal penalty for qualified wildfire-relief distributions and allowing income tax on the distributions to be paid over three years;
- Permitting recontribution of retirement plan withdrawals for home purchases that were cancelled due to eligible disasters; and
- Relaxing the rules for loans from retirement plans for qualified wildfire relief.

These provisions are effective upon enactment.

Deduction for personal casualty losses: For individuals who incur uncompensated disaster-related losses, the agreement temporarily eliminates the current-law requirements that personal casualty losses must exceed 10 percent of adjusted gross income to qualify for deduction. The measure also allows nonitemizers with qualifying disaster-related losses to take advantage of this tax relief.

These provisions apply to losses arising from wildfires on or after October 8, 2017.

Earned Income Tax Credit and Child Tax Credit: The agreement allows taxpayers to determine their Earned Income Tax Credit and Child Tax Credit for 2017 based on their earned income from the immediately preceding year (effective for taxable years beginning after January 1, 2016).

Charitable giving: For businesses and individuals, the agreement temporarily suspends limitations on the deduction for charitable contributions associated with qualified wildfire relief (effective for contributions made during the period beginning on October 8, 2017, and ending on December 31, 2018).

Hurricane benefits expanded: The agreement also modifies a similar package of benefits that was enacted last fall for victims of Hurricanes Harvey, Irma, and Maria by broadening the designated disaster areas that are eligible for relief and explicitly applying section 280C to the employee retention credit.

Changes to the 2017 tax reform legislation

The budget agreement includes several changes that modify or clarify provisions in the major tax legislation that President Trump signed into law on December 22 of last year.

Excise tax on the net investment income of colleges and universities: Last year's tax reform legislation imposes an excise tax of 1.4 percent on net investment income on private colleges and universities defined as applicable institutions – that is, an educational institution as defined in section 25A(f)(2) that has at least 500 students of which more than 50 percent are located in the United States that is not a state college or university and has an aggregate fair market value of non-exempt use assets that is at least $500,000 per student. The budget agreement modifies the definition of eligible institutions to only include institutions that have at least 500 *tuition-paying* students of which more than 50 percent are located in the United States.

Exception for the excess business holding rules for independently operated philanthropic business holdings: The budget agreement includes an exception to the excess business holding rules by excluding from the definition of business enterprise a business that meets the following four criteria: (1) is 100 percent owned by the private foundation, (2) was acquired by means other than purchase, (3) distributes all of the profits to charity within 120 days of the close of the tax year, and (4) is independently operated.

Craft beverages: The agreement provides that provisions in the tax reform bill that modify the tax treatment of certain craft beverages shall not be construed to pre-empt, supersede, or otherwise restrict any state, local, or tribal law that prohibits or regulates the production or sale of distilled spirits, wine, or malt beverages.

Opportunity Zones Rule for Puerto Rico: The budget agreement expands the Opportunity Zones provision in the tax reform legislation to include all census tracts within Puerto Rico. (Under the tax reform law as originally enacted, Opportunity Zones are limited to the mainland United States.)

Corporate estimated tax payments

The budget agreement repeals a provision enacted in the Trade Preferences Extension Act of 2015 that increased corporate estimated tax otherwise due in July, August, or September of 2020 by 8 percent and reduced the payment due in October, November, or December of 2020 by the same percentage. As a result, payments for the third and fourth quarters of 2020 revert to 100 percent of the amount due.

Other tax law changes

The agreement also includes a variety of targeted tax law changes that:

- Provide for reallocation of unused megawatt capacity for purposes of the credit for production from advanced nuclear power facilities (effective on enactment) and allow public entities to transfer credits to specified project partners (effective for taxable years beginning after the date of enactment);
- Enhance the carbon dioxide sequestration credit under section 45Q (effective for taxable years beginning after December 31, 2017);
- Permit amounts, including interest, that are returned to an individual from the IRS as a result of an improper levy on an IRA or employer-sponsored retirement account to be recontributed to the plan without regard to normal contribution limits (effective for levied amounts and interest returned to taxpayers in taxable years beginning after December 31, 2017);
- Direct the Treasury Department to modify current regulations governing hardship distributions from retirement plans to provide that an employee would not be prevented from continuing to make elective deferrals and employee contributions for any period after the receipt of a hardship distribution (revised regulations would be applicable to plan years beginning after December 31, 2018);
- Provide that, at the employer's election, hardship withdrawals from a cash or deferred arrangement may include account earnings and employer contributions in addition to amounts contributed by employees (effective for plan years beginning after 2018);

- Require the Treasury Department to clarify current regulations on inventory rules for tax-paid and nontax-paid beer to allow a unified accounting system for beer on which excise tax has already been paid, including in cases where such beer is consumed on the brewery premises;
- Prohibit increases in the amount of user fees charged by the IRS for installment agreements and require the IRS to waive or reimburse fees for certain low-income taxpayers under certain conditions (effective for agreements entered into on or after the date that is 60 days after the date of enactment);
- Require the IRS to publish a simplified tax form (Form 1040SR) for use by taxpayers age 65 and over by the close of the taxable year (effective for taxable years beginning after the date of enactment);
- Provide that an individual serving in an area designated by the president as combat zone has a tax home outside the United States for purposes of the exclusion of certain foreign-earned income from gross income under section 911 (effective for taxable years beginning after December 31, 2017);
- Modify the reporting requirements under section 6050W(d)(1)(B) with respect to participating payees with only a foreign address (applicable to returns for calendar years beginning after December 31, 2017);
- Allow an above-the-line deduction for attorney fees and court costs paid by or on behalf of taxpayers participating in certain whistleblower programs (effective for taxable years beginning after December 31, 2017) and modify the definition of collected proceeds eligible for whistleblower awards (effective for information provided before, on, or after the date of enactment with respect to which a final determination for an award has not been made before the date of enactment); and
- Extend until December 18, 2018, the waiver of limitations with respect to the gross income exclusion for amounts received by wrongfully incarcerated individuals (effective on date of enactment).

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Taxwriters to examine Treasury, IRS budget requests

Following the anticipated release of the Trump administration's FY 2019 budget request on February 12, House and Senate taxwriters plan to hold hearings to examine the requests for the Treasury Department and Internal Revenue Service, as well as discuss both organizations' progress toward and views on implementation of the new tax law (P.L. 115-97) enacted late last year.

The Senate Finance Committee will hold two hearings February 14 with the morning session (scheduled for 10:30) set to focus on Treasury and the afternoon session (scheduled for 2:30) on the IRS. Treasury Secretary Steven Mnuchin and Acting IRS Commissioner and Assistant Secretary for Tax Policy David Kautter are scheduled to testify.

The House Ways and Means Committee will hold one hearing – at 10:00 a.m. on February 15 – with Mnuchin as the sole witness.

Implementation of the recently enacted tax reform legislation is expected to be a key item of discussion for both panels. Finance Committee Chairman Orrin Hatch, R-Utah, said in a statement that his committee expects to hear how Mnuchin and Kautter plan "to quickly and effectively implement the new law." Ways and Means Chairman Kevin Brady, R-Texas likewise noted in a separate release that "we have a shared responsibility to ensure this new tax law is working for all Americans. That includes making sure the IRS is focused on serving taxpayers and administering this new tax code fairly, effectively, and with integrity."

The IRS has requested an additional $397 million to address implementation issues. The bipartisan budget agreement passed this week (see separate coverage in this issue) will require Congress to allocate the additional funding among competing priorities, and the IRS may be in line for some increase in its budget.

An update to the Treasury-IRS Priority Guidance Plan released February 7 includes 18 guidance projects related to the initial implementation of the new tax law.
URL: https://www.irs.gov/pub/irs-utl/2017-2018_pgp_2nd_quarter_update.pdf

New IRS commissioner in the wings

Kautter may soon return to holding just one job in the tax field, after President Trump announced February 8 that he will nominate Charles "Chuck" Rettig as the new IRS commissioner. If confirmed by the Senate, Rettig, a California-based tax lawyer with Hochman, Salkin, Rettig, Toscher & Perez, will fill the five-year term that began November 13, 2017. (John Koskinen, the previous commissioner who spent much of his tenure under fire from congressional Republicans, stepped down at the end of his term in November.)

During his career, Rettig has served as chair of the IRS Advisory Council and has represented clients before the agency, but unlike previous nominees to the position, he does not have a business and management background. Nonetheless, Finance Chairman Hatch – who will preside over the confirmation hearing – recently lauded Rettig's credentials, telling *Politico*, "[h]e understands the ins and outs of the tax code, which not many do."

In an official statement February 8, Hatch anticipated a "thorough and fair vetting process" by the Finance Committee and said, "[t]he IRS has been bogged down by scandal and disruption in recent years, losing the trust of the American people. It's past time we restore Americans' faith in this agency."

Ways and Means Chairman Brady noted in his own release that "[w]ith a long history of helping families and job creators navigate the tax code and stand up to the IRS when the agency is wrong, Chuck Rettig as the new IRS commissioner is just the partner we need as we work to overhaul our nation's tax administrator."

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JCT describes post-reform federal tax system

The Joint Committee on Taxation (JCT) on February 7 published a description of the federal tax system in the wake of the enactment of last year's tax reform legislation (P.L. 115-97).

The publication, *Overview of the Federal Tax System as in Effect for 2018*, provides a broad overview of the various elements of the new tax system, including individual and corporate income taxes, estate and gift taxes, payroll taxes, and certain excise taxes. It does not reflect provisions in the new law that take effect after 2018 and does not include references to termination dates for those provisions due to sunset in later years. It also does not take into account tax changes made by the just-enacted bipartisan budget agreement (see separate coverage in this issue for details).
URL: https://www.jct.gov/publications.html?func=startdown&id=5060

In addition to describing of the current system, the report includes a variety of historical tables and projections on topics such as distribution of income and taxes, income sources for individual taxpayers, business returns by type, federal receipts by source, and the Social Security taxable wage base and rates of tax.

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