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Partisan rifts over 2017 tax cuts persist at Senate Finance Committee hearing

As the Senate Finance Committee met for a hearing April 24 to take stock of early outcomes of last year’s massive tax cut legislation (P.L. 115-97), Democrats and Republicans on the panel showed they’re still at odds over just about everything related to the new law – from the process for moving it through Congress to the policy merits of provisions such as the deduction for passthrough businesses to its long-term impact on the federal deficit.

Chairman Orrin Hatch, R-Utah, and other Republican taxwriters pointed to the number of businesses now offering employee bonus payments and wage increases as well as surveys indicating increased economic optimism among business owners as proof the law is already working. Hatch also noted that as lawmakers enact technical corrections to the bill, they will “be able to enhance what the law already does well, ensuring that Americans get tax relief, more jobs, and better wages.”

Democrats, fueled by a recent Joint Committee on Taxation report on the distributional effects of the new law, were less optimistic, repeating their arguments that the tax cuts would explode the deficit and that the majority of benefits are accruing to upper-income individuals at the expense of those in the lower and middle classes. Finance Committee ranking Democrat Ron Wyden of Oregon dubbed the measure “one of history’s most expensive broken promises” and cautioned Republicans against moving a second bill that would permanently extend the 2017 tax cuts on the individual side of the code, which currently are set to expire at the end of 2025.

URL: <https://www.jct.gov/publications.html?func=startdown&id=5093>

“Lawmakers ought to keep their promises when it comes to tax cuts before rushing ahead with a second bill,” he said. (House Republican leaders have indicated that they hope to vote on extending the individual provisions this year. But Senate Majority Leader Mitch McConnell, R-Ky., has expressed skepticism over whether such a proposal would garner enough Democratic support in his chamber to clear procedural thresholds. For prior coverage see *Tax News & Views*, Vol. 19, No. 13, Apr. 20, 2018.)

URL: http://newsletters.usdbriefs.com/2018/Tax/TNV/180420_1.html

Finger-pointing over process

Hatch acknowledged in his opening statement that “there are things we could have done to make the bill even better”; but he argued that Republicans were limited by the fact that “Democrats refused to positively participate in writing the bill” and chose to engage in “political theater” and procedural maneuvers instead of making substantive policy contributions.

Wyden countered that Democrats had wanted the bipartisan process that was the hallmark of the Tax Reform Act of 1986 and blamed Republicans for choosing to pursue their tax cut bill under budget reconciliation protections, which effectively excluded Democrats from the legislative process. (Reconciliation allowed Republicans, who at the time controlled 52 seats in the Senate, to push the bill through the chamber with a simple majority vote rather than the three-fifths supermajority typically required to overcome procedural obstacles when legislation is moved under regular order.)

199A deduction

On the policy side, Democrats frequently cited the new section 199A deduction for qualified passthrough business income as an example of a provision in the new law that primarily benefits wealthier business owners. In particular, they noted the JCT distributional analysis shows that 44 percent of the benefits from this provision would accrue to taxpayers making over \$1 million a year in 2018 and that this level would increase to 52 percent in 2024.

Democrats also criticized the provision as overly complex. Sen. Claire McCaskill, D-Mo., contended that the rules outlining taxpayer eligibility for the new deduction are confusing – a result that she said was ironic given the GOP’s repeated emphasis on simplifying the tax code; Wyden noted that confusion around the passthrough rules is making it difficult for many small businesses to accurately calculate their estimated tax payments; and Sen. Ben. Cardin, D-Md., suggested that the provision encourages wealthier passthrough owners who can afford sophisticated tax planning advice to look for ways to game the system.

Among the witnesses, Rebecca Kysar of the Brooklyn School of Law argued in her opening statement that the 199A deduction, “which was aimed at creating parity with the new lower rate available on corporate income, punishes workers and certain industries, substituting congressional judgment for market discipline and allowing for significant tax planning (and revenue-losing) opportunities.” In an exchange with Wyden, she said the “regressivity” of the provision was “unfortunate” and commented that the revenue funding the deduction could have been used instead to expand the earned income tax credit.

David Kamin of the New York University School of Law told Wyden that the eligibility rules for the deduction amount to “haphazard lines in the sand” and present opportunities for taxpayer gaming. And in response to a question from Sen. McCaskill he labeled the deduction “one of the worst provisions to be added to the tax code in several decades.”

In defense of the provision, Sen. John Thune, R-S.D., argued that relief for passthrough entities was necessary to place those businesses on a level playing field with corporations, who received a significantly lower tax rate under the new law – an argument with which Democrats generally agreed in principle. Thune characterized the section 199A deduction as “the best approach to provide that relief while maintaining the flexibility of a passthrough business and recognizing that they are not taxed at the entity level and taxable income is determined at the owner level.”

In response to a question from Thune, Douglas Holtz-Eakin of the American Action Forum (who headed the Congressional Budget Office from 2003-2005) downplayed Democratic criticism of the rules around section 199A.

"If you're going to have preferential treatment of a certain kind of income...you're going to have to have rules to do that. Rules are always complex and people always complain about them, but they're a reality of the tax code," he said.

Holtz-Eakin told Thune that the "vast majority" of passthrough businesses will not have to worry about the eligibility rules because they have income below the section 199A threshold amount (\$157,500 for single taxpayers, \$315,000 for joint filers) and are automatically eligible for the deduction.

Buybacks

Taxwriters also debated the ultimate policy merits of businesses using their savings under the new tax law to repurchase stock from shareholders rather than plowing those savings directly into wage increases and bonuses for their employees.

Finance Committee Republican Charles Grassley of Iowa contended that buybacks do not benefit wealthy taxpayers exclusively, noting that many middle-class individuals own stock through their employer-sponsored retirement plans. He also argued that a buyback "frees up dollars that can be reinvested, [which] in turn provides the type of business expansion and capital investment necessary to help the economy [and] boost productivity."

Douglas Holtz-Eakin agreed, telling Grassley that a stock buyback in and of itself "tells you essentially nothing about the impact of tax reform."

"That's the first transaction. It's the final transaction that matters," he explained. "You want those monies ultimately invested in valuable tangible and intangible capital that will raise productivity and real wages and you can tell nothing about that from a buyback. ...People should put aside the rhetoric about stock buybacks, let the act work, and judge the final result."

Democratic Sen. Sheldon Whitehouse of Rhode Island, citing statistics indicating that businesses are spending \$40 of their newfound tax savings on buybacks for every \$1 they are investing in employee wage increases and bonuses, was more skeptical about the broader economic benefits of corporations buying back stock.

Rebecca Kysar, responding to a question from Whitehouse, agreed with Holtz-Eakin's premise that it's premature at this point to determine who ultimately will benefit from buybacks; however, she also noted that "when you're talking about lowering the corporate rate, most mainstream studies put 75 percent of the benefit of that to shareholders."

David Kamin offered a similar assessment.

Fiscal impact

Another common Democratic criticism of the bill on display at the hearing was its impact on federal revenues over the next decade. As enacted, the new law, which is not offset, was expected to decrease federal receipts by some \$1.5 trillion over 10 years on a traditional scoring basis.

Several Democrats voiced concerns that Republicans would use this increased debt load as leverage for Congress to reduce spending on entitlement programs. Sen. Sherrod Brown, D-Ohio, asked witnesses about the wisdom of making cuts to programs like Social Security and Medicare to essentially offset tax relief for upper-income individuals.

Kysar and Kamin generally agreed the deficit pressures created by new tax law jeopardized the funding of these programs and that low- and middle-income taxpayers could lose out as a result.

Holtz-Eakin argued that in 2017 the US was already facing a \$10 trillion entitlement-driven deficit and that Congress was going to have to look at spending cuts independent of whatever was done on the tax side.

"Had we done a revenue-neutral tax reform – my first choice – my fear is that [it] would have been unwound due to the pressures on the deficit that come from that. ...My view has always been that it's hard to do tax reform and it's harder to keep it. And if you do not control the spending side of the budget you will not keep it," he said.

Republicans – including Sen. Rob Portman of Ohio – hewed to the optimistic view that the 2017 law would pay for itself over time through increased economic growth.

In an exchange with Portman, Holtz-Eakin explained that the US economy would need to grow at an annual rate of between 0.4 percent and 0.5 percent above current levels to offset the cost of the tax cuts over 10 years – a pace that Portman believed to be realistic.

“If this thing works the ways it’s intended to...then 0.4 percent – or 0.5 percent, even – is absolutely within the realm of possibility,” Portman said.

— Jacob Puhl
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Five-year FAA reauthorization clears House

The House of Representatives voted 393-13 on April 27 to approve legislation (H.R. 4) that would extend expenditure authority for the Federal Aviation Administration (FAA), along with the excise taxes on fuel and passenger tickets that supply the agency’s dedicated revenue stream, through September 30, 2023.

The FAA’s current expenditure authorization and the related excise taxes are set to expire on September 30 of this year.

The bill now moves to the Senate, although Republican leaders in that chamber have not yet indicated when it will be taken up on the floor.

Because H.R. 4 is one of the few must-pass pieces of legislation with a revenue title that is expected to move through Congress ahead of the November midterm elections, it could become a magnet for any tax proposals – for example, renewal of expired tax provisions, IRS reform, permanent extensions of the tax breaks for individuals in the 2017 tax cut legislation, or technical or other corrections to the 2017 law – that some lawmakers have said they would like to see enacted this year. The bill as approved in the House does not include tax amendments. But whether Senate leaders intend to open up the legislation to additional tax provisions other than those related to aviation is currently unclear.

Senate Commerce, Science, and Transportation Committee Chairman John Thune, R-S.D., whose panel has jurisdiction over the FAA legislation, told reporters April 24 that the reauthorization bill should be kept free of “unrelated, ancillary tax issues.” (In addition to chairing the Commerce, Science, and Transportation Committee, Thune sits on the Senate Finance Committee.)

For his part, however, Finance Committee Republican Pat Toomey of Pennsylvania said April 24 that that the FAA bill should be fair game for tax amendments of any kind.

“We should be looking at whatever vehicles are available to us,” he said.

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A note on our publication schedule

The House and Senate will be out of session the week of April 30 as lawmakers leave Washington for a district work period.

Barring any unexpected developments on the tax policy front, the next edition of *Tax News & Views* will be published the week of May 7.

— Jon Traub
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