SQUIRE PATTON BOGGS

Tax Policy in the Run-up to the 2020 Elections

"I'm just sitting here watching the wheels go round and round
I really love to watch them roll"

"Watching the Wheels" by John Lennon

On November 3, 2020, voters will cast ballots in what may be the most hotly contested and expensive election in American history. The looming election will cast a shadow over just about every aspect of policymaking in Washington DC throughout 2020, including tax policy.

Election years tend to revive a familiar pattern on Capitol Hill: lots of talk and little legislating. Lawmakers in the House and Senate will try to turn floor time into media airtime in hopes their messages will resonate with voters back home. Among presidential contenders, tax policy has already become a popular point of discussion, with Democratic candidates offering proposals to implement, among other ideas, wealth taxes and a higher corporate rate to pay for ambitious policy goals.

While tax policy will continue to be a talking point on the campaign trail, lawmakers and regulators back in Washington DC still have an opportunity to make some meaningful changes to the tax code. Though the window for making any changes will be tight (i.e., before the August recess), there is *some* chance that lawmakers can reach bipartisan agreement. Certain tax provisions, like Tax Cuts and Jobs Act (TCJA) technical corrections and expanding refundable tax credits, could garner enough support to ride along with a "must-pass" legislative vehicle. That said, the wake of the impeachment trial and its divisive politics will no doubt temper expectations for Democrats and Republicans working together on legislation. While positions may be hardened now, lawmakers are still crafting their policy agendas for the remainder of the year and – in a divided Congress – both sides of the aisle need each other to turn proposals into law. Not to be overlooked, major developments on the international stage could have a dramatic impact on multinational companies. In other words, hope springs eternal as the wheels of Congress keep rolling.

Looking ahead, we expect that three overarching factors will drive the congressional tax policy agenda in 2020: (1) whether House Democrats, Senate Democrats and Senate Republicans can find ways to work together on tax legislation; (2) whether a "must-pass" legislative vehicle takes shape with enough room for tax provisions (*spoiler alert*: mark May 22 on your calendar as a key congressional deadline, discussed below); and (3) when the election will draw lawmakers away from the nation's capital, thus closing the window for major bipartisan deal-making. In this update, we discuss those factors, along with major tax policy issues to monitor in 2020.

Where Are We and How Did We Get Here?

Before we forecast what is ahead in tax policy, it is important to take stock of what happened – and did not happen – at the end of 2019, which saw some significant tax policy proposals become law.

What Happened at the End of 2019?

Near the end of December 2019, Congress passed, and President Trump signed into law, Fiscal Year (FY) 2020 government funding legislation, which included a bevy of tax provisions. Among the many tax items, the legislation featured an extension of expired and expiring tax provisions known as tax extenders, repeal of Affordable Care Act (ACA) taxes, a couple of technical fixes to TCJA, including several provisions directly affecting tax-exempt organizations (which we discuss further here), and a retirement package called the SECURE Act. The tax title came together after days of back-and-forth negotiations between Senate Republicans, House Democrats and the White House. Though it was more modest than some anticipated (or wanted), the tax provisions totaled nearly $426 billion, according to the Joint Committee on Taxation (JCT). That said, and despite the lofty price tag, there is still some significant unfinished business for tax writers to address in the new year, as we discuss below.

What Did *Not* Happen at the End of 2019?

Nearly as important as what became law at the end of last year is what did not quite make it – despite the best efforts of lawmakers negotiating late into cold December nights. Congressional and administration tax negotiators were not able to reach agreement on, among other things, expansions to refundable tax credits, such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), two of the more popular TCJA technical corrections addressing qualified improvement property (QIP) and net operating losses (NOLs), and a whole host of other technical corrections (totaling roughly 90 areas where corrections might be needed to carry out Congressional intent, per JCT). These important provisions were left on the cutting room floor after Republicans and Democrats failed to meet in the middle of the refundable credits' approximately $100 billion revenue cost and the purported zero-revenue impact of the technical corrections. Query whether Democrats still harbor resentment after Republicans passed TCJA without their participation, which meant the two sides could not reach an agreement under the tight deadlines as the holidays quickly approached. Refundable credits and technical corrections for QIP and NOLs are among the most significant tax policy items to monitor in 2020 from a congressional perspective.

Key Tax Policy Issues to Watch in 2020

May Day

Before delving into more of those specific tax policy items, however, it is important to note one date this year that may be the last, best chance to pass meaningful tax legislation before the election: **May 22**. Last year, Senate Finance Committee Chairman Chuck Grassley (R-IA) and House Speaker Nancy Pelosi (D-CA) worked together to convince appropriators to extend certain Medicare and Medicaid programs initially set to expire at the end of FY 2019 until May 22, setting up a must-pass healthcare package this spring. Healthcare extenders include funding for Community Health Centers, surprising billing and changing the cap for Medicaid drug rebates. As relevant to the tax policy world, these expiring healthcare extenders create pressure for a deal before the Memorial Day recess, where certain tax items could hitch a ride on legislation moving through Congress. Other "must-pass" vehicles may materialize as the year unfolds, but May 22 has emerged as one of the top deadlines for legislation that could bring a divided Congress together.

Against the backdrop of the looming election, below we discuss some of the more significant federal, state and international tax policy items to watch this year – starting with the aforementioned technical corrections.

Federal Tax Policy

TCJA Technical Corrections. Given Republicans' interest in moving a technical corrections package during the fall of 2019, it remains possible that one will move through Congress this year. Most Democrats generally acknowledge that the QIP and NOLs technical corrections are true mistakes in TCJA that warrant fixing, but remain steadfast in securing a policy "win" in exchange for pushing the corrections ahead. Members of both parties have introduced bills addressing the fixes in both chambers, indicating the wide swath of support for the fixes. In addition to QIP and NOLs, more than 70 other technical corrections remain in limbo over two years after TCJA became law.

Refundable Tax Credits. At the beginning of 2020, House Ways and Means Committee Chairman Richard Neal (D-MA) announced he is pushing for a floor vote this year to widen the reach of the EITC and CTC, though such expansions will be "impossible" to move in the Republican-controlled Upper Chamber, according to Senate Finance Committee Chairman Grassley. That said, one (slight) sign of progress emerged in December. Sens. Michael Bennet (D-CO) and Mitt Romney (R-UT) introduced a bipartisan proposal to expand and reform the child tax credit for tax years 2019 and 2020. The proposal would create a new credit of up to $2,500 per child for children up to age six and would implement the full list of technical corrections to TCJA. It remains to be seen where this proposal could go in 2020, but it serves as a place-marker for future bipartisan cooperation.

Tax Extenders. Certain temporary tax provisions that Congress extended at the end of 2019 now expire at the end of 2020. In the absence of a bipartisan agreement on which tax incentives warrant permanence and which incentives will be left for dead, extenders may find themselves on the "lame-duck" agenda. Depending on the results of the election, lawmakers may continue the tradition of temporarily extending these incentives until the following year. At this point, it is too early to tell what will happen to extenders – though we do know that House Ways and Means Committee Ranking Member Kevin Brady (R-TX) will likely push to end the "annual temporary tax circus" (as he puts it) once again this year.

Green Energy Tax Incentives. Democrats on the House Ways and Means Committee plan to clear a green energy tax break bill by the end of March, though exactly what is in the package is still up for debate. Notably, Ways and Means Member Rep. Dan Kildee (D-MI) is pushing for an expansion of the existing tax credit for electric vehicle buyers. In addition to electric vehicles, Ways and Means Democrats are also considering tax incentives for solar, wind and other energy sources besides fossil fuels. Though the proposal is likely to be only a messaging bill with a Republican Senate, environment tax incentives will be a key talking point for Democrats up for re-election in November.

Individual Tax Provisions. Speaking of messaging bills, individual tax rates are likely to generate the most buzz this year because they directly impact constituents headed to the voting booths. President Trump has occasionally announced vague details of a "middle-class" tax cut that would keep the economy front and center in voters' minds. That said, any tax package produced by the White House would face an impasse in the Democrat-controlled House, but a "Tax Cuts 2.0" package may offer an important talking point for Republicans on the campaign trail.

TCJA Implementation. The IRS and Treasury hope to complete all remaining regulations related to TCJA by next fall, an effort that will require issuing nearly 100 pieces of guidance. The guidance will include final rules on several important items, including (among others) provisions related to the tax reform law's cap on corporate write-offs of debt interest payments, carried interest three-year holding requirement, passive foreign investment companies, cloud computing transactions, unrelated business income and foreign-derived intangible income (FDII). Indeed, 2020 offers no rest for the weary at Treasury and the IRS following the past two years of implementing TCJA.

Conservation Easements. With uncertain prospects for moving major tax legislation through Congress this year, tax investigations may keep lawmakers on key tax-writing committees busy this year. In fact, a good portion of the Senate Finance Committee's work could center around investigations, such as the probe into conservation easements that Chairman Grassley began last year with Ranking Member Ron Wyden (D-OR).

Tax Treaties. Another sleeper issue to watch on Capitol Hill is the Senate's work on tax treaties. In early 2020, the Senate will likely consider tax treaties with Chile, Hungary and Poland. Senate Foreign Relations Committee Chairman Jim Risch (R-ID) announced earlier in 2019 that he hoped to advance those three treaties before the end of the year. Remember that in July 2019, the Senate ratified protocols amending tax treaties with Spain, Switzerland, Japan and Luxembourg.

Presidential Politics. Though proposals discussed on the campaign trail are just that – proposals – they can serve as indicators of where a party is headed and also place rank-and-file lawmakers in a bind. For example, some of the "red meat" ideas discussed during the Democratic primaries (i.e., wealth taxes) force lawmakers in Capitol Hill to address these ideas, even if they stand little chance of becoming law in the near-term. This will be an important dynamic to watch as the primaries heat up and candidates look for ways to ignite support among their party bases.

State and Local Tax Policy

In addition to the federal tax policy issues noted above, there are some important issues to keep an eye on that impact state and local governments. Below are some of the key state and local tax policy items to monitor this year.

State and Local Tax Deduction. In late December, the House passed a bill to eliminate the $10,000 state and local tax (SALT) deduction cap for 2020 and 2021. To offset the cost, the bill increases the top marginal individual income tax rate to 39.6% through 2025. Though the bill is largely a messaging exercise with elections around the corner, it will be important to watch how the SALT discussion progresses in years to come. Though the SALT cap became law via Republicans' tax reform bill, the issue follows geographic and political lines, especially for members in high-tax jurisdictions like California, New York and New Jersey. In fact, Republican members said the bill would disproportionately benefit the wealthy – the same argument Democrats have made repeatedly about TCJA.

Opportunity Zones. Another key tax policy item affecting states and local governments is how the federal government and states implement opportunity zones. In December, the Treasury Department and IRS finalized rule changes on Opportunity Zones. Among several items, the regulations allow additional real estate projects to qualify for tax advantages and allow for people who sell businesses to invest in Qualified Opportunity Funds (QOFs). On Capitol Hill, a group of Senate Republicans, including Opportunity Zone champion Sen. Tim Scott (R-SC), introduced a bill in December that would reinstate and expand reporting requirements to determine the impact of the more than 8,700 Opportunity Zones across the country. Lawmakers have introduced other bills to require additional transparency on investments and the economic development impacts of the program.

Infrastructure. Though infrastructure is a problem that both sides of the aisle agree warrants bold policy solutions, it is unlikely that lawmakers and the administration will unite on a largescale infrastructure package in this election year. Ways and Means Committee Chairman Neal said earlier this year that one of his legislative priorities is a "big" infrastructure package, though it remains to be seen what such a package would entail. Notably, on January 29, the Ways and Means Committee held a hearing titled "Paving the Way for Funding and Financing Infrastructure Investments." The purpose of this hearing was to examine funding opportunities for an infrastructure package that is the subject of renewed discussion by both parties. By way of reminder, the Committee held a similar hearing on infrastructure funding last year, titled "Our Nation's Crumbling Infrastructure and the Need for Immediate Action." Generally, both parties agreed on the need for infrastructure investment, although members differed on the best way to raise revenue.

New Markets Tax Credit. The FY 2020 government funding bill also extended the New Markets Tax Credit (NMTC) program until December 31, 2020. The bill extends for one year (through 2025) the carryover period for unused New Markets Tax Credits.

Low Income Housing Tax Credit. The same funding bill impacted another important tax credit, though its scope was narrower than some had anticipated. The bill provided additional low income housing credit allocations relating to qualified 2017 and 2018 California disasters.

Empowerment Zones. Tax provisions included in the FY 2020 government funding bill provide tax benefits for certain businesses and employers operating in Empowerment Zones. There are 41 geographic areas specifically designated as Empowerment Zones. The tax benefits available include tax-exempt bond financing, a federal income tax credit for employers who hire qualifying employees, accelerated depreciation deductions on qualifying equipment under section 179 and deferral of capital gains tax on the sale of qualified assets sold and replaced.

Municipal Bonds. While municipal bonds are not likely to generate any major legislative changes this year, expect the increased interest in municipal bonds to continue in 2020. Driven in part by TCJA increasing tax burdens for some high-income households, investors in high-tax states flocked to municipal bonds as a way to generate tax-advantaged returns. With high-income investors constantly looking for ways to diversify their portfolios and reduce their taxable income, municipal bonds are likely to enjoy continued interest in the months ahead.

Global Tax Policy Developments

Moving beyond US tax policy, keep a close eye on international tax developments being negotiated in Paris, France this year. As the Organization for Economic Cooperation and Development (OECD) discusses changes to the international tax landscape, important changes affecting US businesses could emanate from across the pond. As we discussed in detail here, the past year was momentous for international tax professionals and policymakers, due in large part to the efforts of the OECD-led Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The OECD is working on a two-part plan to address tax challenges of the digitalizing economy. The first part, **Pillar One**, would address tax nexus and profit allocation issues by departing from established principles of physical presence and arm's length pricing. The second part, **Pillar Two**, would focus on the design of a global minimum tax regime that could be implemented by all of the Inclusive Framework's 137 member countries. Negotiations among the Inclusive Framework members on how to tax digital services companies, like Facebook and Google, will continue throughout 2020. With the consequences reverberating across the globe, it will be important to watch for any signs of agreement coming out of Paris.

Conclusion

Without a doubt, the election will cast a long shadow over policymaking this year. Though the impeachment trial in the Senate took up much of the bandwidth on Capitol Hill at the outset of 2020, opportunities for deal-making remain possible during the first half of the year. As noted above, May 22 is an important congressional deadline for moving legislation this year, serving as one of the few chances for tax provisions to ride along "must-pass" health extenders.

As temperatures get warmer, however, prospects for negotiating bipartisan agreements get colder. Instead, the House and Senate will serve as stages for lawmakers to advertise their own policy prowess in hopes of re-election, while also bolstering their party's nominee. Messaging bills may pass the House, for instance, but will surely find a familiar fate in the Senate's legislative graveyard. What's more, it is hard to imagine that the impeachment trial and hard-fought campaigns will *improve* relationships between Democrats and Republicans – both lawmakers and staff alike. Despite these obstacles in the way of meaningful legislative action, 2020 will be a pivotal year for shaping the tax policy conversation.

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