Déjà Vu All Over Again?

Tax Reform in the 114th Congress

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As we begin a new year and a new Congress, key players from one end of Pennsylvania Avenue to the other are on board for tax reform. President Obama, Vice President Biden, Senate Minority Leader Mitch McConnell (R-KY), Senate Finance Committee Chairman Orrin Hatch (R-UT), Speaker of the House John Boehner (R-OH), and House Ways and Means Committee Chairman Paul Ryan (R-WI) all say tax reform is a priority.

But wait: haven’t we heard this before? As Yogi Berra famously said, “It’s like déjà vu all over again.” What’s different this year? Should we even bother to pay attention to the tax reform debate?

Yes, there will be a lot of must-dos, political maneuverings, policy disputes, and a presidential election kicking in—all of which could derail comprehensive tax reform. But at the same time, the work on tax reform is not going to let up. There will be working groups, hearings, budget proposals, white papers, discussion drafts, round tables and serious discussions. Ideas emerging from the OECD BEPS project and EU initiatives will further enter the consciousness of Capitol Hill policymakers and influence U.S. tax policy. Old tax reform plans will be tweaked and new ones will emerge.

While no one can predict with certainty how the tax reform debate will play out over the next several months, this is no time to leave the direction of tax reform to others. As Yogi warned, “If you don’t know where you are going, you will wind up somewhere else.”

With that in mind, it’s worth examining where the key players stand on tax reform at the beginning of 2015.

Where the Key Players Stand

Administration

Many policymakers say presidential leadership on tax reform is a must, and the White House says it wants to work on business tax reform this Congress. During his year-end press conference in December, the President said the White House would soon release some “pretty specific proposals” on tax reform as Administration officials work to find common ground with the Republican Congress. The President said the new proposals would be built on ideas he has already proposed.

Seeking common ground on business tax reform, the President noted that he shares the same principles of fairness and simplicity as Republican lawmakers. He commented
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

specifically about high U.S. tax rates and the unfairness in the current tax system that allows sophisticated taxpayers to enjoy lower rates while also encouraging companies to park their cash offshore or invert (a practice he said needs to be fixed). The transition to tax reform could also provide a mechanism for one-time revenues to invest in infrastructure projects. However, he noted “the devil is in the details” of any tax reform proposal, and he has not addressed the issue of how to treat pass-through businesses so they are on equal footing with corporations, which is a sticking point. Commenting on his “business-only” approach to tax reform, the President recently said that Republican attempts to lower individual tax rates might result in higher deficits and a greater tax burden on the middle class.

Administration officials, including Treasury Secretary Jack Lew and Assistant Secretary for Tax Policy Mark Mazur, have recently echoed these remarks and laid out some of the Administration’s priorities for business tax reform, including lowering the corporate rate from 35 to 28 percent (with a 25 percent rate for manufacturers). Assistant Secretary Mazur has said the Administration could put out a detailed business tax reform plan in the next 6 to 12 months if that is what is necessary to move tax reform forward. Comments like these may be geared toward blunting criticism from Republican lawmakers, who have said the Administration has not devoted enough resources to help devise a bipartisan tax reform plan that can pass Congress.

In a shift from his previous focus on business tax reform, the President touted a significant new tax package in his State of the Union address that would rely on increased taxes on financial institutions and higher-income individuals to pay for new and expanded tax credits and savings incentives for working families. The package would, in part, close the “trust fund loophole” on capital gains, raise the top capital gains and dividend rate, and impose a fee on large financial institutions to pay for a series of proposals geared toward working families: (1) a new tax credit for two-earner families; (2) a streamlined child tax credit; (3) the consolidation of tax benefits to improve college affordability; and (4) a retirement tax reform plan. Some of these proposals, like the bank fee, have appeared in the President’s budgets in previous years, with little prospect for enactment. Administration officials continue to talk about business reform, but given the President’s emphasis on individual reform in the State of the Union, key stakeholders on the Hill are skeptical that he is really serious about it. The upcoming budget is expected to include a series of individual and business proposals similar to previous budgets.

House

In the House, Chairman Ryan is expected to make tax reform a top priority, building on his recommendations as Budget Chairman to lower rates, eliminate loopholes, and move toward a territorial tax system. He will have the support of Speaker of the House John Boehner (R-OH), who has made tax reform one of his five points to jump-start the economy, and is “gung ho” about comprehensive tax reform according to senior staff.

In an apparent effort to find common ground with the President, Chairman Ryan recently said he would be willing to entertain the idea of business tax reform as a bridge to comprehensive reform, but only if the taxation of pass-throughs is part of the package. Additionally, recent comments indicate he is open to the idea of using tax reform in part to fund infrastructure, another policy shared with the President. These positions differ from the opinion of many Republicans who oppose a business-only approach, even as an initial step, and want to use any revenue derived from tax reform to lower rates.
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

One question in the House is to what extent former Chairman Dave Camp’s (R-MI) Tax Reform Act of 2014 will factor into the discussions. Chairman Ryan has noted that he will begin with a clean slate, but it is hard to imagine that he will lightly discard the policy and political considerations that resulted in the Camp proposal, and he has retained some key staff members on the Ways and Means Committee who were central in crafting Chairman Camp’s proposal.

Another question is to what extent proposals released by other committee members will impact Chairman Ryan’s efforts. In contrast with former Chairman Camp, Chairman Ryan has encouraged his colleagues to introduce their own tax proposals to spark discussion and share ideas. As one example, fellow Ways and Means Committee member Rep. Devin Nunes (R-CA) recently released a tax reform discussion draft that would institute a consumption tax. On the other side of the aisle, Rep. Chris Van Hollen (D-MD), intends to introduce a proposal addressing income inequality through the tax code.

The recent announcement by Chairman Ryan that he will not run for President in 2016 takes one obstacle to tax reform off the table. Chairman Ryan’s decision will give him the ability to focus more energy in Washington on laying the groundwork for tax reform, developing legislation, and possibly preparing to move ahead on tax reform with a Republican president in 2017 if the opportunity slips away in the 114th Congress. He reportedly has multiple strategic timetables so he is ready for any opportunity to act.

Finally, the Ways and Means Committee has added four new Republican members in the 114th Congress: Rep. George Holding (R-NC), Rep. Pat Meehan (R-PA), Rep. Kristi Noem (R-SD), and Rep. Jason Smith (R-MO). These members will bring their own perspectives and proposals to the table as the discussions move forward.

**Senate**

In the Senate, Chairman Hatch made a splash in the tax policy world before the holidays by releasing a 342-page treatise examining where tax policy has been and where it should go. In the document, he identified seven guiding principles for tax reform, including efficiency and economic growth, fairness, simplicity, revenue neutrality, permanency, competitiveness, and incentives for savings and business. Although he stopped short of specific recommendations, he asserted that many existing tax expenditures should be eliminated to pay for lower rates, and that the U.S. should move toward a territorial tax system. The document, which represents a substantial commitment of thought, time and effort, signaled that Chairman Hatch wants to hit the ground running early this year.

Proving this point, the Finance Committee recently launched a “working group” process, similar to the Ways and Means Committee’s working group process in 2013, to analyze different portions of the Tax Code and offer bipartisan recommendations for reform. The process includes five working groups:

- **Individual tax**, co-chaired by Sen. Chuck Grassley (R-IA), Sen. Mike Enzi (R-WY), and Sen. Debbie Stabenow (D-MI)
- **Business tax**, co-chaired by Sen. John Thune (R-SD) and Sen. Ben Cardin (D-MD)
- **International tax**, co-chaired by Sen. Rob Portman (R-OH) and Sen. Chuck Schumer (D-NY)
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

- Savings and investment, co-chaired by Sen. Mike Crapo (R-ID) and Sen. Sherrod Brown (D-OH)
- Infrastructure and community development, co-chaired by Sen. Dean Heller (R-NV) and Sen. Michael Bennet (D-CO)

The Committee also plans to hold a series of hearings in parallel with the working group process to examine a variety of issues. The goal of Chairman Hatch and Ranking Member Ron Wyden (D-OR) is to have a final report featuring recommendations from the working groups by the end of May. Regardless of the unanswered questions associated with the process (Will the recommendations result in a revenue-neutral proposal? Will the Committee use dynamic scoring?), the process demonstrates that Chairman Hatch is serious about tax reform. In fact, he recently said he plans to introduce and mark up a bipartisan tax reform package before the end of the year.

In another demonstration of how seriously he wants to pursue tax reform, Chairman Hatch has made overtures to the Administration in recent weeks. For example, he recently said he plans to pursue business tax reform first in an effort to obtain support from the White House. He also recently invited Vice President Biden to take part in Senate discussions on the issue this year. The Vice President, who maintains many good relationships with his former colleagues in the Senate and has worked on deals in the past with Majority Leader McConnell, confirmed that he would be willing to take part in upcoming tax reform discussions. Given this history, the Vice President’s involvement could increase the chances of progress.

In many ways, the dynamics in the Senate are similar to those in the House. Senate leadership, like House leadership, has also expressed a commitment to tax reform; in his maiden speech as Majority Leader, Leader McConnell touted tax reform as a potential area of consensus with the White House. Further, Mr. McConnell intends to use regular order in the Senate, meaning many bills and amendments to revise the tax code will be offered and considered and increasing the risk of one-off revenue raisers and loophole closers. Like the House, there are new members of the tax-writing committee (Sen. Heller, Sen. Dan Coats (R-IN), and Sen. Tim Scott (R-SC)) who will bring their own ideas and proposals to the table. Off-panel members, including potential or announced presidential candidates, are also sure to influence the debate.

Unanswered Questions

Since everyone says they want to do tax reform, why haven’t they done it yet? Despite the intense interest in tax reform from the business community and lawmakers over the past several years, there are numerous questions that remain unanswered. As Yogi said, “It was hard to have a conversation with anyone, there were so many people talking.”

What’s the Scope?

One sticking point is the scope of tax reform. President Obama has said Republicans and Democrats should work on business tax reform before tackling the broader tax code. However, some Republicans have insisted that tax reform be comprehensive, addressing corporate taxes, pass-throughs, individual taxes, the international tax system, and other areas. That said, Chairman Ryan and Chairman Hatch have softened their stances on the
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

issue recently, signaling an openness to put business tax reform first if necessary to obtain support from the Administration.

The treatment of pass-through entities is, in many ways, the fulcrum of the debate over whether tax reform should focus on business filers. As Chairman Hatch noted recently, “If we focus only on reforming the corporate tax code, we’d be leaving the majority of U.S. businesses—particularly small businesses, which employ most of our workforce—behind.” A proposal that addresses neither individuals nor pass-through entities may not have the type of far-reaching effect sought by proponents of reform.

Additionally, some Democratic lawmakers like Senate Minority Leader Harry Reid (D-NV) have criticized the Administration’s preferred business-only approach for taking care of big businesses while leaving ordinary Americans behind.

Will Congress Use Dynamic Scoring?

Another issue that continues to complicate tax reform is dynamic scoring. Historically, the Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) have used “static” scoring to estimate the revenue impact of tax bills. Under static scoring, CBO and JCT take into account some behavioral effects of a tax proposal but do not take broader changes to the economy into account. Proponents of “dynamic,” or “macroeconomic,” scoring argue that static scoring does not accurately capture the entire revenue impact of certain larger tax proposals. They assert that major tax legislation like tax reform would affect gross domestic product because of the resulting changes in the cost of capital and the cost of labor, and that these changes should be taken into account when figuring the revenue impact. As a general matter, Republicans tend to favor dynamic scoring while many (but not all) Democrats do not.

The House recently approved H. Res. 5, which adopted rules for the 114th Congress and included a requirement that dynamic scoring be used under certain circumstances. At the time of this writing, it is unclear whether dynamic scoring will be approved in the Senate.

The outcome of the duel between static and dynamic scoring could have a significant effect on the tax reform debate. If dynamic scoring is adopted, Congress would need to repeal or scale back fewer deductions and tax credits to pay for revenue-neutral tax reform. Outcomes could also differ because the overall effect of a comprehensive tax reform plan could result in a positive dynamic score while discrete proposals within the plan would not have a positive growth effect on a stand-alone basis. There are esteemed economists and sophisticated, credible arguments on both sides, and the robust discussion is bound to continue. However, disagreement over the issue could create a new rift between Republicans and Democrats as they evaluate whether consensus on tax reform is feasible.

How Will Congress Answer the Threshold Questions?

Additional threshold questions remain unanswered, including whether tax reform will be revenue-neutral or distributionally-neutral. In addition, it’s unclear right now to what extent lawmakers are willing to broaden the tax base by eliminating deductions and credits important to their constituents. As Chairman Camp’s draft demonstrated last year, achieving low rates is not an easy task, and many members backed away from the tough choices reflected in the Camp draft.
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

The 2016 Election: What Impact Will It Have?

The upcoming presidential election could also throw a wrench in any tax reform discussions. Although Chairman Ryan ended speculation about his intentions by announcing that he would not run for President, other candidates could also complicate the debate. As the Republican and Democratic primaries heat up, candidates are almost certain to champion their own tax reform ideas and proposals, and members may be unwilling to interfere with those discussions for fear of derailing their favored candidates. Many lawmakers may make the calculation that they should wait until their preferred candidate is in office to pursue tax reform rather than push through a package before a new president takes office.

What Impact Will “Must-Do” Items Have?

There are several must-do items on the congressional agenda, including transportation funding, the Medicare “doc fix,” raising the debt ceiling, and others. These items bring with them the significant risk that Congress will look to repeal, modify, or scale back certain tax expenditures in order to raise revenue for these priorities. Additionally, some lawmakers continue to view repatriation as an ideal way to raise revenue for transportation infrastructure. To the extent the other must-do items on Congress’s plate include these types of one-off revenue raisers, it could have a major impact on tax reform.

Will Congress Use Reconciliation for Tax Reform?

Advocates of tax reform have been discussing the possible use of the reconciliation process for several months. Using reconciliation would allow the Senate to pass a tax reform package with a simple majority instead of the usual 60 votes. Several lawmakers, including Sen. Thune, have called for the congressional budget committees to include reconciliation instructions in their FY16 budget resolutions to advance a tax reform package instead of using reconciliation for other priorities, like amending or repealing the Affordable Care Act. Others, however, have argued that even if Congress is able to pass a tax reform package through reconciliation, the President is unlikely to sign any tax reform bill that passes the Senate with a simple majority without the support of his party. Still others point to technical restrictions on reconciliation that limit the ability of Congress to make certain types of policy changes.

Prospects for Tax Reform

So what are the chances for tax reform in the 114th Congress? Realistically, the chances of enacting a comprehensive package are slim. But that leaves plenty of room for narrower reforms, one-off pay-fors, and cementing the foundation for broader legislation in the next Congress. The President will release his budget, building on the proposals in his State of the Union address. The tax-writing chairmen have made tax reform their top priority and have already taken significant steps to demonstrate their commitment. House and Senate leadership agree tax reform is one area where they might find agreement with the President, and Mr. Boehner has identified it as a top five issue to restart the economy. Majority Leader McConnell’s commitment to regular order in the Senate means amendments to revise the tax code will be offered and considered. Must-do items may require revenue offsets that could put controversial tax provisions in play. Members of Congress are releasing their own detailed plans. Think tanks and thought leaders are weighing in. And the OECD and the EU
Déjà Vu All Over Again?

Tax Reform in the 114th Congress

are coming up fast from behind with their own policies that will pressure the U.S. into taking action.

These signs point to the fact that tax reform will be front and center throughout this Congress. This momentum will create ongoing risks and opportunities for the deductions, credits, and other tax measures important to you. Staying on top of these developments will require diligent monitoring and a keen eye for spotting opportunities and threats.

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Déjà Vu All Over Again?

Tax Reform in the 114th Congress

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