OECD endorses international tax rewrite efforts, punts on ‘safe harbor’ proposal

Following two days of meetings in Paris, officials from the Organisation for Economic Co-operation and Development (OECD) announced January 31 that the 130-plus countries working to revise international tax rules have endorsed the ongoing work and reiterated their commitment to achieving consensus – but punted any resolution on a recent US “safe harbor” proposal perceived by some to be a deal-breaker.

A statement from the group, an outline of the project’s architecture, and other update information are available on the OECD website.


Technical and political challenges

Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration, and other officials acknowledged at a briefing that there are still significant technical and political challenges ahead as the participating jurisdictions...
work towards agreement on exactly how to levy taxes that account for the digitalized global economy. Among these is a proposal made by Treasury Secretary Steven Mnuchin this past December that the new allocation of taxing rights be implemented on a "safe harbor" basis. The safe harbor proposal came as a surprise and many stakeholders have understood it to mean that the new allocation rules would be optional for companies.

Saint-Amans said that "nothing is agreed until everything is agreed" but noted that the US is still engaged in the process and that all the participants agreed this week to keep working on both pillars of the project. (For prior coverage, see Tax News & Views, Vol. 21, No. 3. Jan. 24, 2020.)

URL: https://newsletters.usdbriefs.com/2020/Tax/TNV/200124_1.html

In their statement, the participating countries – known as the Inclusive Framework – endorsed the OECD's Unified Approach to Pillar One, which deals with the reallocation of taxing rights, and noted some refinements and decisions made at this week's meeting. One key decision made was that the scope of impacted companies will have two main components: automated digital services, which is expected to include search engines, social media platforms, online intermediaries, streaming and gaming platforms, cloud computing services, and online advertising; and consumer-facing businesses, which was in the draft released last fall. (For prior coverage, see Tax News & Views, Vol. 20, No. 32, Oct. 11, 2019.) Extractive industries and other producers and sellers of raw materials and commodities will be excluded, as will airline and shipping businesses, and the document notes the compelling case for excluding most activities of the financial services sector.

URL: http://newsletters.usdbriefs.com/2019/Tax/TNV/191011_2.html

Projected timeline

The project is still aiming to achieve consensus by the end of 2020 – a timeline that Saint-Amans acknowledged "may look a bit insane." Further technical work would occur in 2021, so implementation is not likely before 2022. This still means the many details and technical challenges need to be tackled before the work product is presented to the leaders of the G-20 at a meeting scheduled for late this coming November.

"We don't have a Plan B," Saint-Amans said, adding that "the alternative looks pretty bleak" and that the practical reality of failure at the OECD would be "a trade war."

US and France recently stepped back from a series of retaliatory tax and trade actions that began with France's implementation last fall of a digital services tax (DST) on large, mostly US-based technology companies. France has agreed to postpone its next collection of the tax until the end of this year in the hope that there will be a multilateral consensus at the OECD by then that will supersede what it views as the need for a unilateral measure. One refinement to the unified approach announced this week was a commitment by countries to "withdraw relevant unilateral actions" when the new agreement is implemented.

In addition to keeping alive Pillar One, which requires global consensus, the Inclusive Framework countries and OECD also provided an update on the work under Pillar Two, which seeks to ensure that companies are subject to a minimum level of taxation globally but does not require action by all countries. The progress note stated, that "[s]ignificant work on key issues is advancing at a fast pace with good technical progress on many aspects of the GloBE [Pillar Two] proposal but significant work still remains.”

Next Steps

Technical work on both pillars will continue in the months ahead, and the Inclusive Framework will convene again July 1-2. By this time, many of the key decisions about the new Pillar One architecture – including relevant business activities, thresholds, and formulas – will likely need to be agreed to if the project is to meet the year-end target for full consensus. This week's statement notes that the work of identifying the necessary changes to tax treaties to remove implementation barriers does not need to be done until November. However, this point is a reminder that implementing such a new tax regime will almost certainly require treaty changes and congressional approval.

On February 13, the OECD will provide an overview of its work to date analyzing the economic impact of the proposals under consideration. This assessment will look at the impact not only on individual countries but also on the global economy.
Ways and Means members debate highway funding options as House Democrats unveil infrastructure framework

Lawmakers at a January 29 House Ways and Means Committee hearing on options for funding and financing infrastructure investments split over the idea of increasing the federal fuels tax to pay for surface transportation maintenance and construction projects. But there was greater consensus when the discussion turned to the possibility of generating revenue through a vehicle-miles-traveled tax and attracting outside investment through incentives such as tax-preferred bonds.

The hearing came as House Democrats released their framework for a five-year infrastructure proposal that calls for $760 billion in new spending – including $434 billion just for highways, bridges, and mass transit – but makes no recommendations with respect to revenue offsets. (The framework also calls for investments in rail transportation, airport and aviation infrastructure, harbor maintenance and water resources, and broadband infrastructure, also without recommending offsets.)

URL: https://transportation.house.gov/imo/media/doc/Moving%20Forward%20Framework.pdf

A little background

The bulk of the revenue stream for the Highway Trust Fund comes from excise taxes on gasoline and diesel fuel. Additional revenue is generated from a sales tax on heavy highway vehicles, an annual use tax on heavy vehicles, and an excise tax on heavy-vehicle tires. These taxes are authorized in multi-year surface transportation bills and must be renewed periodically. Expenditures from the Highway Trust Fund have outstripped revenues since 2001, and since fiscal year 2008 Congress has supplemented the Highway Trust Fund with transfers from the Treasury General Fund and occasionally has approved discrete revenue-raising provisions in transportation funding bills to address the shortfall.

Expenditure authority for the Highway Trust Fund is authorized through September 30 of this year, and the taxes that provide the trust fund’s dedicated revenue stream are scheduled to expire on September 30, 2022.

The nonpartisan Congressional Budget Office (CBO) has estimated that total outlays from the trust fund’s Highway Account and Mass Transit Account will exceed revenue collected from the fuels taxes by a total of more than $188 billion over the 2020-2030 budget window, with shortfalls beginning in fiscal year 2021 for the Mass Transit Account and by fiscal year 2022 for the Highway Account. Those projections assume that the taxes dedicated to the Highway Trust Fund will not expire in 2022 as currently scheduled. (See separate coverage in this issue for details on the CBO’s budget and economic outlook for 2020-2030.)


An overview of options for funding and financing infrastructure investments is available from the Joint Committee on Taxation (JCT) staff.

URL: https://www.jct.gov/publications.html?func=startdown&id=5243

Gas tax

During the hearing, Ways and Means Committee Chairman Richard Neal, D-Mass., did not explicitly endorse or reject the idea of increasing the federal gasoline tax, which has remained at 18.4 cents per gallon since 1993, but he did ask witnesses for their thoughts about the need for a predictable, sustainable revenue stream for the Highway Trust Fund.

New Jersey Department of Transportation Commissioner Diane Gutierrez-Scaccetti, who in her opening statement urged taxwriters to keep the gas tax and index it to inflation, told Neal that state and local governments cannot plan or prioritize projects unless they know what revenues will be available from the federal government over the long term.
In response to a subsequent question from Rep. Danny Davis, D-Ill., Gutierrez-Scaccetti explained that the gas tax gives states “a strong foundation” to plan for current and future infrastructure projects. Knowing that the revenue stream is there “on a foundational level” frees up local governments to consider additional, more creative financing techniques, she added.

Other Democrats on the panel were emphatic about retaining and increasing the gas tax. Rep Don Beyer of Virginia, for example, said Congress should approve “the largest gas tax increase the public will support” and Reps. Tom Suozzi of New York and Jimmy Gomez of California urged their colleagues to accept the fact that paying for infrastructure improvements will require raising new revenue.

Republican taxwriters, for their part, agreed with the need to pay for new infrastructure spending but rejected the notion of a gas tax increase as the way to do it.

“We need infrastructure, not tax increases on the American people or job-creating businesses,” ranking member Kevin Brady, R-Texas, said in his opening statement. Brady noted that infrastructure legislation traditionally has cleared Congress with bipartisan support, but he warned that would not be the case if Democrats insist on paying for it by increasing taxes.

Two Republicans on the panel – Tom Reed of New York and Mike Kelly of Pennsylvania – commented that a number of states have been aggressive about raising their own gas taxes to make up for the shortfall from federal tax receipts. Reed also asked whether the federal gas tax is “a dying tax,” alluding to the increasing number of electric and hybrid vehicles on the road.

Responding to Reed, Joung Lee of the American Association of State Highway and Transportation Officials acknowledged that 39 states have indeed been “proactive” in raising their fuel taxes to pay for infrastructure projects, but he added that states still expect the federal government to provide their share of the funding.

Republican taxwriter Darin LaHood of Illinois also commented on the number of states increasing their gas taxes and added that the public might be more supportive of a federal gas tax hike if they could be assured that their tax dollars would actually be used to pay for infrastructure projects and not be diverted to other budget priorities.

**Vehicle-miles-traveled taxes**

One infrastructure-related tax proposal that appeared to spark interest among Republicans (like LaHood and Rep. Jackie Walorski of Indiana) as well as Democrats (such as Rep. Jimmy Panetta of California) was a vehicle-miles-traveled tax (VMT) that would be levied on vehicle owners based on the number of miles actually driven over a specified period of time. (The House Democratic framework calls for a multi-year national pilot program to test the feasibility of surface transportation user fees, including a VMT. It’s worth noting, though, that Rep. Peter DeFazio, D-Ore., who chairs House Transportation and Infrastructure Committee – one of the panels with jurisdiction over highway legislation – said this week that it is “not possible” to include a VMT in a highway bill this year.)

Some witnesses at the hearing commented that a VMT has merit and deserves further study, although they questioned whether it could be implemented in the near term.

Diane Gutierrez-Scaccetti said in response to a question from Panetta it is too soon to consider a federal VMT as a replacement for the gas tax. States that have experimented with a VMT are still collecting data on their programs and policymakers would have to iron out issues around how revenues from a federal VMT would be distributed, she said.

Joung Lee told Panetta that the technology exists to collect data and implement a federal VMT but noted that policymakers would need to address “public perception issues” about the proposed tax.

Witness DJ Gribbin of Madrus, LLC, said in response to a question from LaHood that the transportation industry is prepared to address potential privacy concerns around a VMT from a technological as well as a cultural perspective. He noted that younger people are often more comfortable with the general idea of personal data collection than some other generations.
Tax-preferred bonds and other incentives

Financing infrastructure projects through tax-preferred bonds likewise prompted bipartisan support among taxwriters. Chairman Neal called them "one of our most powerful tools" that "allow us to leverage our federal investment dollars, which is essential at a time when the United States faces the largest infrastructure funding gap in the world...."

Neal was particularly enthusiastic about the Build America Bonds program, which was enacted in the American Recovery and Reinvestment Act of 2009 and expired in 2010, lauding it as "a more efficient way to support state and local governments' borrowing costs."

Ranking member Brady likewise called for using private activity bonds to finance regional infrastructure projects.

Philip Fischer, the former head of fixed income and municipal bond strategy at Bank of America Merrill Lynch, urged the panel to reinstate the Build America Bonds program, expand private activity bonds, and bring back tax-exempt refundable bonds.

In an exchange with Democratic Rep. Mike Thompson of California, Fischer said that Build America Bonds led to a significant influx of capital for infrastructure projects in the municipal bond market. And in response to a question from Rep. Terri Sewell, D-Ala., he commented that the elimination of advanced refundable bonds left state and local governments with less flexibility for infrastructure financing.

But some taxwriters cautioned that bond programs are not a panacea to address the inadequacies of the current infrastructure funding system. Democrat Jimmy Gomez commented that tax-preferred bonds can be effective in paying for some infrastructure projects but they could not serve as a replacement for the federal gas tax.

Democratic Rep. Dan Kildee of Michigan warned that low-cost debt offerings are not sufficient to pay for the infrastructure needs of some chronically distressed communities.

Other incentives: Neal and Brady both expressed support for tapping other incentives in the tax code to encourage investment in infrastructure. Neal specifically endorsed the low-income housing tax credit, new markets tax credit, and historic tax credit as incentives that “have a real, positive impact on our communities,” while Brady floated the idea of expanding the Opportunity Zone program to include investments in infrastructure projects.

Dynamic scoring

Neal and Brady also agreed that the JCT staff should use “dynamic” scoring to estimate the revenue impact of an eventual infrastructure package. (Dynamic scoring incorporates the feedback effects of legislation on macroeconomic variables such as economic growth.)

Neal said in his opening statement that dynamic scoring would demonstrate that investing in infrastructure leads to "meaningful, substantial economic growth."

Brady said that dynamic scoring is "real-life scoring."

House rules for the 116th Congress do not require the Congressional Budget Office and Joint Committee on Taxation to use dynamic scoring in estimating the revenue effects of major tax and spending legislation. (Republicans adopted a dynamic scoring requirement in 2015 when they still controlled the chamber, but Democrats dropped it when they took over the House at the beginning of 2019.)

Negotiating with the White House – in private

When House Speaker Nancy Pelosi, D-Calif., earlier this month announced her intention to unveil an infrastructure proposal, she indicated that she hoped to work with the Trump administration to negotiate the details of a final plan.

Ways and Means Chairman Neal told reporters at a news conference shortly before the hearing that he has already had discussions about infrastructure with Treasury Secretary Steven Mnuchin and indicated that as negotiations with the administration continue, details about specific provisions – including offsets – likely would remain private until the two sides agree on a deal. (Neal also commented that the negotiation process around an infrastructure deal would be
similar to the process that led to the United States-Mexico-Canada Agreement, which was signed into law earlier this week."

"I think it’s really important that we not volunteer a revenue stream until the administration reaches an agreement with us. And I think that will provide an opportunity for Republicans and Democrats, after our committee negotiates with them over what the revenue stream ought to be, to get on with what is a sorely needed investment in America."

Speaker Pelosi, who addressed reporters at the news conference along with Neal and other House Democratic leaders, did not lay out a timeline for reaching a deal and moving a bill through the committee process, saying only that legislation will come to the House floor "when it’s ready.”

— Michael DeHoff
Tax Policy Group
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**Familiar divisions on display as House taxwriters discuss paid family and medical leave**

Democrats and Republicans on the House Ways and Means Committee agreed at a January 28 hearing that lack of access to paid family and medical leave benefits can lead to lower employee retention rates for businesses and greater economic uncertainty for workers – particularly for those at the lower-end of the income scale – but they split on the question of how to make those benefits more widely available.

**Neal: FMLA ‘not enough’**

Ways and Means Committee Chairman Richard Neal, D-Mass., opened the hearing by noting the impending 27th anniversary of the enactment of the Family and Medical Leave Act (FMLA) – a law that guarantees most workers job-protected (but unpaid) leave, and continued health coverage, for certain family and medical reasons.

"I was proud to vote for the FMLA and to play a role in making it the law of the land, but today we know that the FMLA alone is not enough,” Neal said. "This is because while the FMLA entitles workers to leave, if that leave isn’t paid many workers simply can’t afford to take it."

Ranking Republican Kevin Brady of Texas agreed that lawmakers need to take additional steps on paid leave, while at the same time touting family-friendly changes made as part of the GOP’s 2017 tax overhaul known informally as the Tax Cuts and Jobs Act (TCJA, P.L. 115-97).

"Paid family leave is an issue that the president, Republicans, and Democrats alike all agree is crucial,” Brady noted. "We've succeeded in providing greater opportunities for all Americans, and now we can provide greater support for their families as parents rejoin the workforce.”

But bipartisan consensus largely ended there.

**Democrats back federal mandate**

Most Ways and Means Democrats expressed support for the Family and Medical Insurance Leave (FAMILY) Act (H.R. 1185) as a model for a nationally mandated paid family and medical leave policy. That measure would provide up to 12 weeks of partial wages – 66 percent wage replacement, capped at $4,000 a month – to workers who need to take time off from their jobs to address a serious personal or family health issue, care for a newborn or newly adopted child, care for an injured service member, or address family issues related to the deployment of a service member. Benefits would be portable as workers change jobs and would be available to "traditional" employees as well as individuals who have multiple jobs or are self-employed.

**URL:** https://www.congress.gov/bill/116th-congress/house-bill/1185/text?q=%7B%22search%22%3A%5B%22H.R.1185%22%5D%7D&r=1&s=1
The leave program would be funded through a 0.4 percent payroll tax on wages that would be split evenly between employees and employers. An independent trust fund within the Social Security Administration would be created to collect the dedicated payroll taxes and administer benefits.

The FAMILY Act was introduced by Rep. Rosa DeLauro, D-Conn., last February and has garnered 203 cosponsors to date, including Chairman Neal. Only one of those cosponsors, however – Rep. Christopher Smith of New Jersey – is a Republican.

DeLauro testified at this week’s hearing and, in her opening statement, sought to play down the size of the new payroll tax her bill would establish.

The FAMILY Act “is self-funded through payroll contributions from employers and employees of just two-tenths of 1 percent each (two cents per $10 in wages),” DeLauro said.

Kemi Role, Director of Work Equity at the National Employment Law Project, who testified as part of a separate panel of experts and business owners, praised the “portability” feature of the FAMILY Act which enables workers to keep their leave benefits if they switch jobs.

"Low-income workers are especially likely [to] change jobs due to the frequent churn that is common in low wage industries...” Role wrote in her prepared testimony. “Given this reality, if we really want to provide effective paid leave for our workforce, we need to move away from a framework in which benefits are tied to a specific employer.”

GOP objections: But Republicans on the panel generally chafed at the notion of a “one-size-fits-all” federal program and pointed to what they see as design flaws in the FAMILY Act.

Rep. Brady argued in his opening statement that the income from a new employment tax would be insufficient to sustain the level of benefits promised under the FAMILY Act.

"Democrats claim the FAMILY Act will be fully paid for by a 0.4 percent payroll tax increase...,“ Brady said. “But the nonpartisan Joint Committee on Taxation proves that wrong. They estimate the true cost of the FAMILY Act will require a substantial payroll tax increase, anywhere between 2.7 and 3.1 percent."

**Republicans push tax code-driven incentives**

In rejecting a new federal mandate, Ways and Means Republicans argued that it would be more efficient to expand access to paid family leave by building on incentives already in the tax code. Ranking member Brady and other GOP taxwriters noted that the TCJA provides a temporary credit under section 45S to qualifying employers that offer paid family and medical leave to their employees and also includes incentives, such as an increased child tax credit, that put more money in workers’ pockets.

"In 2017, we doubled the child tax credit,” Brady said. “We also created the first-ever national policy on paid family and medical leave by creating the Family and Medical Leave Tax Credit.”

The credit under section 45S was originally scheduled to lapse after 2019, but was extended an additional year – through 2020 – as part of a sweeping tax and appropriations package (H.R. 1865) enacted at end of last year. (For prior coverage of H.R. 1865, see Tax News & Views, Vol. 20, No. 42, Dec. 19, 2019.)

**URL:** https://www.congress.gov/bill/116th-congress/house-bill/1865/text?q=%7B%22search%22%3A%5B%22h.r.1865%22%5D%7D&r=1&s=1

**URL:** http://newsletters.usdbriefs.com/2019/Tax/TNV/191219_1.html

Several GOP taxwriters argued the section 45S credit should be made permanent.

**Advanceable child tax credits:** Rep. Elise Stefanik, R-N.Y. – who testified alongside Rep. DeLauro as part of the hearing’s panel of congressional witnesses – discussed bipartisan legislation she introduced late last year with Rep. Joe Cunningham, D-S.C., the Advancing Support for Working Families Act (H.R. 5296), which would allow new parents to receive an advance of up to $5,000 of their future child tax credits upon the birth or adoption of a child.

**URL:** https://www.congress.gov/bill/116th-congress/house-bill/5296/text?q=%7B%22search%22%3A%5B%22h.r.5296%22%5D%7D&r=1&s=2
That advance payment would then be repaid – in the form of reduced future child tax credits – over the following 10 or 15 years, depending on whether the household qualifies for the refundable portion of the credit (sometimes called the “additional child tax credit”).

Stefanik argued her bill would not raise taxes on net, would be compatible with new or existing state and local paid leave laws around the country, and would complement and enhance paid leave programs established by private employers.

“A family’s choice to advance some of their child tax credit is their own,” Stefanik said. “And it does not reduce the strong incentive on the private sector to do more for their workers and provide benefits like paid family leave.”

An identical companion bill was introduced in the Senate (as S. 2976) by Finance Committee member Bill Cassidy, R-La., and Sen. Kyrsten Sinema, D-Ariz. Neither taxwriting committee, however, has thus far indicated that it intends to schedule a formal mark-up of the legislation.


URL: https://www.congress.gov/bill/116th-congress/house-bill/1940/text?q=%7B%22search%22%3A%5B%22hr+1940%22%5D%7D&r=1&s=1

That advance payment would be repaid through a proportionate reduction in Social Security benefits over the taxpayer’s first five years of retirement or, alternatively, an increase in the taxpayer’s Social Security retirement age of between three and six months.

H.R. 1940 also has a companion in the Senate (S. 920, introduced by Sen. Marco Rubio, R-Fla.) but, unlike Rep. Stefanik’s bill, does not have any Democratic cosponsors – a dynamic that seems likely to persist.

Chairman Neal noted in his opening statement that he is “concerned about proposals that would force new parents to choose between paid leave and the Social Security benefits they need to protect their families and have a secure retirement.”

Democrats did, however, lend their support to a provision enacted last month that allows penalty-free withdrawals of up to $5,000 (per individual) from an IRA or qualified retirement plan to cover expenses associated with the birth or adoption of a child and permits recontributions of withdrawn amounts. (That provision was part of a broader retirement security bill – the SECURE Act – that was incorporated into H.R. 1865, the year-end tax-and spending deal that President Trump signed on December 20, 2019.)

— Alex Brosseau
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Grassley seeks details on improper electric vehicle tax credit claims

Senate Finance Committee Chairman Charles Grassley, R-Iowa, joined GOP Sens. Ron Johnson of Wisconsin, John Barrasso of Wyoming, and a dozen other Senate Republicans this week to ask the Internal Revenue Service to provide information on how it enforces the electric vehicle tax credit program. The request follows a Treasury Inspector General for Tax Administration (TIGTA) audit report released in September of 2019 that details what the senators characterize as “systemic problems” with the program.

‘Improper’ claims

Current law provides a tax credit under section 30D of up to $7,500 for taxpayers who purchase a qualified plug-in electric drive motor vehicle, subject to a phase-out once a manufacturer sells 200,000 qualified vehicles.
In a January 27 letter to IRS Commissioner Charles Rettig, the senators noted that TIGTA’s audit report from last September revealed that “taxpayers improperly claimed $72 million in tax credits for electric vehicles and that the IRS ‘does not have effective processes to identify and prevent [these] erroneous claims.’”


The senators also commented that the $72 million in improperly claimed credits TIGTA identified marks a sharp increase from the $33 million in improper credits it uncovered in an earlier audit report released in 2011. That spike points to “apparently systemic problems” with the electric vehicle credit that “are even more concerning as Congress considers a potential $16 billion expansion to the program,” they observed.

Democrats on the House Ways and Means Committee included a proposal in the discussion draft of a green energy bill they unveiled last November that would expand the credit to make it available to an additional 400,000 vehicles per manufacturer before it begins to phase out. (For prior coverage, see Tax News & Views, Vol. 20, No. 38, Nov. 22, 2019.) The committee expects to mark up a green energy package in the coming weeks. House Democrats advocating for the electric vehicle credit also lobbied – unsuccessfully – to include an expansion of the credit in the just-enacted 2019 tax-and-spending deal. Congressional Republicans, for their part, generally have argued that the credit primarily benefits wealthier taxpayers and have been wary of expanding it.

URL: http://newsletters.usdbriefs.com/2019/Tax/TNV/191122_2.html

Information request

The letter asks the Service to provide a variety of details about its administration of the electric vehicle credit, including, among other things:

- Information on the number and dollar amount of credits awarded for each tax year since 2010 and the number and dollar amount of credits that were determined to be erroneous;
- Whether the IRS has conducted a program-wide audit of the electric vehicle program to determine the number and dollar amount of improperly claimed credits (along with the results of any audits the Service has conducted);
- Actions the IRS has taken to reduce improper claims; and
- How a reporting requirement for electric vehicle dealers might improve administration of the program.

The Service’s response is due by February 11.

In addition to Grassley, Johnson, and Barrasso, lawmakers who signed the letter include Finance Committee Republicans Mike Crapo of Idaho, John Cornyn of Texas, Pat Toomey of Pennsylvania, Bill Cassidy of Louisiana, and James Lankford of Oklahoma, along with GOP Sens. Joni Ernst of Iowa, Mike Braun of Indiana, Thom Tillis of North Carolina, Jim Risch of Idaho, Ted Cruz of Texas, John Kennedy of Louisiana, and James Inhofe of Oklahoma.

— Michael DeHoff
Tax Policy Group
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IRS provides transition relief for financial institutions affected by 2019 change to required minimum distribution rules

The Internal Revenue Service announced January 27 that it will provide transition relief to financial institutions affected by a recently enacted provision that increased the age for beginning required minimum distributions from a defined contribution plan or IRA to 72 (from 70-1/2 under prior law), effective for distributions required to be made after December 31, 2019, for plan participants and IRA owners who reach age 70-1/2 after December 31, 2019.

The change to the required minimum distribution rules was included in the SECURE Act, a broader set of retirement security provisions that was incorporated into the year-end tax-and-spending deal (H.R. 1865) that President Trump signed into law on December 20, 2019. (For additional details on the SECURE Act and other tax provisions in H.R. 1865, see Tax News & Views, Vol. 20, No. 42, Dec. 19, 2019.)
Financial institutions are expected to provide required minimum distribution statements for 2020 to IRA owners by January 31, 2020. The transition relief (Notice 2020-6) clarifies that if a financial institution issues a required minimum distribution statement for 2020 to an IRA owner who will turn age 70-1/2 in 2020, the Service will not consider the statement to be incorrect, but only if the institution notifies the IRA owner no later than April 15, 2020, that no required minimum distribution is due for 2020.

— Michael DeHoff
Tax Policy Group
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URL: https://www.irs.gov/pub/irs-drop/n-20-06.pdf

Budget deficits, debt on a ‘worrisome trajectory,’ CBO says

A just-released report from the nonpartisan Congressional Budget Office (CBO) on the outlook for the federal budget and economy over the next decade projects that without deficit-cutting action by lawmakers, the budget deficit will top $1 trillion this year – the first time since fiscal year 2012, in the wake of the “great recession” – and grow steadily into the future.

Deficits, public debt on the rise

The CBO’s Budget and Economic Outlook: 2020 to 2030, which was released January 28, predicts deficits will hover between 4.3 and 5.4 percent of the economy between 2020 and 2030 – a slight uptick from the budget outlook the agency released last January, which projected deficits reaching as high as 4.8 percent of gross domestic product (GDP), and much higher than the average 3.0 percent of GDP deficit registered over the past 50 years. Over the next decade, CBO predicts cumulative deficits will total $13.1 trillion, about $720 billion higher than the overlapping 10 years (2020-2029) included in last year’s report. While many factors are at play in that increase, the two biggest legislative factors driving the change are the enactment of the Bipartisan Budget Act of 2019 (H.R. 3877) – which lifted the statutory caps on discretionary spending for fiscal years 2020 and 2021 – and the Further Consolidated Appropriations Act, 2020 (H.R. 1865), a sweeping appropriations measure that also carried more than $400 billion in tax cuts to President Trump’s desk. (For prior coverage of H.R. 1865, see Tax News & Views, Vol. 20, No. 42, Dec. 19, 2019.)

URL: https://www.cbo.gov/publication/56073#_idTextAnchor003

Revenues and spending: Over the course of the next decade, CBO projects revenues will average 17.4 percent of GDP – exactly in line with the average revenue level experienced over the past 50 years, but a notable decline from the 18.2 percent of GDP 10-year average projected in the report preceding the enactment of the 2017 tax reform law.

Meanwhile, federal spending is expected to grow steadily over the budget window, averaging 22.2 percent of GDP – a significant increase over the 20.4 percent of GDP average seen over the past five decades. As it has in most of its recent reports, CBO continues to attribute most of the projected increases in spending to demographics (an aging population translates into more Social Security and Medicare beneficiaries), rising health care costs, and growing debt service costs due to (eventually) rising interest rates and an accumulating federal debt. Though often misunderstood as a deficit driver, the report makes clear that discretionary spending (that is, annual appropriations on defense and domestic programs) is not contributing to the growth in future deficits even after accounting for the four sequester-relief packages enacted since 2013. In fact, between 2020 and 2030, CBO sees that component of the budget shrinking from 6.4 percent to 5.6 percent of GDP, a far cry from the 11.5 percent of GDP level registered in 1970.
Publicly held debt: On the debt front, by the end of the 10-year budget window (fiscal 2030), CBO projects the federal debt held by the public – that is, debt not held in intragovernmental accounts such as the Social Security and Medicare trust funds – will total more than 98 percent of the economy, a level not reached since the immediate aftermath of US involvement in World War II.

CBO Director Phillip Swagel put the risk of growing deficits and debt in stark terms during a January 29 hearing of the House Budget Committee called to explore the report's findings.

"CBO projects continued economic growth and job creation over the coming decade, but also a worrisome trajectory for the federal budget," Swagel said in his written testimony. "Not since World War II has the country seen deficits during times of low unemployment that are as large as those that we project – nor, in the past century, has it experienced large deficits for as long as we project."

More likely fiscal forecast could be even worse

Pursuant to the Congressional Budget and Impoundment Control Act of 1974 – the law that established the CBO and laid the groundwork for the current congressional budget process – the agency is generally required to make its projections on the basis of "current law," or laws as they are currently in effect (one exception is excise taxes dedicated to trust funds, for example, highway taxes, which are assumed to be continued beyond any scheduled expiration). Inherent in CBO's projections, therefore, is an assumption that all temporary tax provisions that are set to expire during the budget window – including, most notably, nearly all of the tax relief for individuals, estates, and passthrough entities that were approved in the 2017 tax cut legislation (P.L. 115-97, known informally as the Tax Cuts and Jobs Act or TCJA) and are set to expire after 2025, and as well as the election under the TCJA to invest capital gains in an Opportunity Zone, which is set to expire after 2026 – will not be renewed, and revenues will be higher as a result.

That assumption similarly applies to scheduled taxpayer unfriendly changes affecting bonus depreciation, the business interest deduction limitation under section 163(j), the timing of research expenditure deductions, and the minimum tax affecting US multinationals known as the Global Intangible Low-Taxed Income (GILTI) regime which, if left untouched by lawmakers, will have the effect of raising revenue under current law later in the budget window. (By contrast, a "current-policy" revenue baseline would assume that those lapsing tax provisions will instead remain in effect as they are today.)

To that end, CBO explains that the bulk of the 1.6 percentage point increase in total revenue levels the agency predicts will occur between fiscal year 2020 (16.4 percent of GDP) and fiscal year 2030 (18.0 percent of GDP) can be traced to these expirations and other changes that are scheduled to occur under current law. (Other factors, including "real bracket creep" – that is, the tendency of revenues to rise over time as wage levels grow faster than the inflation index against which the tax brackets are tied – and the scheduled expiration after 2020 of the "tax extender" provisions most recently renewed in the aforementioned H.R. 1865, also play a role.)

Thus, if all – or some combination of – temporary tax provisions are instead made permanent or otherwise extended beyond their scheduled expiration, revenue levels as projected by CBO would be lower, pushing cumulative (10-year) deficits higher than the $13.1 trillion level projected under current-law assumptions.

Growth effects of tax reform to taper off

As it has noted in past reports, CBO generally sees the economic boost from the Tax Cuts and Jobs Act tapering off over time. In broad terms, the agency predicts that real GDP growth will fall from 2.4 percent in 2019 to 2.2 percent in 2020 and then average roughly 1.7 percent over the remainder of the 10-year budget window – levels that it says are generally in line with the private-sector Blue Chip Economic Indicators.

Although economic growth will be buoyed in 2020 by growth in business fixed investment relative to last year – due in part to reduced uncertainty about future trade policies as well as higher oil prices, which could boost investment in the energy sector – CBO believes both business investment and consumer spending will moderate later in the decade.

In the case of business investment, CBO says that moderation is due in part to certain tax changes that, as discussed above, are scheduled to occur over the next several years.
"In addition, the tax code’s treatment of research and development expenditures becomes less favorable beginning in 2022, and the treatment of equipment investment under bonus depreciation becomes progressively less favorable beginning in 2023,” the report notes.

In theory then, future legislative action that staves off these tax changes could support economic growth relative to CBO’s current-law projections.

However, any such action – if not paid for through other budget measures – must be balanced against CBO’s frequent warning that taking on additional federal debt can lead to a “crowding out” of investment, and thus economic growth, over time as more and more dollars are directed to financing the government’s deficits rather than invested in private capital.

Current large and growing budget deficits also could constrain lawmakers’ ability to enact such expansionary fiscal policies or to respond to unforeseen events.

“...[H]igh debt might cause policymakers to feel constrained from implementing deficit-financed fiscal policy to respond to unforeseen events or for other purposes, such as to promote economic activity or strengthen national defense,” the report states.

Still, given persistently low interest rates and low unemployment levels, CBO admits that those risks to the fiscal and economic outlook “are not currently apparent in financial markets.”

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