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Tax Policy and Politics: An Uneasy Coexistence

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Where we are

Extenders recap
Half-full or half-empty?

Yes, it was just one year, but….

- Camp (and Wyden and Reid) were all lame ducks in their then-current roles
- Some Republicans wanted to hold out for a better deal in 2015
- Certain extenders are increasingly controversial, especially wind production tax credits
- Sharp split in political interests of Senate Democrats and President Obama
- GOP anger at Obama's executive order on immigration made the House reluctant to make permanent ARRA-era expanded refundable tax credits, something Obama demanded (even though they don't expire until 2017)
- Uncertainty among House Republicans about the deal-making abilities of outgoing Finance Committee Chairman Wyden
- Business community had little leverage to force a better/longer deal

Tax policy challenge #1

Which tax plan do you prefer?

Plan	Top rate	Key features
Plan A	**45%**	First $14 trillion of individual's income exempt from tax
Plan B	**32%**	Applies to first dollar of income; no deductions, credits, exclusions, or exemptions; 32% rate also applies to all income, including capital gains, dividends, and currently tax-exempt interest

Tax policy challenge #2

Is Congress too busy to get any work done?

- Extenders are already expired
- Funding for the Department of Homeland Security expires again at the end of this week
- Debt limit suspended through March 15, 2015, but Treasury can use extraordinary measures to extend the "X-Date" for several weeks or months thereafter
- Congress will attempt to pass a budget in the spring and then need to turn to the twelve annual spending bills
- Highway funding and the Medicare "doc fix" also on tap in first half of 2015
- The upcoming Supreme Court decision in King v. Burwell (tax credit subsidy case) could create substantial pressure on Congress to address ACA issues
- 2016 Presidential campaign is already underway

Senate Finance Committee establishes bipartisan working groups to dive deeper into the code

- Five bipartisan working groups created
  - *Individual Income Tax* – Sens. Chuck Grassley (R-Iowa), Mike Enzi (R-Wyo.) and Debbie Stabenow (D-Mich.)
  - *Business Income Tax* – Sens. John Thune (R-S.D.) and Ben Cardin (D-Md.)
  - *Savings and Investment* – Sens. Mike Crapo (R-Idaho) and Sherrod Brown (R-Ohio)
  - *International* – Sens. Rob Portman (R-Ohio) and Chuck Schumer (D-N.Y.)
  - *Community Development and Infrastructure* – Sens. Dean Heller (R-Nev.) and Michael Bennet (D-Colo.)
- Reports due by the end of May
- Membership is evenly split between Republicans and Democrats
- Unlike similar working groups in the House in 2013, these are charged with making legislative recommendations

International Tax Policy

Hot topics

Snapshot of President Obama's FY 16 budget

Returning elements

- Repeal various tax preferences including oil and gas, corporate jets, carried interest, and LIFO; extend R&D and renewable energy production tax credits; expand tax benefits for middle-class families; establish small reserve fund for corporate tax reform

New proposals

- Permanent extension of CFC look-through and Subpart F rules for active financial services income; revised approach to international tax reform; new refundable tax credits

Adopts pieces of Camp's 2014 Tax Reform Bill

- Bank tax; deemed repatriation; mark-to-market for derivatives

Higher taxes on the wealthy

- "Buffett Rule;" limitations on the value of itemized deductions; 28% top rate on capital gains; elimination of stepped-up basis at death on appreciated assets; and increase in the estate tax

In focus

Obama’s new international tax proposals

- What are the key features?
  - 19% minimum worldwide tax (with adjustments / foreign tax credits) but no additional U.S. tax on repatriation
  - 14% deemed repatriation transition tax (but no differentiation between cash v. bricks and mortar assets)
- What sort of system is it?
  - Worldwide, but with a lower rate for foreign-source income?
  - Territorial, but with very high base erosion safeguards?
  - Hybrid?
- What are its prospects on Capitol Hill?
  - Better in concept than as written

Inversions – problem to be solved? Or symptom of broader weaknesses in the tax code?

In recent months, several companies have undertaken (or attempted to undertake) an inversion transaction

- Several Democrats have suggested retroactively tightening 2004's anti-inversion rules to block this new type of inversion and/or making legislative or regulatory changes to limit tax benefits available to inverters
- GOP Members have generally expressed skepticism of fixes outside of the context of fundamental tax reform and are generally opposed to retroactive effective dates

With little prospect of legislative action, Treasury issued Notice of forthcoming regulations in September to deter inversions and remove tax benefits available to companies that do invert

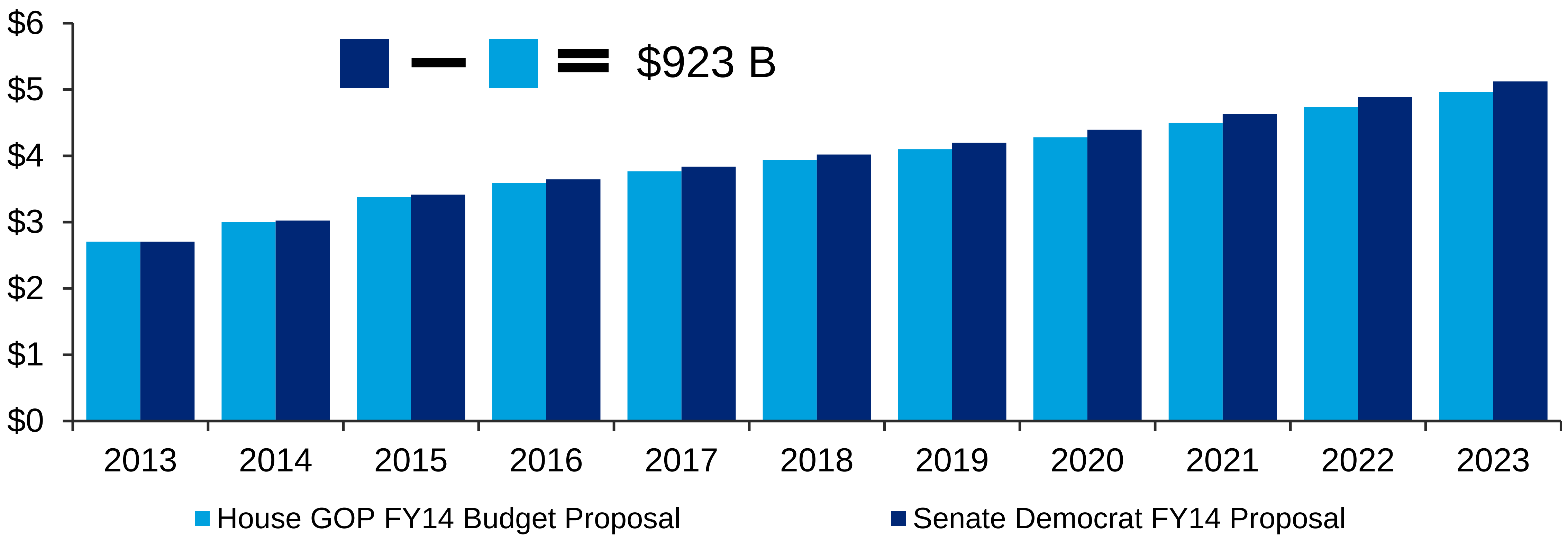
Tax policy challenge #3
Tax reform means tough choices for business

- Repeal deferral (Wyden)
- Limit value of corporate interest deduction (Wyden)
- Retroactive reduction in value of Section 45 PTC (Camp)
- Tax carried interest as ordinary income (Camp)
- New rules for related-party reinsurance (“the Neal bill”) (Camp)
- Limitation on treaty benefits for inbound companies (“Doggett Treaty Raiser”) (Camp)
- Slower cost recovery (Baucus, Camp, Wyden)
- Phase-out Section 199 deduction (Camp, Wyden)
- Repeal LIFO and LCM (Baucus, Camp, Wyden) and like kind exchanges (Baucus, Camp)

Tax Policy challenge #4

Still can't decide whether tax revenues are high enough or need to rise further

(in trillions)



Note: The updated May baseline for current law basically mirrors the House GOP budget but for some minor technical adjustments.

Source: House Budget Committee, Path to Prosperity (FY14)—Summary Tables (Mar. 2013); Senate Budget Committee, Foundation for Growth (FY14)--Summary Tables (Mar.2013)

House adopts dynamic scoring

- Unlike the traditional “static” score, a “dynamic” score takes into account behavioral changes related to macroeconomic growth
- Former W&M chair Dave Camp released both a “static” score and a “dynamic” score of his discussion draft in February 2014; JCT issued a series of estimates projecting that Camp’s draft would boost the size of the economy and therefore also boost federal receipts by between $50 billion and $700 billion over ten years
- The House approved a rules change this year requiring CBO and JCT to incorporate the budgetary effects of changes in economic output, employment, capitol stock and other macroeconomic factors in their scores of major tax and entitlement spending legislation

But will dynamic scoring matter?

1. Applies only to the House, but not the Senate or White House
2. Choice of model matters – when JCT reviewed former Chairman Camp's tax reform draft, it gave eight different projections of changes in revenue; the choice of which point estimate to use (and who will be making that decision at JCT and CBO) is critical
3. Longer horizon review – the rule requires an examination of the macroeconomic impacts through the third decade after passage, which is a two-edged sword
   - Growth effects likely to be larger in the second and third decades
   - Some one-time revenue shifts that might create the illusion of balance over the first decade, such as LIFO repeal or deemed repatriation, don't show up outside the traditional ten-year budget window

Six final thoughts and takeaways

The first three

1. Extenders debate is the “Groundhog Day” of tax policy
2. Key players are gearing up to take another run at tax reform in 2015; funding shortfall for the highway bill could be the needed action-forcing event
3. Presidential leadership is the Catch-22 of tax reform

The last three

4. Allowing the broader politics of tax reform to be defined by a single variable – marginal tax rates – makes compromise especially difficult

5. Even with the timing of passage of tax reform uncertain at best, it would be a mistake to ignore it now

   - Tax reform remains inevitable; work being done now (along with what Camp, et. al. worked on last year) likely will form the basis of what is eventually enacted

   - The OECD BEPS project introduces additional risk into the tax policy environment

6. Congress members' stated desire to "make the tough choices" sometimes exceeds their willingness to actually do so, especially if final outcome is uncertain

Please remember to complete your evaluation

Speaker bios

Jonathan Traub joined the Washington National Tax practice of Deloitte Tax LLP in June 2012 as managing principal of its Tax Policy Group. Jon leads a team that identifies, evaluates and monitors legislative proposals, and interprets the practical issues surrounding the application of tax proposals on behalf of Deloitte's clients. Jon assists Deloitte's clients in their efforts to stay aware of the numerous and often complicated debates in tax policy.

With considerable career experience in the legislative arena, especially in tax policy, Jon is able to provide clients with critical insights on the most complicated issues impacting their businesses and offer recommendations and guidance. His immense experience on Capitol Hill has provided him the valuable ability to anticipate legislation and the various impacts associated with new or revamped policies, which will in turn prove essential to the success of clients' businesses.

Jon was previously the staff director for the Committee on Ways and Means of the U.S. House of Representatives, his most recent senior staff position in the U.S. House of Representatives. During his tenure as Staff Director for the Committee on Ways and Means, Jon was responsible for developing legislative policies and strategy on issues in the Committee's jurisdiction, including taxes, healthcare and trade.

He also played a key role in the Tax Relief Act of 2010 and the Budget Control Act (debt limit increase, 2011). He was also deeply involved in the work of the Joint Select Committee on Deficit Reduction, better known as the Super Committee.

Jon received his bachelor's degree from Haverford College and juris doctor from the University of Virginia.

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