Lawmakers clear spending deal – without extenders – ending near-term shutdown threat

Congress this week approved and President Trump promised to sign a massive spending bill that bundles together seven appropriations measures funding numerous departments and agencies, including the Internal Revenue Service, for the remainder of fiscal year 2019 (through September 30). But despite some late stage efforts to address them in the funding bill, lawmakers did not include an extension of the so-called “tax extenders” that lapsed in 2017 and 2018.

The bill, dubbed the Consolidated Appropriations Act, 2019 (H.J.Res.31), is the culmination of work by a bipartisan, bicameral conference committee formed in the wake of the record 35-day partial government shutdown that ended on January 25 after congressional Democrats and the president struck a deal on a stop-gap bill that reopened the government and gave the committee three weeks (that is, until February 15) to resolve the funding impasse.

The omnibus spending bill cleared the Senate February 14 on a bipartisan 83-16 vote and cleared the House of Representatives just hours later by a vote of 300-128. President Trump was expected to sign the measure into law on February 15, thus preventing any lapse in funding.
What’s in

Although seven fiscal 2019 appropriations bills remained outstanding, the conference committee’s main focus was the measure providing funding to the Department of Homeland Security – the vehicle Congress would use if it were going to provide money for the president’s proposed wall along the southern US border.

Congressional Democrats have staunchly opposed the border wall policy from the outset – the president’s demand for $5.7 billion in wall funding was the ostensible reason for the shutdown at the end of 2018 – and, even in the wake of the deal, Democrats and Republicans discussed the package’s border security measures, particularly with respect to barriers, in very different terms.

Democrats, for their part, said they did not accede to a “wall” but rather to providing dollars for a style of fencing already employed at the border.

“The Homeland Security appropriations bill...denies President Trump the billions of dollars he demanded for a concrete wall, providing just $1.375 billion for bollard fencing with limitations to address community and environment concerns,” House Appropriations Chairwoman Nita Lowey, D-N.Y., said in a statement accompanying the deal’s release late February 13.

Meanwhile, the administration discussed the barrier funding more in terms of a down payment on the wall, noting that the president was prepared to use other means at his disposal to achieve his signature policy priority.

“Like the president himself said yesterday, he’s not happy about it, but he’s okay because he’s going to get the job done no matter what,” White House Press Secretary Sarah Huckabee Sanders said on February 13. “The president and his team have been looking at every option possible to get the full funding they need in order to complete the wall.”

And indeed, the president announced during remarks delivered in the White House Rose Garden February 15 that he would declare a national emergency to secure funds for border wall construction without the affirmative consent of Congress. That plan is likely to elicit court challenges from congressional Democrats and other groups, however.

IRS gets near-term budget certainty: Through the Financial Services and General Government appropriations bill – which also provides funding for the Department of Treasury – the deal funds the IRS for the remainder of fiscal year 2019 at a level of $11.3 billion – which is in line with a Senate-passed measure from last year, but shy of the $11.6 billion included in a bill cleared by House Republicans when they controlled that chamber in 2018.

According to a "joint explanatory statement" of the package released by its negotiators, the top-line figure includes roughly $2.49 billion for taxpayer services, $4.86 billion for enforcement, $3.72 billion for operations support, and $150 million for business systems modernization. The agreement also provides $77 million to implement the 2017 tax cut law (P.L. 115-97), subject to certain reporting requirements by the IRS to the House and Senate Appropriations Committees as to its spending plans.


Other departments and agencies funded by deal: Other federal departments receiving full-year funding under the agreement include Agriculture, Commerce, Justice, Interior, State, Transportation, and Housing and Urban Development, as well as agencies such as Food and Drug Administration and the Environmental Protection Agency.

The Departments of Defense, Labor, and Education, and well as the Veterans Administration and the Legislative Branch – among other agencies – had received full-year fiscal 2019 funding as part of an omnibus spending package enacted during 2018.

What’s out (tax extenders for one)

Notably, the short timeframe conference committee members were operating under to hammer out a deal meant that practically all extraneous policies had to be set aside – unlike, as often happens, when a "must-pass" bill becomes a legislative vehicle that carries other, unrelated policies to the president’s desk for signature. For example, lawmakers did not include an extension of the Violence Against Women Act (which expires after February 15), nor did they act to provide back pay to federal contractors affected by the recent shutdown (a priority of many lawmakers in addition to the back pay already enacted for federal employees).
On the tax side, the excluded riders also include the roughly two dozen temporary tax provisions – collectively known as the “tax extenders” – that most recently lapsed at the end of 2017 and a handful of others that expired at the end of last year. (A complete list of expired and expiring provisions from 2017-2019 is available from Deloitte Tax LLP.)

Those provisions at this point primarily consist of incentives on the business side of the tax code for renewable energy and energy efficiency, narrow tax breaks for owners of race horses and motorsports entertainment complexes, and a credit for maintenance of short-line railroad tracks. Because many business taxpayers extend the due date to file their tax returns, there is still time – in theory – for Congress to extend the expired provisions retroactively so that business filers could include these breaks on their originally filed 2018 tax returns (setting aside the implications of retroactive incentives as a tax policy matter, and their potential impact on estimated tax payments and financial reporting).

But there are also a handful of expired provisions affecting individual taxpayers for which there is a greater sense of urgency given that the 2018 filing season is open and the IRS is accepting returns. These provisions include the exclusion from gross income for cancellation-of-debt income on a principal residence, the itemized deduction for mortgage insurance premiums, and the above-the-line deduction for certain tuition and fees.

**Next vehicle?:** Given lukewarm support for the provisions among House Republicans and a level of unfamiliarity with the extenders among the ranks of newly elected House Democrats who are grappling with the implications of the restoration of pay-as-you-go rules, it is generally thought the extenders may require a bigger legislative vehicle to get them over the finish line. But what the vehicle might be is still unclear.

The next “must-pass” bill could relate to raising the statutory debt limit, which was suspended until March 1 of this year under a budget agreement Congress approved in 2018. Once the suspension lapses, however, it is widely expected that the Treasury Department – as it has several times in recent years – will employ so-called “extraordinary measures” to stave off the official date by which lawmakers must raise (or suspend the application of) the debt limit to avoid default.

Treasury has not yet estimated how long such measures could last. (That calculation depends on a number of factors, including the timing and amount of anticipated tax receipts.)

Should any extraordinary measures delay legislative action on the debt limit into late spring or summer as is generally expected, the extenders discussion could become intertwined with another effort generally regarded as a “must-do” – that is, lifting the statutory sequester caps on discretionary spending that, barring action by Congress and the president, will result in tens of billions of dollars in reduced funding for defense and nondefense programs beginning on October 1 when fiscal year 2020 begins. Democrats and Republicans have come together three times since 2013 to lift the sequester caps, always in increments of two fiscal years.

Separate from any high-level sequester deal, by October 1 lawmakers will also have to pass appropriations legislation for fiscal year 2020 providing funding at a programmatic level – an effort that was far from smooth during fiscal 2019.

Senate Finance Committee Chairman Charles Grassley, R-Iowa, told reporters February 14 that he is determined to find a way to advance an extenders package this year.

“There have been press reports stating that, if the extenders aren’t part of the funding bill, they’re dead – and I reject that conclusion. Regardless of what happens on the bill to keep the government open, I will continue to fight to get the extenders enacted,” Grassley said.

— Alex Brosseau
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**Pascrell, Menendez propose repeal of SALT deduction cap**

Maintaining a drumbeat on an issue that is a focus for many “blue state” lawmakers, House taxwriter Bill Pascrell and Senate taxwriter Robert Menendez, both New Jersey Democrats, introduced companion bills February 11 that would
repeal the cap on the federal deduction for state and local taxes (SALT), a provision enacted in the 2017 tax cut law that is impacting taxpayers for the first time this filing season.

The Stop the Attack on Local Taxpayers (SALT) Act of 2019 would eliminate the $10,000 deduction limit imposed under the 2017 tax overhaul known informally as the Tax Cuts and Jobs Act (TCJA, P.L. 115-97) and would offset the cost by increasing the top rate for individuals from 37 percent to its pre-TCJA level of 39.6 percent.

The SALT deduction tends to be used more heavily in higher-taxed “blue” states disproportionately represented by Democrats, such as New Jersey, New York, and California; but lawmakers in both parties who represent jurisdictions with expensive housing markets and steep property and income taxes have decried the cap as unfair to their constituents.

"We know all too well that New Jersey is a high-cost state, where families face high property tax bills and high cost of living," Menendez said in a statement about the bill’s release. "Well, our bill is designed to provide some relief. …Allowing property taxes to be fully deducted has been a bedrock principle of our tax code and is commonsense tax policy that rewards states that invest in things like education, public safety, infrastructure and economic opportunity for all."

Two other House members have introduced SALT repeal bills this year but neither serves on the taxwriting committee, and neither bill includes any revenue offsetting provisions.

Among House Republicans, 11 of the 12 members who voted against the TCJA in 2017 were from California, New Jersey, or New York and cited the SALT deduction cap as the reason for their opposition. (The twelfth, Rep. Walter Jones of North Carolina, who died February 10, voted against the bill because of its projected impact on the federal deficit.)

One Republican, Rep. Chris Smith of New Jersey, has signed on as a co-sponsor of Pascrell’s bill this year.

**Action possible in the House, less likely in the Senate**

The new chairman of the House Ways and Means Committee, Rep. Richard Neal, D-Mass., has also been highly critical of the SALT deduction cap, making it likely that House taxwriters will consider some relaxation or repeal of the $10,000 cap. (The cap was a topic of discussion at a February 13 Ways and Means subcommittee hearing on the TCJA’s economic impact on the middle class. See separate coverage in this issue for details.)

However, repeal of the cap does pose something of a messaging challenge for Democrats because it impacts only those taxpayers who itemize their deductions – a population that is expected to be significantly smaller and concentrated at higher income levels after the 2017 law doubled the standard deduction. Pascrell indicated at a press conference February 12 that the provision returning the top individual tax rate to 39.6 percent was included in the legislation in part to ameliorate concerns that the bill was skewed toward wealthier taxpayers.

Any legislation to repeal or relax the deduction cap that may clear the House is likely to be dead on arrival in the Senate, however. Senate Finance Committee Chairman Charles Grassley, R-Iowa, has indicated he does not plan to revisit the SALT deduction, which makes any change improbable for at least the next two years. (For prior coverage, see Tax News & Views, Vol. 20, No. 6, Feb. 8, 2019.) However, President Trump has signaled recently that he might be open to addressing the deduction cap and met with New York Gov. Andrew Cuomo about the issue this week. If the president were to reverse course and embrace modifications to the cap, the Senate outlook would certain brighten substantially.

**URL:** http://newsletters.usdbriefs.com/2019/Tax/TNV/190208_2.html

— Storme Sixeas
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Boom or bust? House taxwriters split over economic impact of 2017 tax cuts

Familiar partisan fault lines on the impact of the 2017 tax cuts were on full display at a February 13 hearing by the House Ways and Means Select Revenue Measures Subcommittee on how middle-class families are faring in the current economy.

Republicans on the panel generally argued that the 2017 tax law – known informally as the Tax Cuts and Jobs Act or TCJA (P.L. 115-97) – has fueled economic growth, led to a lower unemployment rate, and generated so many new jobs that employers are having a hard time finding workers to fill them. Democrats, meanwhile, contended that the bulk of the economic benefits stemming from the TCJA have redounded primarily to those on the upper end of the income scale and that for many middle-class families any tax savings are being eroded by the rising costs of child care, health care, higher education, and housing.

Dems shaken over SALT deduction cap

Some Democrats on the panel singled out a revenue-raising provision in the TCJA that caps the deduction for state and local taxes (SALT) at $10,000 as particularly detrimental to the middle class.

Under prior law, taxpayers who itemized could deduct all their state and local income taxes (or sales taxes) as well as their property taxes paid against their federal tax liability. The new cap on that deduction became effective for taxable years beginning after January 1, 2018. The SALT deduction tends to be used more heavily in higher-taxed “blue” states such as California, New York, and New Jersey; but the limitation has raised concerns among lawmakers in both parties who represent constituents in jurisdictions with expensive housing markets and steep property and income taxes.

Unfair subsidy?: Subcommittee Democrat John Larson commented that the new cap has had a severe impact on taxpayers in his home state of Connecticut, where the average SALT deduction in prior years had been around $19,000. He asked witness Mark Zandi, chief economist at Moody’s Analytics, whether the cap, in effect, forces Connecticut taxpayers to subsidize the cost of the TCJA’s tax cuts for corporations and wealthy individuals.

Zandi replied that reducing the value of the SALT deduction amounted to “a significant financial hit” to many individuals living in high-cost, high-tax areas. He also noted that house values in these communities are flattening or in some cases dropping as markets adjust to the now-diminished SALT deduction.

Economic disincentive: Witness Kevin Brown, who spoke on behalf of the National Association of Realtors, said in response to questions from Larson and subcommittee member Tom Suozzi, D-N.Y., that capping the deduction creates a disincentive to home ownership and an impediment to wealth building for those in the middle class and those aspiring to rise to the middle class.

“If people can’t write off those taxes it takes the incentive away to buy a house. We strongly believe that entering the housing market is a way to enter the middle class,” Brown told Larson. The TCJA’s cap on the SALT deduction threatens to put the prospect of home ownership out of reach for middle-class individuals in highly competitive real estate markets such as his home state of California, where the median listing price exceeds $500,000, he added.

Pascrell introduces cap repeal: Ways and Means Committee Democrat Bill Pascrell of New Jersey, a vocal opponent of the cap, introduced legislation on February 11 that would restore the SALT deduction and raise the top marginal income tax rate from 37 percent under current law to its pre-TCJA level of 39.6 percent. Senate Finance Committee Democrat Robert Menendez, also of New Jersey, introduced a companion measure in that chamber the same day. (See separate coverage in this issue for details.)

Shrinking refunds

Subcommittee Chairman Mike Thompson, D-Calif., noted early filing season reports from the Internal Revenue Service show that some taxpayers are receiving smaller refunds this year – the first filing year under the TCJA – than in the past, and that other taxpayers who received refunds in the past may now find themselves owing additional tax because of adjustments the Treasury Department made to the income tax withholding tables following the enactment of the new law.
According to the Service’s 2019 filing season statistics for the week ending February 1, the average refund amount paid out was $1,865, a decrease of 8.4 percent from the average of $2,035 for the same period in 2018. The number of refunds was just under 4.7 million, compared to nearly 6.2 million in 2018 – a decrease of 24.3 percent. (Filing season statistics for the week ending February 8, which were released the day after the hearing, show the average refund amount down 8.7 percent from the same period last year – $1,949 in 2019 vs. $2,135 in 2018. The number of refunds was down by 15.8 percent – roughly 11.4 million in 2019 vs. 15.1 million in 2018.)

Mark Zandi of Moody’s told Thompson that it is too early in the filing season to draw definitive conclusions about these statistics, but the lower refund amounts are proving to be a “big surprise” for taxpayers who in the past have relied on income tax withholding throughout the year as a form of forced savings. He added that many people will be "struggling" if this trend continues.

The way the Treasury adjusted the withholding tables post-TCJA “contributed significantly to this shortfall in refunding,” Zandi said. Treasury sought to “juice things up” for taxpayers (by reducing withholding and thus increasing take-home pay) once the TCJA became law, and “now we’re paying the price on the other side,” through a drop-off in refunds, he explained.

**Retail impact:** Thompson argued that shrinking income tax refunds may have a ripple effect on the broader economy. Many taxpayers in the past have treated those payments as an annual bonus that they then used to make major purchases; but smaller refunds may give taxpayers less of an incentive to spend and the retail sector may feel the pinch as a result, he said.

Zandi agreed that retailers traditionally count on refund spending to goose sales. He noted that recent data from retailers appears "very weak" and that smaller-than-expected tax refunds could be one factor – although not the only factor – in lower spending levels.

**Brady, Grassley weigh in:** Republicans on the panel did not address the refund issue in their comments or their questions to witnesses. But Ways and Means Committee ranking Republican Kevin Brady of Texas downplayed concerns over the decline in refund amounts in a February 12 interview on the Fox Business Network.

“Tax refunds, the amount of that, simply means how much you didn’t have in your paycheck last year. If you are living paycheck-to-paycheck like most families, you want that tax relief every month, you don’t want it a year later – which is what refunds represent,” he said.

And on the other side of the Capitol, Senate Finance Committee Chairman Charles Grassley, R-Iowa, suggested to reporters February 13 that some of the TCJA’s detractors in Congress may be misleading taxpayers by conflating the size of their refund with the amount of tax they paid.

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**Underpayment penalties:** In a related development, Ways and Means Committee Democrats John Lewis of Georgia and Judy Chu of California (who are not on the Select Revenue Measures Subcommittee) expressed concern that post-TCJA adjustments to withholding tables may leave some taxpayers subject to penalties for underpayment of tax for 2018 because of insufficient withholding over the past year.

In a February 12 letter to Treasury Secretary Steven Mnuchin and IRS Commissioner Charles Rettig, Larson and Chu requested that the underpayment penalty be waived for 2018 for taxpayers whose withholdings and payments equal at least 80 percent of their total liability. (The current-law threshold for penalty relief is 85 percent.)

Republicans upbeat

For their part, Republican subcommittee members offered statistical and anecdotal evidence to make a case that the tax cuts enacted last year are already improving the economy.

Subcommittee ranking member Adrian Smith, R-Neb., said in his opening statement that “[o]ur economy is growing at greater than 3 percent. Wages are growing at nearly 4 percent. The state of our economy is strong. It has never been easier for an American who wants to take advantage of economic opportunity to get training, enter the workforce, or find a better job.”

Subcommittee Republican Tom Rice of South Carolina likewise noted that because of the TCJA the outflow of jobs overseas is declining, job opportunities for blue collar workers are expanding, and the future for the middle class is “brighter now than it has been in decades.”

Rep. Drew Ferguson, a Republican from Georgia who joined the Ways and Means Committee earlier this year, said that business owners in his community report that the investments they are making in their businesses, their employees, and new equipment and technology are a direct result of the new law and that all of those investments “are just beginning to come to fruition.”

For his part, the GOP’s sole invited witness, Guy Berkebile, president and founder of Guy Chemical Company in Somerset County, Pa., told the panel in his opening statement that the TCJA enabled him to keep more money in his company and invest it in new equipment, increase employee salaries and bonuses, and hire more workers.

Policy prescriptions

Subcommittee Chairman Mike Thompson asked Moody’s Mark Zandi how he would have written a tax bill in 2017 if given the chance.

Zandi replied that he is “a fan” of a lower corporate tax rate, but that it would have to be paid for to provide a net benefit to the economy. He added that he would not have cut rates for wealthy individuals or provided more generous exemptions for the estate tax.

Responding to a subsequent question from subcommittee Democrat Lloyd Doggett of Texas, Zandi noted that deficits will increase and economic growth will decline over time because the TCJA is largely unoffset. He urged lawmakers not to exacerbate those problems by passing additional deficit-financed tax cuts.

But ranking Republican Adrian Smith cautioned against undoing any of the TCJA’s tax cuts.

“The worst thing we could do for middle class families is to take more of what they earn through tax increases,” he said.

Echoing comments from other Ways and Means Republicans over the past year, Smith also argued that taxwriters should not approach tax reform as a once-in-a-generation exercise but should instead “work every year to ensure the tax code is working well for as many Americans as possible.”

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

McConnell tees up vote on Desmond’s nomination for IRS chief counsel post

Senate Majority Leader Mitch McConnell, R-Ky., on February 14 filed cloture on President Trump’s long-stalled nomination of Michael Desmond to serve as IRS chief counsel and Treasury assistant general counsel.
Filing cloture

McConnell’s action means that the Senate is now poised to hold a vote on the motion to proceed to the Desmond nomination during the week of February 25. (Congress is not scheduled to be in session the week of February 18). If the cloture vote is successful, a final vote on confirmation could follow soon thereafter.

Importantly, because of changes to Senate rules pushed by then-Majority Leader Harry Reid, D-Nev., in 2013 and expanded upon by McConnell last year, at this point all presidential nominations (including Supreme Court nominees) can clear the chamber with a simple majority vote (i.e., 51 votes), rather than the usual three-fifths majority typically needed to overcome procedural hurdles.

Because they control 53 Senate seats and can rely on Vice President Mike Pence to cast a tie-breaking vote in their favor if necessary, Republicans appear very likely to achieve cloture on Desmond’s nomination, which would then set in motion up to 30 hours of post-cloture debate followed by another simple majority vote to confirm the nomination. Timing of the votes will depend on the Senate’s time in session, the number of other items on the schedule, and the extent to which anyone who opposes Desmond’s nomination wants to use up the 30 hours of debate time allotted to them.

Second swing

This is Desmond’s second swing at the Senate confirmation process. President Trump tapped him for the IRS and Treasury posts last year; but even though his nomination cleared the Finance Committee, it was never taken up on the Senate floor during in the 115th Congress and expired when that Congress adjourned early last month. The president renominated Desmond to the positions on January 16 and the nomination advanced out of the Finance Committee by a vote of 26-2 on February 5.

Finance Committee Democrat Robert Menendez of New Jersey, who (along with Democrat Sheldon Whitehouse of Rhode Island) voted against advancing Desmond, promised to put a hold on Desmond’s nomination when it was sent over to the Senate, citing his disagreement with IRS and Treasury guidance from last year that effectively shut down efforts in certain states – including New Jersey – to allow taxpayers to characterize certain state and local tax (SALT) payments as charitable contributions in order to circumvent the $10,000 annual cap on deductibility of state and local income and property taxes that was enacted in the 2017 tax cut law. (Menendez likewise placed a hold on Desmond’s nomination when it was sent over to the Senate last year.)

The SALT deduction tends to be used more heavily in higher-taxed “blue” states such as New Jersey, New York, and California. House and Senate lawmakers in both parties who represent constituents in jurisdictions with expensive housing markets and steep property and income taxes have decried the cap as unfair to their constituents. (The deduction cap was a target of criticism among Democrats at a House Ways and Means subcommittee hearing this week and companion bills to repeal the cap were introduced by Sen. Menendez and House taxwriter Bill Pascrell, D-N.J. See separate coverage in this issue for details.)

Running out the clock

Menendez’s hold is largely rhetorical in nature, given McConnell’s ability to file cloture on the nomination at any time with requisite Republican support and the GOP’s ability, under the rule changes already noted, to clear the nomination with a simple majority vote. Nonetheless, Menendez, or any other Democratic senator for that matter, could ensure that the Senate expends the full 30 hours of post-cloture debate on Desmond’s nomination, thus occupying floor time that would otherwise be spent on other nominees or other legislation waiting to be taken up in the chamber.

― Michael DeHoff
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A note on our publication schedule

The House and Senate will be out of session from February 16 through February 24 for the Presidents’ Day recess. Barring any unexpected developments on the tax policy front, the next edition of *Tax News & Views* will be published the week of February 25.

— Jon Traub  
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