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Tax Policy

With Tax Extenders Settled, Congress Turns to Tax Overhaul Talk in 2016

If 2015 was the year Congress started to close the door on short-term tax policy extensions, 2016 may be the year that a longer-term approach begins to take shape.

A big overhaul of the U.S. tax code isn't likely, but lawmakers may have a better idea what such an effort will look like when it does happen, perhaps in 2017 or later, lawmakers, lobbyists and tax policy analysts told Bloomberg BNA. The extension of expiring tax credits and deductions at the end of 2015—several made permanent in the tax code—has opened the way toward possibly more ambitious changes.

“We’ll see what we get people to coalesce on. We don’t pull any fast shenanigans on people. We want to work together.”

ORRIN G. HATCH
SENATE FINANCE COMMITTEE CHAIRMAN

At the top of the list, lawmakers said in November and December, is the U.S. system for taxing multinational corporations on the income they hold in foreign countries. Democrats such as Sen. Charles E. Schumer (D-N.Y.) have been working with Republicans, including Rep. Charles Boustany Jr. (R-La.), on a plan to give corporations a break on taxes on income related to patents and other intellectual property, for instance, in the hope of encouraging companies to invest more of that money in U.S. operations. Schumer is a senior member of the Senate Finance Committee, and Boustany chairman of the House Ways and Means Subcommittee on Tax Policy.

The possibility of legislation on international taxes will “be one of the things we work on right off the bat” in 2016, Senate Finance Committee Chairman Orrin G. Hatch (R-Utah) told reporters.

The moves on international tax changes could be the next step toward a broader overhaul of the tax code that would reduce top tax rates for businesses and individuals while paring back credits and deductions that have questionable public policy value and siphon revenue away from the government, lawmakers said.

The atmosphere for big tax changes is only partly sunny.

The chances for international changes look somewhat bright, and the budget picture has improved since Congress agreed to make some so-called tax extenders permanent in a year-end package, since those tax provisions will now be included in the federal budget baseline and won't require offsets. But the presidential election year throws partisan politics into the mix, and Democrats and Republicans haven't shown common ground on how to pull passthrough entities—which are taxed at higher individual rates applied to shareholders—into any deal that lowers taxes on the corporate side of the code.

“I think it depends on the appetite of the president,” Boustany told Bloomberg BNA as Congress completed legislation for the year. “I'm not optimistic he's going to agree to a whole lot, but we think now is the time to escalate our efforts and set the stage for after the election, to really work through a lot of the issues, hopefully get to where we have draft legislation that our Republican nominee can run on.”

Campaign Complications. Congress' ability to advance tax changes is bound to be shaped by presidential politics, and an especially divisive contest doesn't bode well for the kind of bipartisan cooperation that's needed for a tax overhaul, said Hatch.

“This one's going to be a bitter one, I suspect,” he said. “A lot depends on who the Republicans pick for our nominee.”

Candidates' platforms don't always align perfectly with policy preferences on Capitol Hill.

Boustany said Congress' ability to advance changes in international tax policy depends on White House support. He said he would continue to push for an “innovation box” that taxes income from intellectual property more favorably, as well as lower corporate tax rates and a dividends exemption system.

“It would be real reform,” Boustany said.

Outside observers who keep tabs on congressional developments are watching closely, as the general contours of an agreement on international taxes between Republicans and Democrats on Capitol Hill and President Barack Obama suggest that a deal this year can't be ruled out.

“Is it likely? Probably not,” said Jon Traub, managing principal of Deloitte LLP's Tax Policy Group. “But ignoring it would be at your own peril.”

Essence of Agreement. Such talks would carry over from 2015, when all the factions worked on changes for U.S.-based multinational corporations and revenue pos-

sibilities for repatriating earnings they currently keep abroad.

“I still think there is the essence of an agreement there,” said John Gimigliano, principal-in-charge of federal legislative and regulatory services in the Washington National Tax practice of KPMG LLP. “I’m not saying it’s going to be easy, but I wouldn’t put that in the impossible bucket, even if it’s not likely.”

At a minimum, Boustany said, he hopes to pass legislation to tamp down the country-by-country reporting requirements of the Organization for Economic Cooperation and Development’s base erosion and profit shifting project. He and other Republican lawmakers, including Hatch, have raised strong objections to requiring U.S. companies to report financial information to other countries in connection with BEPS.

Tax changes will advance on two fronts—in the House Ways and Means Committee, now led by Chairman Kevin Brady (R-Texas), who took over from Rep. Paul D. Ryan (R-Wis.) late in 2015—and in the Senate Finance Committee, where Hatch enters his second year as chairman.

Hatch said he would seek to lower top corporate tax rates. The specifics of how to do that, and what other changes to seek, remain to be worked out in as bipartisan a fashion as possible, he told reporters. Lowering tax rates should dampen companies’ appetites for inversions, for instance, he said.

How Low Can You Go? “If we could get the corporate tax rate down to say, even, 25 percent, the inversions would stop overnight, and we’ve got to find a way to do that,” Hatch said.

As low as 20 percent would be even more preferable, Hatch said. “If we did that, we’d have companies moving here,” he said, though Hatch added that election-year dynamics might minimize Democrats’ willingness to negotiate.

Still, Congress’ ability to pursue tax changes in bipartisan fashion appears to have more promise in the Senate, where Hatch and Ron Wyden (D-Ore.), ranking member of the Finance Committee, have emphasized their points of agreement. That’s in contrast to the Ways and Means Committee, where Democrats haven’t shown much appetite for the Republicans’ approach to overhauling taxes.

“We’ll see what we get people to coalesce on,” said Hatch, who credited Wyden with being a good legislative partner. “We don’t pull any fast shenanigans on people. We want to work together.”

An open process would contrast with the approach lawmakers took on the year-end tax package; that deal came from talks among top leaders, in secret. Democrats are looking for a change, Rep. Xavier Becerra (D-Calif.) told Bloomberg BNA in an interview.

“We should do it up front, in the open and transparently,” said Becerra, a Ways and Means member and chairman of the House Democratic Caucus. “Right now, the special interests are winning on tax policy.”

Hints From Extenders. The tax package Congress passed to end 2015 may have settled a few areas of tax policy. Lawmakers made the credit for research and experimentation, in Section 41 of the tax code, permanent, as well as provisions that lighten taxes on pass-through entities that converted from C status and the earned income tax credit. Congress made 19 provisions

permanent, out of 52 credits and deductions in need of renewal.

Other provisions, such as bonus depreciation, received temporary extensions longer than the typical two years. Bonus depreciation would phase out in five years, but Boustany said he expects Republicans will try to extend it permanently as part of a tax overhaul.

Many other policy areas, including tax credits related to energy efficiency, depreciation of racetracks, and federal excise taxes on alcohol, received short extensions and are likely to see a flurry of lobbying in 2016 as advocates push for their long-term survival.

“Obviously getting as much of these cleared off the table as possible is something I think helps us because it’s kind of a bellwether for tax policy,” Rep. Tom Reed (R-N.Y.), a member of the Ways and Means Committee, told Bloomberg BNA in an interview. “Even with many of these made permanent, there’s a lot of tax provisions that we still have to debate one by one, and that’s a fair debate to have.”

The more narrowly written a provision—such as the “cover-over” provision that dictates the distribution of excise tax revenue from Puerto Rican rum—the more scrutiny it’s likely to face, Reed said.

In addition, Reed said, discussion on depreciation schedules is likely to pick up as lawmakers contemplate a tax overhaul. Both Democrats and Republicans have said the depreciation timetables don’t always reflect accurately the useful life of equipment, for instance.

Making some of the extenders permanent in 2015 provides benefits for more broadly remaking the tax code in the future.

It remains to be seen whether extenders only renewed through this year will be revived again, together, or move in separate groupings or simply expire for good, Gimigliano told Bloomberg BNA.

Feeling a Draft. Although the chances for a tax overhaul in 2016 are all but dead, lobbyists and lawmakers say, Ways and Means Committee Republicans could well introduce a tax overhaul draft as a legislative marker, said Rohit Kumar, principal and co-leader of PricewaterhouseCoopers LLP’s National Tax Services office in Washington. It would likely be based on former committee Chairman Dave Camp’s (R-Mich.) proposal from 2014 but be less limited in terms of revenue neutrality, for instance, he told Bloomberg BNA.

Kumar said the Senate Finance Committee could release a discussion draft on corporate integration, changing the current ways corporations are taxed at the business and shareholder levels. That would be a significant development that would follow work by Hatch’s staff in 2014, he said.

Excise Taxes in Play. Considering the debate probably won’t be settled until late 2017, Traub told Bloomberg BNA that the best bet for renewal may ride with two new temporary provisions enacted in the tax package from late 2015: the two-year suspension of the excise tax on medical devices and the two-year delay in starting the tax on high-cost insurance—the “Cadillac tax.”

That's the time frame in which both of those are now scheduled for expiration, or renewal.

A sprinkling of other excise taxes may be on the congressional agenda. Lawmakers adjusted alcohol taxes, for instance, to allow stronger cider of up to 8.5 percent alcohol to be treated more like beer, but they didn't address complaints within the beer industry that taxes should be restructured for the craft beer industry. Wyden has introduced legislation (S. 1562) on that issue, as has Rep. Erik Paulsen (R-Minn.), with H.R. 2903.

Ways and Means Republicans will huddle for a brief retreat over several hours one day at the start of the new year, a smaller-scale gathering than a year earlier, when they convened out of town for two days. Every subcommittee chair will put together a discussion session "to fine tune what we did last year," said Rep. Dave Reichert (R-Wash.).

Members want to finish a conference report on customs, Brady told Bloomberg BNA, and the tax policy subcommittee will address its agenda.

"Clearly, four of the five priorities for Speaker Ryan, for the Republican conference, either begin in the Ways and Means Committee or principally in our committee," Brady said. "So he's got high expectations for us, and we intend to deliver."

Inside Baseball: Baseline Benefit. Making some of the extenders permanent in late 2015 provides baseline benefits for more broadly remaking the tax code down the road by reducing revenue targets. In other words, the current law baseline and current policy baseline have been harmonized.

"It's important in terms of changing the math for tax reform, and I think that's going to be important in terms of how the discussions on tax reform play out in 2016," said Gimigliano, former senior tax counsel for Ways and Means.

Funding necessary to make a provision permanent as part of an overhaul effort at the expense of lowering tax rates is no longer needed for the newly permanent extenders, and on the flip side, revenue can be gained from repealing a provision already made permanent.

"To be revenue neutral, you now need less revenue," said Traub, former Ways and Means staff director.

"We can become more aggressive in our approach to actually completing tax reform as a result of what's happened," Reichert told Bloomberg BNA.

Downbeat Democrats. Although Ways and Means Republicans said they remain optimistic that a tax overhaul can happen in the next presidential administration, some Democrats aren't so sure.

The idea of revising the tax code by lowering rates and ditching popular tax deductions doesn't seem plausible, based on the tepid reaction former Chairman Camp received on his proposal in 2014 to do just that, said Rep. Earl Blumenauer (D-Ore.), a Ways and Means Committee member.

A big tax rewrite isn't likely until Congress finds a new source of revenue, such as a carbon tax, Blumenauer told reporters the day the tax deal passed. Sifting through tax credits and deductions, all with constituencies fighting for them, doesn't appear promising, he said.

"It's really a stretch when the people who have a benefit only need a couple of people to go to bat for them in strategic positions," Blumenauer said. "It's not, I think, the most likely path for tax reform."

BY MARC HELLER AND AARON E. LORENZO

To contact the reporters on this story: Marc Heller in Washington at mheller@bna.com and Aaron E. Lorenzo in Washington at aaron@bna.com

To contact the editor responsible for this story: Brett Ferguson at bferguson@bna.com