Policy Alert

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The Year Ahead in Tax Policy: Recurrent Issues in a New Congress

The new 114th Congress has now convened, and speculation is widespread as to the tax legislative agenda for 2015. Republicans now control both houses of Congress, and new chairmen are in place in leadership roles of both tax-writing committees. While much is new in the Congress and in the two tax committees, many tax legislative issues are recurrent and are likely to demand attention in 2015. Some issues will be driven by calendar deadlines—others will be discretionary with the two chairmen and dependent on the emergence—or failure—of political consensus. Others still could be driven by adoption of a congressional budget resolution for FY 2016 with reconciliation instructions requiring legislative action by the tax committees. This update identifies the critical calendar deadlines that will confront the two tax committees, as well as other significant tax policy issues, such as tax reform, that could emerge in the course of the year.

Calendar Deadlines

1. March 31: expiration of the current physician reimbursement regime under Part B of the Medicare program (the so-called "doc fix")

2. March-Summer: expiration of the debt ceiling suspension (specific date unknown due to Treasury administrative authority to utilize "extraordinary measures" to avoid default)

3. May 31: expiration of funding for the federal highway program

4. September 30: expiration of funding for the Children's Health Insurance Program (CHIP)

5. September 30: expiration of federal aviation taxes funding the Airport and Airway Trust Fund

6. December 31: expiration of tax extenders (most expired at the end of 2014)

Note that all of these calendar items are within the legislative jurisdiction of the two tax committees and could involve revenue issues or other budgetary offsets. In addition, legislation in some of these areas could expand to related tax policy initiatives, such as in the case of the highway funding bill, and infrastructure investment incentives.

The Prospects for Tax Reform

With the start of the 114th Congress, comprehensive tax reform is once again at the forefront of congressional debate. With House Ways and Means Committee Chairman Dave Camp (R-MI) now retired, and Republicans in control of the Senate, two new chairmen, Rep. Paul Ryan (R-WI) (House Ways and Means Committee) and Sen. Orrin Hatch (R-UT) (Senate Finance Committee), will now attempt to find a path forward to shepherd a tax reform bill through a maze of competing interests and ideas.

A. The Current State of Play in the House

House Ways and Means Chairman Ryan has already held his first hearing of the year, focused on economic growth. In his opening statement at the hearing, Chairman Ryan listed tax reform as among his committee's top priorities, saying "We need to make the tax code simpler, fairer, and flatter." Chairman Ryan has indicated that he will move aggressively to put together a comprehensive tax reform package, though the vehicle for that passage is still unclear. Importantly, the chairman has recently expressed a willingness to explore the possibility of a "business-only" approach to tax reform with the Obama administration and other interested parties.

It is important to note that a tax reform bill could also possibly advance through the budget reconciliation process, which would require only 51 votes in the Senate, protecting the bill against a Democratic filibuster. In order to do so, both the House and Senate would have to first adopt a budget resolution by April 15 that includes reconciliation instructions pertaining to tax reform. Then, both chambers would need to develop and pass tax legislation to implement any reconciliation instructions. This process (budget reconciliation) would add political controversy, as well as several layers of complexity, by tying the success of tax reform to the ability of the Congress to reach and implement a budget resolution.

Based on several budget resolutions passed in previous congresses while Chairman Ryan was chairman of the House Budget Committee, we would expect Chairman Ryan to pursue a tax reform package that contained significantly lower tax rates while simplifying the tax code. While Chairman Ryan has not released any specific proposal since assuming the Ways and Means Committee chair, past "Ryan Budgets" adopted by the House of Representatives called for two individual tax brackets of 10 percent and 25 percent and a top corporate rate of 25 percent. In addition, Chairman Ryan has been a principal advocate of changing budget scorekeeping conventions to reflect macroeconomic effects of tax legislation (often referred to as "dynamic scoring")—a change formally adopted by the House in its Rules for the 114th Congress—and strongly resisted by congressional Democrats and the Obama administration. It is important to note that the change in budget scorekeeping conventions is a House rule change only and has no direct application in the Senate or in analyses prepared by the administration and the Office of Management and Budget.

B. The Current State of Play in the Senate

In the Senate, new Finance Committee Chairman Orrin Hatch has begun a process similar to former Ways and Means Chairman Camp by creating several bipartisan working groups to tackle different topics related to tax reform. Chairman Hatch, along with Ranking Member Ron Wyden (D-OR), announced this week that the groups will address five policy areas:

1. individual taxation (co-chaired by Grassley (R-IA), Enzi (R-WY) and Stabenow (D-MI))

2. business taxation (co-chaired by Thune (R-SD) and Cardin (D-MD))

3. international taxation (co-chaired by Crapo (R-ID) and Brown (D-OH))

4. savings and investment (co-chaired by Portman (R-OH) and Schumer (D-NY))

5. community development and infrastructure (co-chaired by Heller (R-NV) and Bennet (D-CO)).

The working groups are likely to have several months, possibly until Memorial Day, to develop recommendations for consideration by the full Finance Committee. Apparently, the working groups will not be given specific instructions or overarching policy principles (such as budget or distributional neutrality) to guide their work. Chairman Hatch and Ranking Member Wyden have made clear that, while the upcoming activities of the working groups are important to the tax reform process, they will not necessarily embrace what each group recommends.

It should also be noted that, while policy principles will apparently not be established at this time, in a December floor speech, Chairman Hatch did outline seven principles for tax reform: economic growth, fairness, simplicity, permanency, competitiveness, the promotion of savings and investment, and revenue neutrality. In addition, as the 113th Congress concluded, Chairman Hatch released an in-depth tax reform "primer" analysis, which outlined the policy issues that must be considered in the context of tax reform. The report, titled Comprehensive Tax Reform for 2015 and Beyond, concludes that any tax reform legislation should lower the corporate and individual tax rates (while eliminating individual tax exclusions or exemptions) and provide certainty through permanency of continually expiring tax provisions, as well as move the United States to a territorial taxation system.

The Finance Committee plans to hold hearings on a variety of tax reform issues starting in mid-February, but it is not likely to issue any concrete proposals until the working groups have had time to complete their discussions. Chairman Hatch has said that he would prefer to move a tax reform bill through regular order, but that he is open to all procedural and substantive options as the debate evolves. It should be noted that other senators, including Sen. John Thune (R-SD), chairman of the Senate Republican Conference, as well as a member of the Senate Finance Committee, have suggested that the budget reconciliation process may be used to advance a tax reform initiative. However, Senate Democrats are likely to view any such effort to utilize the budget reconciliation process as problematic, if not hostile, to the tax reform process.

C. The Obama Administration

President Obama has indicated support in principal for pursuing business tax reform in the new 114th Congress. In this regard, the president advanced "A Framework for Business Tax Reform" in 2012, which proposed reducing the top corporate tax rate to 28 percent (25 percent in the case of manufacturing) with a significantly broadened corporate tax base. That framework could become a starting point for any negotiation on tax reform with congressional Republicans. More recently, President Obama signaled that he would not accept reductions of tax levels or additional tax benefits for business interests without similar tax benefits for middle-and lower-income individuals. Additionally, the president has indicated his preference for a tax reform effort that raises revenue on a net basis to help fund transportation and other infrastructure projects. This position is at odds with congressional Republicans who favor structuring tax reform to be "revenue neutral." The president is also unlikely to support any tax overhaul that passes Congress on a party-line vote or is moved through the budget reconciliation process without Democratic support.

In December, the White House stated that it would be releasing "specific" proposals on tax reform for consideration by congressional Republicans, which could be previewed in the State of the Union address or included in the president's FY 2016 budget proposal (expected on February 2). The president also stated in late 2014 that he would begin staff-level discussions with lawmakers to determine whether a tax reform agreement can be reached.

D. Current Assessment

To succeed, tax reform will require a consistent and determined effort—by the president and the bipartisan congressional leadership—at every stage of the legislation's development in both tax committees and on the floors of the respective houses of Congress. Nothing short of a bipartisan, bicameral and co-branch commitment will be required.

While the preliminary signals from all relevant players are promising, there are many hurdles yet to be navigated. For starters, the fundamental building blocks for a successful tax reform effort must be set to guide the policy process. Fundamental policy principles are currently elusive and could ultimately be controversial: whether tax reform should be comprehensive to include both individual and corporate reform, or whether "business" tax reform (to include not only publicly traded "C" corporations, but also small businesses, sole proprietorships, partnerships, Subchapter S corporations, etc.) should proceed separately and go first. In addition, a fundamental difference of opinion must be bridged between congressional Republicans, who favor "revenue neutral" tax reform, and President Obama and congressional Democrats, who favor raising some additional revenues from tax reform for deficit reduction or infrastructure investment.

Stipulating to an eventual political consensus on the "fundamentals," what might tax reform ultimately look like? While the devil will certainly be in the details, the policy momentum appears to be developing along the lines of "classic" reform in the model of 1986 Reform Act (i.e., a substantial reduction in tax rates with a significant broadening of the income tax base). Few members of Congress appear inclined to pursue "substitutional" reform as a repeal of the current progressive income tax in favor of a consumption-based tax system.

Important tax reform models and proposals were advanced in the 113th Congress just concluded. Former House Ways and Means Committee Chairman Dave Camp and former Senate Finance Committee Chairman Max Baucus made significant contributions to the tax reform debate by advancing various discussion drafts and actual legislation (H.R. 1 introduced in the 113th Congress by Chairman Camp). The work products of both chairmen will likely be policy "benchmarks" against which future tax reform legislation is measured, as will the "Framework for Business Tax Reform" advanced by President Obama.

Seen to a successful conclusion, tax reform holds the potential for significant policy change and beneficial effect on the national economy—but with no guarantee of universally good results for all taxpayers. Given the elements of the likely legislative “bargain” of lower rates for a broader tax base, taxpayers will have to do the math and evaluate the trade offs to determine whether they are “winners” or “losers” as tax reform legislation progresses.

During its congressional journey, tax reform will present various policy threats and legislative vulnerabilities, as well as selective opportunities for positive change. To end up on the right side of the trade-off equation, a high level of substantive skill and political sophistication will be required to navigate the critical policy and political challenges ahead.

The Prospects for Other Revenue Legislation

While the 2015 tax agenda will likely focus on the calendar deadlines identified above and the possibility of tax reform, other legislative matters may arise in the new Congress that stimulate debate on the issue of possible revenue or funding offsets. These could include:

1. repeal of the medical device tax and other features of the Affordable Care Act

2. trade legislation that involves tariff concessions, such as a possible Trans-Pacific Partnership agreement

3. funding shortfalls in the Social Security Disability Program.

These and other unexpected revenue issues may develop in the course of 2015 in one or both tax committees, and will require vigilant attention.

Conclusion

At this early stage of the 114th Congress, much uncertainty exists about the 2015 tax agenda, specifically on the prospects of tax reform. Clearly, if tax reform is actively pursued, it will dominate the time and attention of both tax committees, their new chairmen and committee members. However, important calendar issues also loom and cannot be ignored—ultimately vying for and demanding action by both committees. The budget reconciliation process could also be an important factor in shaping the 2015 tax agenda while potentially injecting a level of partisanship inimical to other legislative initiatives. Finally, other legislative priorities—unrelated to tax reform or calendar deadlines, but generating debate and possible action on budgetary and revenue offsets —may present themselves. In this uncertain legislative environment of vast potential and vulnerability, stakeholders must be well-represented by sophisticated and seasoned counsel to safeguard and secure their tax policy interests.

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