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House taxwriters stick to partisan scripts at subcommittee hearing on small business tax cuts

A May 23 House Ways and Means Tax Policy Subcommittee hearing on how the tax cut package enacted last year (P.L. 115-97) has affected small businesses once again had taxwriters divided along party lines, with Republicans touting statistics and anecdotes showing new law is already having a positive economic impact and Democrats arguing that a rushed and secretive drafting process resulted in legislation that provides more benefits to large passthrough entities than it does to "mom and pop" enterprises.

This was the second in series of hearings planned by the full Ways and Means Committee and the Tax Policy Subcommittee on the economic impact of the new law. Dates and topics of future hearings have not yet been announced.

Republicans: Business is booming

Republicans on the panel pointed to record high small business optimism and increases in capital expenditures and gross domestic product (GDP) as signs the law is already helping American businesses.

In his opening statement, subcommittee Chairman Vern Buchanan, R-Fla., cited Congressional Budget Office statistics indicating that the GDP this year is growing faster than anticipated and quoted statistics from a *Wall Street Journal* article indicating that “capital spending by firms in the S&P 500 grew by 24 percent in the first quarter of 2018 – the fastest pace since 2011 and the best first quarter since 1995.”

The four witnesses invited by Republicans on the panel shared this optimism, explaining how the new 20 percent passthrough deduction for qualified business income along with other new provisions will allow them to hire more staff, give bonuses and wage hikes to employees, and increase their capital investments.

Michael Baach, president and chief executive officer of Philpott Solutions Group in Brunswick, Ohio, said the new law had allowed his company to give their employees a $1,500 bonus, invest $5 million back into their operations, and make plans to bring back jobs they had previously sent to China.

Philip Homan, president and chief executive officer of Loram Maintenance of Way, Inc., in Hamel, Minn., said that a lower tax burden has allowed his company to boost employee pay by $1 an hour, give rank-and-file employees a $1,500 bonus, and invest in new equipment.

Larry Gray of Alfermann Gray & Co., CPAs, LLC, in Rolla, Mo., told the panel that lower tax rates have contributed to a general sense of economic well-being and that more people in his community are either starting new businesses or expanding businesses they already own.

John Horne, owner of Anna Maria Oyster Bars on Anna Maria Island, Fla., said he has used his tax savings to provide bonuses to his employees and make a capital investment in new signage. He also commented that the tax cuts have been a boon to the hospitality industry generally since people now have more discretionary income to spend on activities such as traveling and dining out.

Democrats: Small business left out

For their part, Democrats on the subcommittee lamented that because of the GOP’s rush to get a bill drafted, approved, and sent to the president’s desk last year, the small business community was largely left out of the debate and as a result received little in the way of substantive benefits and is now burdened with additional tax code complexity.

In his opening remarks, subcommittee ranking member Lloyd Doggett, D-Texas, characterized the small business provisions in law as an afterthought and stated that “the best time to devote some attention to the impact of the tax code on small businesses would have been before this new tax law was approved, not after, when it’s too late to have any impact.”

Doggett also expressed concern that the individual and passthrough provisions in the new law are temporary – they generally are set to expire after 2025 – and argued that the passthrough deduction for qualified business income is so complex that many smaller businesses are finding it difficult to determine whether or not they even qualify.

Doggett asked John Arensmeyer of Small Business Majority – the sole witness at the hearing invited by the panel’s Democrats – if it would be possible to design a passthrough provision that would target tax relief to businesses with more modest incomes rather than larger entities. Arensmeyer, who noted that the average income for “self-employed entrepreneurs” is about $50,000 a year, said there are multiple ways to provide relief “from the bottom up,” such as making the first $25,000 of small business income tax-free, but limiting that relief to businesses with income below $600,000.

“The way you do it is not to have cuts come from the top so that the majority of benefits go to 2.3 percent of passthrough firms, he said.

A number of Democrats on the panel also argued that the provision in the 2017 law that essentially repeals the individual health insurance mandate under the Patient Protection and Affordable Care Act by reducing the penalty for noncompliance to zero imposes an additional financial burden on many small businesses by taking younger, healthier people out of the risk pool and driving up insurance costs for small business owners who want to purchase coverage for themselves or their employees.

Depreciation for qualified improvement property

Although there was little discussion of specific provisions in the new law, John Horne, the Florida restaurant owner who appeared as one of the GOP's witnesses, called on lawmakers to restore a 15-year depreciation period for qualified improvement property.

The 2017 law modified prior-law depreciation rules by eliminating the separate definitions of qualified leasehold improvements, qualified restaurants, and qualified retail improvement property, and instead providing for a single asset class called qualified improvement property; but due to what is generally acknowledged to be a drafting error, it omitted qualified improvement property from the list of property that has a depreciable life of 15 years rather than 39 years.

"I know you are all aware of this technical error and are working hard to make the correction. We need to get the depreciation back to 15 years as soon as possible so we can keep investing our dollars back into our business," Horne told the panel in his opening statement. "Cash flow is very important to restaurants as we operate on very, very small margins," he added.

Subcommittee members did not comment on the issue during the hearing, but it is expected to be addressed in an eventual technical corrections package.

Tax Cuts 2.0

As the discussion around last year's tax legislation continued in Washington, House Ways and Means Committee Chairman Kevin Brady, R-Texas, also touted his proposed follow-up tax cut package – popularly dubbed Tax Cuts 2.0 – despite the view of many tax policy watchers that such a bill is extremely unlikely to make it through both chambers of Congress and be signed into law this year.

Brady told Fox Business on May 23 that he is working closely with President Trump and Senate Republican leaders to develop a package and that he believes it can be completed before the midterm elections in November. (President Trump made a similar comment in a speech to the Susan B. Anthony List the same day.)

As he has said in recent weeks, Brady reiterated that the heart of the legislation would be making permanent the individual tax changes passed in December, which are generally set to expire at the end of 2025.

"You have to start with permanence because you can't overestimate the importance for growth and for certainty there," he said on *Varney & Co*.

Brady said he also supports policies that will encourage households to save and will encourage more innovation in the US," but he did not provide any details on those aspects of potential legislation.

Dim prospects in the Senate: Taxwriters last year decided to sunset most of the changes on the individual side of the code to ensure that the bill did not lose any revenue outside of the 10-year budget window – a requirement of the tax reconciliation process that Republicans used to pass the legislation. House Republicans in particular have been vocal in their advocacy for making permanent the tax changes for individuals, which include new brackets and rates, a doubling of the standard deduction, and a higher child tax credit. In the Senate, however, Majority Leader Mitch McConnell of Kentucky has been less optimistic about the prospects for moving a significant tax cut package this year. Republican senators generally support that idea, but because Republicans have chosen not to adopt a budget resolution this year, they would not be able to rely on the fast-track budget reconciliation process – which would allow for Senate passage by a simple majority – and would instead have to move the legislation under regular order, which requires a three-fifths supermajority (typically 60 votes) to overcome procedural hurdles in that chamber. The GOP controls only 51 seats in the Senate and even if all 51 Republicans were to vote in favor of the measure it is highly unlikely that they could corral enough Democratic support to cross the 60-vote threshold.

Concerns over the deficit also could weigh against enactment of additional tax cut legislation, particularly during an election year. The Congressional Budget Office recently revised upwards its forecast of the 10-year deficit to $12.4 trillion, and it estimates that extending the individual provisions in last year's tax bill would cost another $650 billion.

Finance Committee staffing changes: As Senate taxwriters work with the House and consider whether to take up legislation this year, they will have some new senior staff members to lean on. Finance Committee Chairman Orrin Hatch, R-Utah, announced this week that Mark Prater, the Republicans' chief tax counsel and deputy staff director, is leaving Capitol Hill after nearly 30 years. He will be succeeded as chief tax counsel by Jennifer Acuña, a tax counsel and policy advisor at the committee who also previously served on the Ways and Means staff. His successor as deputy staff director is Jeff Wrase, the committee's chief economist since 2011.

Hatch also announced that Becky Cole will join the Finance staff as policy director. Cole previously worked as chief economist at the Senate Budget Committee.

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Treasury, IRS promise proposed regs on SALT workarounds

The Treasury Department and Internal Revenue Service on May 23 announced in Notice 2018-54 that they intend to issue proposed regulations that address efforts by certain states to allow their residents to skirt the new limitation on the federal deduction for state and local taxes (SALT) in last year's tax cut legislation (P.L. 115-97) by characterizing payments of certain state and local taxes as deductible payments to state-sponsored charitable agencies.
URL: https://www.irs.gov/pub/irs-drop/n-18-54.pdf

Legislation permitting such a workaround has been approved in New York, New Jersey, and Connecticut, and currently is under consideration in California.

Before the 2017 tax cut law was enacted, taxpayers who itemize could deduct all their state and local income taxes (or sales taxes) as well as their property taxes paid against their federal tax liability; but the new law caps the SALT deduction at $10,000, effective for taxable years beginning after January 1, 2018. (The deduction tends to be used more heavily in higher-taxed "blue" states.)

Notice 2018-54 cautions that "taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes" and explains that the forthcoming proposed regulations "will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment" of payments to funds controlled by state and local governments.

The IRS said in a news release that the proposed regulations will be issued "in the near future."

Kautter: IRS ready for 2018 filing season

Also this week, IRS Acting Commissioner – and Treasury Assistant Secretary for Tax Policy – David Kautter said May 22 that the IRS continues to work on guidance to implement other provisions in the 2017 law and expects "to have proposed regulations on most of the major pieces…out by the fall."

Kautter, who spoke at a Senate Appropriations Financial Services and General Government Subcommittee hearing on the Trump administration's fiscal 2019 budget request for the Treasury Department and IRS, also said that the Service is modifying its forms, publications, and computer systems to reflect all the changes to the tax code that were enacted in the new law and will have everything in place in time for the start of the 2018 filing season.

"We have all the forms drafted. We're working on the instructions – they'll be done within the next two weeks. The plan is for the forms and instructions to be released over the summer for public comment," Kautter said. Software to implement the new law is already under development, he added.

Also at the hearing, Treasury Secretary Steven Mnuchin told the panel that Treasury and the IRS are working on a five-year plan to overhaul the Service's information technology infrastructure and hope to have a preliminary version ready within the next 90 days.

IRS Acting Commissioner Kautter commented in his opening statement that 59 percent of the IRS's hardware and 32 percent of its software is "obsolete." In a subsequent exchange with subcommittee Chairman James Lankford, R-Okla., Kautter said the agency's technology issues need to be addressed "in a major, comprehensive way" and that an incremental approach would be "highly inefficient."

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JCT releases federal tax expenditures estimate

The Joint Committee on Taxation (JCT) staff on May 25 released its estimate of federal tax expenditures for fiscal years 2017-2021 (JCX-34-18).
URL: https://www.jct.gov/publications.html?func=startdown&id=5095

Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." The JCT provides cost estimates for these provisions to "help both policymakers and the public to understand the actual size of government, the uses to which government resources are put, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation."

In addition to the cost estimates, the JCT report includes a description of modifications to corporate and individual expenditures resulting from recent legislation – including the tax cut legislation (P.L. 115-97) that was enacted at the end of last year. The report also shows the distribution of tax returns by income class, and distributions of selected individual tax expenditures by income class.

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A note on our publication schedule

The House and Senate will be out of session the week of May 28 as lawmakers leave Washington for their Memorial Day recess. Barring any unexpected developments on the tax policy front, the next edition of *Tax News & Views* will be published the week of June 4.

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