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## Paul & Patty's Potluck: Budget Conference Could Have Big Implications for Tax Reform

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After weeks of tense negotiations, Congress passed legislation on October 16, 2013 to end the government shutdown and raise the debt ceiling. As part of the deal, congressional leaders agreed to establish a conference to address long-term federal budget issues.

House Budget Committee Chairman Paul Ryan (R-WI) and Senate Budget Committee Chairwoman Patty Murray (D-WA) will be sitting down with conferees over the next several weeks to set goals for spending, revenue, and other matters, and discuss the menu of options for how to achieve these goals. One featured item on the menu will be tax reform, which the tax-writing committees are preparing to serve.

### Setting the table

To temporarily end the stalemate in Washington, Congress passed legislation last week that: (1) funds the federal government at a topline level of \$968 billion until January 15, 2014 (current sequestration levels); (2) raises the debt ceiling until February 7, 2014, while allowing the federal government to use "extraordinary measures" after that date; (3) requires the Secretary of Health and Human Services to certify to Congress that the Affordable Care Act's insurance exchanges verify eligibility for subsidies consistent with the requirements of the law; and (4) delivers back pay to federal workers who were furloughed during the shutdown.

As part of the package, leadership also agreed to establish a bipartisan, bicameral budget conference to negotiate differences between the budget resolutions the House and Senate passed earlier this year and produce a conference report by December 13, 2013.<sup>1</sup> Earlier this year, the Senate-passed Budget Resolution (S. Con. Res. 8) established a FY2014 discretionary spending limit of \$1.058 trillion, but the House-passed Budget Resolution (H. Con. Res. 25) set a much lower limit of \$967 billion. After the passage of these budget resolutions, a budget conference would have been the next step under regular order, but conferees were never named in the current, highly charged environment. The wide gap in the budget resolutions and the lack of political will to resolve the differences through a formal conference has contributed to the difficulty in passing appropriations bills and funding the federal government that resulted in the shutdown.

### What will the conference do?

Generally speaking, the conferees will be negotiating long-term budget goals. In particular, they will focus on top-line numbers on issues such as federal spending, revenue, deficit reduction, and overall appropriations. The conference report may also include instructions to the authorizing committees to develop legislation designed to achieve these goals -- including an instruction to the House Ways and



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Means Committee and the Senate Finance Committee on tax reform legislation, as discussed in further detail below.

Several prominent items are likely to take up the bulk of the conference's attention. For instance, both sides have expressed an interest in reworking sequestration. In the case of Republicans, Chairman Ryan is likely to push to replace sequestration with more targeted spending cuts, including cuts to entitlement programs. In the case of Democrats, Chairwoman Murray is likely to push to reduce the impact of sequestration and protect entitlement programs. Both sides have also expressed an interest in exploring options for tax reform as a means of achieving long-term spending and revenue goals.

Unlike previous negotiations -- for example, the 2011 "supercommittee" established by the Budget Control Act -- the December 13 deadline for producing a conference report is non-binding, meaning that no automatic policy changes will kick in if the conferees are unable to come to an agreement. That said, the expiration of government funding in January and the debt limit shortly thereafter is intended to provide an incentive for the conferees to negotiate these issues now. In the event the budget conference does not result in an agreement, the President and Congress will be forced to negotiate again to prevent a government shutdown and breach of the debt limit early next year.

### How does tax reform fit in?

- **Tax reform instructions could be on the menu.** A conference report could instruct the tax-writing committees to introduce, mark up, and approve tax reform legislation by specific dates. If tax reform instructions are part of the conference report, the legislation would likely need to conform with various requirements included in the instructions, such as raising a set amount of revenue or setting specific top marginal tax rates.
- **Camp and Baucus will keep cooking -- but is anyone hungry?** In anticipation of such instructions, the House Ways and Means Committee and the Senate Finance Committee will continue to develop their tax reform proposals. In particular, reports indicate that Chairman Camp may release a draft tax reform bill in the coming weeks. It is possible that Chairman Camp will release and mark up a bill while the conference negotiations are ongoing. Meanwhile, the Senate Finance Committee may release parts of their tax reform proposals (perhaps as conceptual drafts). On the other hand, concerns about a tax reform bill conflicting with ongoing budget negotiations -- particularly if the bill could be used as a revenue raiser -- may delay the release of any draft until after budget negotiations have concluded.
- **A full serving? Disagreements over revenue mean that tax reform may not be comprehensive.** It will be difficult for the conferees to come to an agreement on instructions for comprehensive tax reform, particularly if the conference is unable to agree on the extent to which tax reform should raise revenue. As a result, in lieu of comprehensive reform, it is possible that the conference will include instructions on a smaller piece, like corporate tax reform. Another option would be to call for another "one-time" repatriation provision, which would allow multinational companies to bring their overseas income back to the U.S. at a lower tax rate as part of a transition to a territorial international tax system.

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- **Settling on finger food? If tax reform instructions are not included, tax expenditures could be at an even greater risk than before.** Even if the conference report does not include instructions on tax reform, the conferees may look to cherry-pick some tax expenditures to help meet their topline revenue targets. Some of the options on the table include limiting net interest expense deductions, capping itemized deductions, repealing accelerated depreciation (with a possible carve-out for small businesses), and modifying the section 199 manufacturing deduction. Importantly, if these changes occur outside the context of tax reform, they would come without corresponding reductions in the marginal tax rate.
- **Ryan and Murray are at the table, but Camp and Baucus will not be far away.** Chairs Ryan and Murray, the key negotiators during the upcoming budget talks, are both experienced on tax reform issues. Chairman Ryan comes to the table with experience crafting his own comprehensive tax reform plan, and Chairwoman Murray was critical in passing the budget resolution that instructed the Senate Finance Committee to raise \$975 billion in revenue through tax reform. However, Chairmen Camp and Baucus will be closely watching the situation and pushing to include a tax reform instruction in any deal. The main sticking point continues to be the issue of revenues, with Republicans insisting that tax reform should be revenue-neutral and Democrats insisting that tax reform include revenues to help reduce the deficit.

### Conclusion

It is unclear whether Chairman Ryan and Chairwoman Murray will be able to agree on any conference report, let alone an agreement that includes tax reform. However, even if comprehensive tax reform seems unlikely, the situation bears a close watch due to the risks of narrower tax reform (e.g., corporate tax reform) and one-off proposals to repeal or modify specific tax provisions. Regardless of the outcome, it is important to stay tuned as the negotiations unfold. Further, we highly encourage engagement with the House Ways and Means Committee and the Senate Finance Committee before the feast at the potluck begins.

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<sup>1</sup> The House conferees include Chairman Ryan, Rep. Tom Cole (R-OK), Rep. Tom Price (R-GA), Rep. Diane Black (R-TN), Budget Committee Ranking Member Chris Van Hollen (D-MD), Rep. Nita Lowey (D-NY), and Rep. James Clyburn (D-SC). The Senate conferees include every member of the Senate Budget Committee: Chairwoman Murray, Sen. Ron Wyden (D-OR), Sen. Bill Nelson (D-FL), Sen. Debbie Stabenow (D-MI), Sen. Bernie Sanders (I-VT), Sen. Sheldon Whitehouse (D-RI), Sen. Mark Warner (D-VA), Sen. Jeff Merkley (D-OR), Sen. Chris Coons (D-DE), Sen. Tammy Baldwin (D-WI), Sen. Tim Kaine (D-VA), Sen. Angus King (I-ME), Budget Committee Ranking Member Jeff Sessions (R-AL), Sen. Charles Grassley (R-IA), Sen. Mike Enzi (R-WY), Sen. Mike Crapo (R-ID), Sen. Lindsey Graham (R-SC), Sen. Rob Portman (R-OH), Sen. Pat Toomey (R-PA), Sen. Ron Johnson (R-WI), Sen. Kelly Ayotte (R-NH), and Sen. Roger Wicker (R-MS).