Democratic effort to overturn Treasury rules on workarounds for SALT deduction cap fizzes in Senate

Senate Democrats forced a vote October 23 on a resolution that would have weakened the impact of the $10,000 cap on the deduction for state and local taxes (SALT) included in 2017’s tax overhaul, but they were unable to muster enough support to secure its passage.

The Democratic resolution, which, if approved in both chambers and enacted into law, would have invalidated final regulations from the Treasury Department that clamp down on efforts by certain states to allow their residents to work around the deduction cap, was defeated by a largely party-line vote of 43-52.

One Democrat broke ranks to oppose the resolution and one Republican voted to support it.

Background

The SALT deduction cap was a rare provision from the law informally known as the Tax Cuts and Jobs Act (TCJA, P.L. 115-97) that drew opposition from some congressional Republicans (mainly in the House) in addition to the more united outcry from Democrats.
Before the TCJA was enacted, 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; but the new law capped 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 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 $10,000 cap as unfair to their constituents.)

After TCJA took effect, a number of states contemplated workarounds – which typically involve allowing taxpayers to characterize payments of certain state and local taxes as deductible payments to state-sponsored charitable agencies in exchange for a state or local tax credit – and programs were enacted in New York, New Jersey, Connecticut, and Oregon. However, in final regulations released in June, Treasury and the IRS held that, in general, taxpayers who make payments or transfer property to an entity eligible to receive tax-deductible contributions must reduce their charitable deduction by the amount of any state or local tax credit they receive or expect to receive.


In July, Democrats introduced joint resolutions of disapproval of those regulations in the House (H.J. Res. 72) and the Senate (S.J. Res. 50) under the Congressional Review Act, which allows Congress to review and disapprove certain rules recently issued by federal agencies. Resolutions moved using this process require only a simple majority vote for passage in each chamber – something that can be particularly important in the Senate, where a three-fifths supermajority typically is needed to overcome procedural hurdles.

URL: https://www.democrats.senate.gov/imo/media/doc/KAT19129.pdf

Little crossover appeal

Getting the disapproval resolution through the Senate was seen as a longshot for Democrats: they control only 47 seats in the chamber; Republicans generally were unlikely to support an effort that would have undermined a key provision in their signature tax cut legislation; and even though several GOP senators represent states where there has been some interest in SALT workaround programs, none felt enough political pressure to be induced to cross the aisle and cast an “aye” vote.

A spokesman for Kentucky Sen. Rand Paul, the one Republican who voted for the resolution, told Tax Notes that the senator supported the TCJA as a whole but objected to provisions that limited existing tax deductions.

For his part, Colorado Democratic Sen. Michael Bennet, the sole Democratic “no” vote, said in a Senate floor speech that the IRS rules are overly broad and detrimental to programs that pre-dated the TCJA. But he opposed the resolution using the argument generally made by Republicans and bolstered by a report from the Joint Committee on Taxation staff on the distributional effects of various provisions in the TCJA: that weakening the regulations or repealing the cap would disproportionately advantage wealthier taxpayers.

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

In his own floor remarks, Majority Leader Mitch McConnell, R-Ky., accused Democrats of wanting to “[change] the tax code so that working families across the country have to subsidize wealthy people in states like New York, New Jersey, and California” and Senate Finance Committee Chairman Charles Grassley, R-Iowa, referred to state-enacted workaround programs to the deduction cap as “state-sanctioned tax shelters.”

House developments

The House has not held a floor vote on its disapproval resolution and this week’s results in the Senate would appear to render such an effort moot. But House Democratic taxwriters have been grappling all year with the SALT deduction cap – including whether to push for full or partial repeal and whether to offset the cost of any changes to the TCJA provision.

An informal working group led by Rep. Mike Thompson of California, chairman of the House Ways and Means Select Revenue Measures Subcommittee, has not yet produced a legislative solution. But Thompson told reporters October 22 that the group is working to draft a bill and still hopes to see action in the House Ways and Means Committee before the end of this year.
“We’re going to write legislation that’s paid for and legislation that addresses this mess that the Republican tax bill created,” Thompson said.

According to The Hill newspaper, Rep. Bill Pascrell, D-Mass., another Ways and Means member involved in the discussions, indicated on October 22 that the bill being drafted could involve increasing the cap from $10,000 to $25,000 or $30,000 and could be paid for by increasing the top individual income tax rate.

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**Prospects for extenders remain uncertain, despite small signs of activity**

Even as a pair of House bills that would permanently extend temporary tax incentives for short-line railroads and craft brewers reached a support milestone this week that guarantees their eventual consideration on the House floor – and House Democratic taxwriters appeared to be closing in on a separate deal to extend renewable energy incentives – the broader debate around the tax extenders remains mired in uncertainty with most stakeholders still eyeing the November 21 government funding deadline as the next potential opportunity for action.

**Grassley cites lack of Democratic ‘interest’**

That uncertainty was exemplified by Senate Finance Committee Chairman Charles Grassley, R-Iowa – a long-time supporter of presently lapsed incentives for the production of biodiesel and renewable diesel fuel – in comments he made to reporters on October 22 suggesting that Democrats lack the political will to move an extenders package.

“Whether it’s the biodiesel tax credit or any one of the other extenders – 27 today and five more are going to be added by December 31 – I don’t see the interest of Democrats in tax extenders like they’ve traditionally had,” Grassley said.

That lack of interest does not, it would seem, extend to the panel’s top Democrat, Ron Wyden of Oregon, who together with Grassley introduced legislation this past February that would retroactively extend through the end of this year some two dozen temporary incentives that expired at the end of 2017 and a handful of others that expired at the end of 2018. (For prior coverage, see Tax News & Views, Vol. 20, No. 8, Mar. 1, 2019.)


But despite its high-profile support in the upper chamber, the Grassley-Wyden bill has not been taken up by the full committee and a mark-up is not currently on the panel’s official schedule – an implicit recognition that any tax legislation is unlikely to move on its own this year but will instead be attached to a broader, “must-pass” legislative package – such as an appropriations measure. Indeed, Grassley recently told Tax Notes that his staff is currently involved in a “four-corner negotiation” on an extenders deal with aides to Wyden, House Ways and Means Committee Chairman Richard Neal, D-Mass., and Ways and Means ranking Republican Kevin Brady of Texas, that could be incorporated into a year-end tax package and obviate the need for Senate taxwriters to mark up a bill of their own. (For prior coverage, see Tax News & Views, Vol. 20, No. 33, Oct. 18, 2019.) Ways and Means Democrats, for their part, staked out their position on extenders in legislation that cleared the committee on June that would re-up through 2020 the bulk of the 2017 and 2018 expired provisions as well as those set to lapse at the end of 2019. (For details on that bill, see Tax News & Views, Vol. 20, No. 21, June 21, 2019.)


Finance Committee Republican Steve Daines of Montana told reporters October 24 that progress on extenders negotiations has been slowed by Democratic efforts to add certain non-extenders provisions into the mix – for example, expansions of the child tax credit and the electric vehicle credit – something he said Republicans would oppose. (Daines said his comments were based on a recent meeting that Chairman Grassley held with Finance Committee Republicans to discuss extenders issues.)
Incentives for short-line railroads, craft brewers get a boost in the House

On a micro level, a pair of House bills dealing with discrete sets of extenders provisions received positive attention this week due to the breadth of their support, even though they are unlikely to be enacted on a stand-alone basis.

Under current House rules, sponsors of legislation with the formal backing of at least two-thirds of the House, or 290 members, may move to have it placed on the “consensus calendar” which then fast-tracks its consideration on the floor after a layover period of 25 legislative days. Bills brought to the floor under this process are also considered “under suspension of the rules” – a scenario that suspends application of House rules (for example, House Democrats’ pay-as-you-go rule, which requires the budgetary cost of certain legislation to be offset) that may otherwise apply.

Separate tax legislation from House Democratic taxwriters Earl Blumenauer of Oregon and Ron Kind of Wisconsin reached that level of support this week, meaning that the bills are virtually guaranteed a House vote in the upcoming weeks, bypassing a mark-up by the Ways and Means Committee.

Blumenauer’s bill, the Building Rail Access for Customers and the Economy (BRACE) Act of 2019 (H.R. 510) – which would permanently extend the credit under tax code section 45G for expenditures related to maintaining so-called “short-line” railroad tracks – had garnered 293 cosponsors as of October 25. The section 45G credit remains expired after its most recent lapse on December 31, 2017.

Kind’s bill, the Craft Beverage Modernization and Tax Reform Act of 2019 (H.R. 1175), which he introduced earlier this year with fellow taxwriter Mike Kelly, R-Pa., had collected 299 cosponsors by October 25. That legislation would permanently reduce excise taxes on craft beer, wine, and distilled spirits – policies that were originally enacted as part of the GOP’s 2017 tax cut legislation (P.L. 115-97) but are slated to expire after 2019 – and make other nontax changes for the industry as well.

Support in the Senate: It’s worth noting that companion versions of both bills have been introduced in the Senate and boast a bipartisan roster of co-sponsors, including several Finance Committee members. The Senate version of the BRACE Act (S. 203), introduced by GOP taxwriter Mike Crapo of Idaho, has 62 co-sponsors, and the Senate version of the Craft Beverage Modernization and Tax Reform Act (S. 362), introduced by top Democratic taxwriter Ron Wyden, has 71. The Senate, however, has no similar consensus calendar rule that assures floor time for bills with broad, bipartisan backing.

It’s also worth noting that permanent extensions of the short-line railroad credit and the craft brewing incentives are among the few concrete recommendations to emerge from the four-month effort by the six bipartisan Finance Committee task forces that were responsible for examining expired and expiring provisions from 2017 through 2019 and identifying potential ways to declutter the tax code – for example, by calling for provisions to be made permanent or expunged from the code based on their relative policy merits. (For prior coverage, see Tax News & Views, Vol. 20, No. 33, Oct. 18, 2019.)

‘Green energy’ tax incentives

In other tax extenders news this week, House taxwriter Dan Kildee, D-Mich., told reporters on October 22 that he and his Democratic Ways and Means Committee colleagues were closing in on an energy-focused tax package, generally understood to be aimed at addressing expired and expiring incentives for renewable and alternative energy sources and expanding the current-law credit for electric vehicles.

Ways and Means Democrats earlier this summer had hoped that an energy tax package could be marked up by the full committee early this fall; but the practicality of holding such a mark-up appears to be fading as the November 21 deadline rapidly approaches for lawmakers to agree on appropriations legislation to prevent a government shutdown.

“Timing has been an issue,” Kildee said on October 22. “My goal from the beginning was get it done this fall. It may be the cooler section of this fall.”
Of course, even if a package is not formally taken up the full committee, a consensus bill put forward by Ways and Means Democrats could in theory lay down a marker and influence future negotiations with House and Senate Republicans.

**As for budget offsets?** Kildee also noted that the package as currently structured does not include offsets. However, Ways and Means Committee ranking member Kevin Brady reportedly said this week that he expects Democrats to target oil and gas tax incentives as pay-fors – an outcome that would be consistent with prior discussions among House Democratic taxwriters but that would surely hit a roadblock during bipartisan negotiations.

**Appropriations bill still the likely extenders vehicle**

As taxwriters and outside stakeholders continue to pin their hopes of moving tax extenders legislation on the passage of an appropriations package, the House and Senate continue to work on the 12 spending bills needed to fund government agencies for fiscal year 2020, which began on October 1. In the meantime, the government is operating on a continuing resolution that keeps the doors open – at fiscal 2019 funding levels – through November 21. So, in theory, the next possible opportunity for lawmakers to move tax legislation may be in late November when the stopgap spending agreement is set to expire. But any delays in the appropriations process could require additional short-term spending bills to keep the government open, which in turn could mean a delay in wrapping up an agreement on tax legislation.

— Alex Brosseau
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**Ways and Means OKs bills addressing e-cigarettes, health savings and spending arrangements, prescription drug pricing**

The House Ways and Means Committee cleared a series of bills this week that would harmonize the tax treatment of e-cigarettes and traditional cigarettes, relax some of the rules around eligible expenses for tax-preferred health savings accounts and flexible spending arrangements, and impose an excise tax on drug manufacturers that do not participate in a proposed mandatory federal program to negotiate maximum prices for certain prescription drugs.

**E-cigarettes, health savings arrangements**

The taxwriting panel approved legislation (H.R. 4742) on October 23 that would align the tax treatment of e-cigarettes and traditional cigarettes by imposing a new excise tax on nicotine used in vaping. H.R. 4742 is sponsored by Ways and Means Committee member Tom Suozzi, D-N.Y., and Rep. Peter King, R-N.Y.

**URL:**

Smoking-related excise taxes currently apply only to various types of traditional tobacco products as well as cigarette papers and tubes. H.R. 4742 would expand those levies to include “taxable nicotine” – defined as any nicotine which has been extracted, concentrated, or synthesized. That definition would exclude nicotine that will be used in a product which has been approved by the Food and Drug Administration for sale as a nicotine replacement therapy (although it would be up to manufacturers and importers to provide proof of that intended use to the Treasury Department). Other tobacco products that are currently subject to tax would not be treated as containing taxable nicotine solely because the nicotine naturally occurring in the tobacco from which those products are manufactured has been concentrated during the ordinary course of manufacturing.

The amount of tax would be the greater of:

- The dollar amount specified for small cigarettes in section 5701(b)(1) or
- $50.33 per 1,810 milligrams of nicotine (and a proportionate tax on any fractional part thereof).
The bill provides that taxable nicotine also would be subject to the same general provisions that currently apply to tobacco products – for example, packaging requirements; provisions relating to the purchase, receipt, possession, or sale; and provisions relating to civil and criminal penalties.

H.R. 4742 would take effect for products manufactured and imported in calendar quarters beginning more than 90 days after the date of enactment. A description of the bill is available from the Joint Committee on Taxation (JCT) staff.

**URL:** https://www.jct.gov/publications.html?func=startdown&id=5225

**Partisan split:** Passage of the bill came largely party lines, with 24 members voting "aye," 15 voting "nay," and 1 voting "present." Democrat Stephanie Murphy of Florida voted against the measure and Democrat Lloyd Doggett of Texas voted present after they noted that it would not raise enough revenue to completely offset the cost of the health care tax incentives also being considered at the mark-up (more on all of that below). Doggett also expressed doubt that the bill as drafted would do enough to curb vaping.

Republicans Vern Buchanan of Florida and Tom Rice of South Carolina broke ranks to vote in favor of the bill.

Democrats on the panel generally argued that taxing nicotine used in vaping products – and thereby raising the cost to consumers at the point of sale – would reduce the incidence of vaping, particularly among young people, and would, in turn, curb the recent spike in vaping-related illnesses and deaths.

Republicans, for their part, agreed that vaping poses a public health threat that Congress needs to address; but they questioned whether imposing a new tax on nicotine would produce the desired public health results and suggested that such an approach would simply drive up purchases of vaping products on the black market. They also contended that before holding the mark-up, Democrats should have followed regular order and held hearings that would have allowed the committee to explore other possible approaches to the problem (such as increasing the age for legal sale and use of vaping products) and consider the public health impact of non-nicotine substances (such as THS and CBD) that are also used in vaping.

**Revenue to offset health care incentives:** The revenue from this proposal – estimated at $9.9 billion over 10 years, according to the JCT staff – would largely offset the cost of several targeted bills approved at the mark-up that would expand certain benefits available under various tax-preferred health care savings vehicles. These measures, which would reduce federal receipts by a combined $11.7 billion over 10 years, would:

- Treat purchases of over-the-counter drugs and over-the-counter menstrual products as qualified medical expenditures for purposes of tax-preferred health savings accounts, Archer Medical Savings Accounts, health flexible spending arrangements, and health reimbursement arrangements (H.R. 1922, sponsored by Ways and Means Committee members Ron Kind, D-Wis., Jackie Walorski, R-Ind., Darin LaHood, R-Ill., and Rep. Grace Meng, D-N.Y.). This proposal generally would be effective for amounts paid or expenses incurred after December 31, 2019 (JCT estimated 10-year revenue loss: $8.5 billion).

- Provide a safe harbor for high-deductible health plans that do not include a deductible for certain inhalers to treat chronic lung conditions (H.R. 4716, sponsored by Ways and Means member Terri Sewell, D-Ala., and Rep. T. J. Cox, D-Calif.). H.R. 4716 would take effect in months beginning after the date of enactment (JCT estimated 10-year revenue loss: $1.4 billion).
  **URL:** https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HR%204716%20AS%20INTRODUCED.pdf

- Permit a taxpayer with a primary care service arrangement whose fixed periodic fee does not exceed $150 a month to participate in and contribute to a health savings account (H.R. 3708, sponsored by Ways and Means members Earl Blumenauer, D-Ore., Devin Nunes, R-Calif., Brad Schneider, D-Ill., and Jason Smith, R-Mo.) H.R. 3708 would be effective for months beginning after December 31, 2019, in taxable years ending after that date (JCT estimated 10-year revenue loss: $1.8 billion).
  **URL:** https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HR%203708%20AS%20INTRODUCED.pdf
All three bills cleared the committee by voice vote.

**Next steps:** The nicotine tax proposal and the three health care tax incentive measures now advance to the full House for consideration, although it is currently unclear when or if they will be brought to the floor. Also unclear is whether the four measures will be packaged into a single bill either before or after any floor action and how, if at all, Democrats would seek to close the gap between the revenue generated by the vaping tax bill and the revenue lost as a result of the three bills modifying health savings accounts.

Senate Finance Committee ranking Democrat Ron Wyden of Oregon introduced similar anti-vaping legislation (S. 2463) in his chamber in September. That measure currently has 21 co-sponsors – all Democrats. Finance Committee Chairman Charles Grassley, R-Iowa, is said to support legislation to reduce vaping but has not signaled whether he is open to addressing the problem through the tax code.

**Prescription drug pricing**

In other developments, the committee on October 22 approved on a party-line vote of 24-17 legislation (H.R. 3) that, broadly speaking, would require prescription drug manufacturers to negotiate with the federal government to determine maximum prices for certain selected prescription drugs and insulin products. Negotiated prices would have to be offered under Medicare and Medicare Advantage, and could be offered under private health insurance unless the insurer opts out.

**Manufacturer excise tax:** The bill provides that drug manufacturers that do not participate in the mandatory price-setting program would face a new “manufacturer excise tax” under Internal Revenue Code Chapter 32 that would apply to all sales by a manufacturer, producer, or importer of those products that are subject to a negotiated price cap.

The initial tax rate would be set at 65 percent and would increase incrementally, up to a maximum of 95 percent, for taxpayers that fail to meet certain compliance benchmarks that are laid out in the bill. Certain civil penalties also would apply. The provision would be effective for sales after the date of enactment. According to the JCT staff, the excise tax is not expected to have an effect on federal budget receipts for fiscal years 2020 through 2029. (A description of the drug pricing program and the excise tax provision is available from the JCT staff.)

**Unlikely to become law:** It is currently unclear when H.R. 3 will reach the House floor. House leaders had planned to hold a vote the week of October 28, but some reports this week suggested that action might be delayed until mid-November.

Assuming that H.R. 3 eventually clears the House along party lines, it is not expected to become law. Senate Majority Leader Mitch McConnell, R-Ky., has already stated that he does not intend to take up the bill when it reaches his chamber. The Senate Finance Committee approved its own prescription drug pricing bill – the Prescription Drug Pricing Act of 2019 (S. 2543) – in July. That measure does not include tax provisions.