KPMG report: U.S. congressional elections and tax policy; preliminary observations

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Introduction

Election Day in the United States was yesterday, November 6, 2018.

All seats in the U.S. House of Representatives and just over a third of the seats in the U.S. Senate were in play. Based on election results thus far, the Democrats will control the House at the start of the next Congress, although the exact magnitude of their majority is still being determined. Meanwhile, Republicans will continue to control the Senate, having potentially increased their number of seats by an, as of yet, unresolved amount.

This report provides preliminary observations as to how yesterday's elections could affect federal tax legislation in the next Congress, and observations regarding what might be addressed during the short "lame duck" session before the current Congress adjourns.

The big picture

As is explained below, given the election results, the likelihood of substantial additional net tax cuts for upper income individuals and businesses becoming law in the near future appears low—but so too does the possibility of enactment in the next Congress of substantial changes to the massive tax legislation enacted in 2017 (such as increases in the individual and corporate rates). Nonetheless, there is still a decent chance that bipartisan consensus could be reached on some pieces of tax legislation with respect to matters such as expired provisions, retirement issues, technical corrections, and, possibly, infrastructure.

Learn more

Read ***TaxNewsFlash*** for a report of the results of significant state and local ballot initiatives relating to tax.

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Election results

U.S. House

The current House consists of 235 Republicans and 193 Democrats, with seven (7) open seats.

Based on the election results as of November 7 at 6 p.m., it appears that in the next Congress (the 116th Congress), the House will be comprised of at least 224 Democrats and at least 201 Republicans. Results of 10 races are not yet official.

The Democrats, therefore, will be in control of the House at the start of the next Congress and will control the Speaker's gavel, will chair the committees, and will generally set the agenda for the House.

U.S. Senate

The current (pre-election) Senate consists of 51 Republicans and 49 Democrats (counting as Democrats two Independents who caucus with the Democrats).

Based on the election results as of November 7 at 6 p.m., in the next Senate, there will be at least 51 Republicans and 46 Democrats. [Results of three races are still not official.]

Thus, the Republicans will continue to be in control of the Senate by what may be an increased margin.

Organizing the next Congress

The current Congress (the 115th Congress) will end when the House and Senate adjourn later this year. The 116th Congress is scheduled to convene on January 3, 2019. Any tax bills that were introduced in the 115th Congress, but that have not yet become law, expire at the end of the 115th Congress and would need to be reintroduced in the 116th Congress to move forward in the legislative process—bills do not “carry over” to the next Congress.

Leadership of House and Senate

Even though the new Congress does not begin until early next year, Republicans and Democrats are expected to hold orientations for incoming members in what remains of this year (i.e., during the "lame duck" session). In addition, Republicans and Democrats who will serve in the next House and Senate are expected to meet before the end of this year to elect their party leaders for the 116th Congress and to make committee assignments and designate committee chairs and ranking members.

Note, however, that the new House must vote to elect its Speaker; that vote will be taken when the new House convenes in January. Designating the Speaker typically requires a majority vote of the House. Thus, as a practical matter, substantially all of the House Democrats may need to vote in favor of their party leader for that person to become Speaker because the minority party—in this case the Republicans—typically are expected to vote for their leader. The leading candidate for Speaker is the current top-ranking Democrat in the House, Nancy Pelosi (D-CA).

In the Senate, it is expected that Sen. Mitch McConnell (R-KY) will remain majority leader and that Chuck Schumer (D-NY) will remain minority leader.

Leadership of tax-writing committees

Chairs, ranking members, and membership of the committees for the new Congress have yet to be determined. However, the current top-ranking Democrat on Ways and Means, Rep. Richard Neal (D-MA), is expected to be the next chairman of that committee.

Meanwhile, either Sen. Crapo (R-ID) or Sen. Grassley (R-IA) is expected to be the chairman of the Senate Finance Committee.

One other important development to watch is how the tax-writing committees will be constituted in the new Congress. For example, with Democrats taking control of the House, the ratios of majority and minority committee members will reverse from what they are currently. This means there would be a number of new Democratic members on the Ways and Means Committee along with fewer Republican members. These new Committee members are almost certain to bring new priorities to the Committee's agenda in 2019.

Possible legislative agenda for next Congress

Given that Democrats will control the House next year while Republicans will control the Senate, the House and the Senate can be expected to have different legislative priorities, including in the area of tax. Of course, for any legislation to become law, it must pass both the House and the Senate, and be signed into law (or not vetoed) by the president.

The following discussion first briefly summarizes the general legislative process and then highlights what the respective tax priorities of the House and Senate might be and what priorities might most likely become law.

General legislative process

As explained above, for a bill to become law, the House and Senate must pass identical legislation and the president must sign (or not veto) such legislation.

House

In the House, the majority party controls the legislative agenda, and it only takes a simple majority to pass legislation. Thus, it would not be surprising for the House to pass tax legislation reflecting its priorities with only Democratic votes. The critical question is whether the House would pass some legislation that could also be agreeable to the Senate and the White House.

Senate

Under current Senate rules, 60 votes are generally needed to avoid a filibuster of legislation. Thus, barring a change to long-standing Senate rules (a very controversial process known as the "nuclear option")[1] the support of at least some Democratic senators generally would be needed to achieve this 60-vote threshold—that is, some level of bipartisan support would be required for tax legislation to move through the Senate. With a possibly increased Republican majority, it remains to be seen whether securing 60 votes might be easier in the next Senate than has been the case in the current Senate.

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[1] Maintaining the 60 vote/filibuster standard has long enjoyed overwhelming bipartisan support in the Senate. Further, with a House and Senate each under different control, the nuclear option holds diminished utility.

There is an alternative to the general Senate rules—known as "budget reconciliation"—pursuant to which some types of legislation (including certain tax measures) can be moved forward in the Senate with only a simple majority vote. These are the procedures the 115th Congress used to pass last year's major tax legislation with only Republican votes. Nonetheless, the use of budget reconciliation to move tax legislation through the next Senate appears unlikely because using this process requires both the House and the Senate to agree on and pass a budget resolution. This resolution creates "reconciliation instructions" charging specified committees to report legislation in the form of a "reconciliation bill" that achieves certain revenue objectives. It would be surprising for the Democratic-controlled House and the Republican-controlled Senate to reach agreement on a budget resolution that would allow the Senate to move tax legislation with fewer than 60 votes.[2]

Thus, as a practical matter, any tax legislation that passes the Senate is likely to be bipartisan legislation that also has a chance of passing the House (perhaps with some modifications) and becoming law.

President

It is unclear how President Trump will work with the House Democrats. Nonetheless, it seems likely that President Trump would work closely with the Republican Senate in an effort to ensure that any tax legislation that might pass the Senate is amenable to the White House. Some of the big questions will be, however, what the president's tax priorities are; what trade-offs he might be willing to make (including, for example, what revenue raisers he might be willing to entertain in exchange for a middle-income tax cut); and how his priorities might align with those of Senate Republicans.

The possible non-tax agenda

It is impossible to predict the full agenda of the next Congress, but certain non-tax items (including both legislative and oversight matters) could take considerable effort and time. For example, the Democratic-controlled House might pursue a host of legislative issues, including some that might not be addressed by the Senate or on which agreement with the Senate is not likely.

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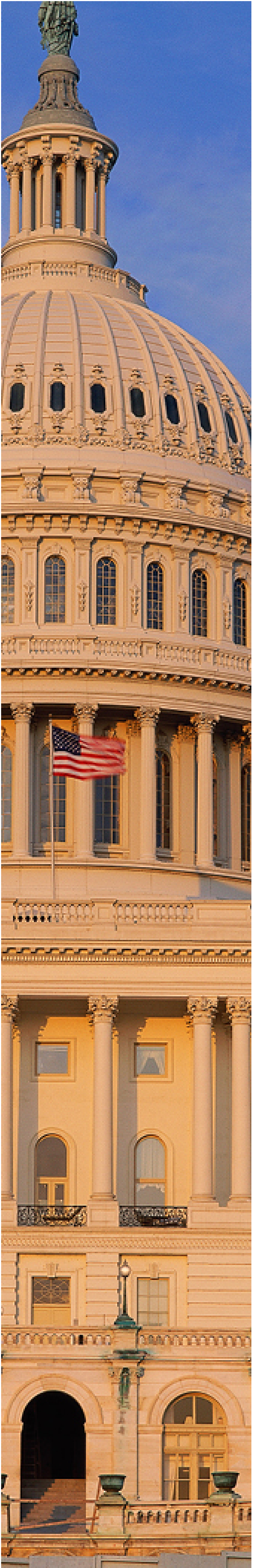
[2] Even if such a resolution could be passed, keep in mind that, at least under current budget reconciliation rules, various procedural limitations can constrain the substance of the legislation, making it difficult to address provisions that have no revenue effect (like technical corrections) or that increase the deficit outside the 10-year window (like making last year's temporary individual tax cuts permanent without offsets).



Based on a document the current Democratic leadership of the House released earlier this year, entitled ***A Better Deal***, nontax priorities may include such matters as:

- Lowering prescription drug prices
- Immigration reform
- Clean energy
- Public housing
- Addressing corporate monopolies
- Education

In addition, the potential replacement to NAFTA—the United States, Mexico, Canada Trade Agreement (USMCA)—will require congressional ratification. It is not yet clear if the USMCA will be approved, and if not, how the trade agenda would proceed.

Other matters that the next Congress might address could become potential "vehicles" for some tax provisions. For example:

- The current suspension of the debt limit expires after March 1, 2019. At some point—possibly in summer or fall of 2019—Congress will again need to suspend the debt limit so that the Treasury can continue to issue debt. In recent years, suspension of the debt limit has often been a controversial measure in Congress. Historically, Democrats have supported these debt limit suspensions, but it remains to be seen whether next year's debt limit vote will be a controversial one. Addressing the debt limit, in the past, has sometimes served as a vehicle for tax provisions.

- Depending upon what happens in the lame duck session, the next Congress may need to address the funding of some parts of the government early in 2019. Further, depending on what happens with the appropriations process next year, it may need to address government funding by the start of the next fiscal year (October 1, 2019). Government funding legislation, such as a continuing resolution, has in the past sometimes been a vehicle for tax legislation.

- At varying times, both Republicans and Democrats have expressed support for an enhanced commitment to infrastructure investment. President Trump has also voiced his support for new infrastructure policies. It remains possible that Congress could pursue an infrastructure bill next year. Whether Republicans and Democrats can agree on the direction of (or sources of funding for) such a bill remains to be seen. However, if infrastructure legislation moves forward, it could be a vehicle for infrastructure-related tax provisions (new incentives as well as revenue offsets).

- Existing House Democrats have expressed an interest in pursuing legislation to address failing pension plans. If legislation addressing pension plans were to move forward in some form, it could be a vehicle for retirement-related tax provisions.

Keep in mind, however, that some Democrats have vowed to use the oversight power vested in various committees of the House of Representatives to examine both the Executive Branch generally and, potentially, the president specifically. These actions could undercut the prospects for bipartisan cooperation in other areas.

Possible tax agenda

With Democrats in control of the House in the next Congress, there is likely to be a shift in the House's priorities for tax policy. Some of these priorities could conflict with efforts of the Republican-controlled Senate. For example:

- Although the House might advance legislation revisiting and possibly reversing some of the tax cuts in the new U.S. tax law known as the *Tax Cuts and Jobs Act* (TCJA) that benefit upper-income individuals and corporations, the Republican Senate might not agree with carving back those cuts.

- Conversely, if the Senate were able to secure 60 votes to move tax legislation that, for example, would make the TCJA tax cuts for upper income individuals and businesses permanent, the Democratic House would seem unlikely to be supportive.

- In addition, the House might enforce "pay as you go" rules that, in some situations, might require the revenue costs of tax legislation to be offset by "revenue raisers" within the "budget window." This could put the House and Senate on fundamentally different footings in structuring tax legislation and make agreement difficult given likely different views as to both the need for revenue raisers and the appropriateness of particular revenue raising proposals—even if Congress were considering something like a middle-income tax cut on which they might otherwise potentially be able to reach consensus.

Nonetheless, there are some tax issues on which bipartisan consensus may be more likely and that may have a better chance of making it through the entire legislative process and becoming law. For example:

- Presumptive Ways and Means Chairman Neal has long been an **advocate of better tax policy around retirement security**. Further, bipartisan retirement bills have been introduced in both the current House and Senate (**H.R. 5282** and **S. 2526**). Thus, the House and Senate might be willing to move retirement legislation and ultimately might be able to agree on its substance.

- There also has been bipartisan consensus around some proposals relating to IRS administration in the past Congress. It's possible these could move forward in the next session, if not addressed in the lame duck session.

- To the extent not addressed in the lame duck session, bipartisan agreement may be able to be achieved with respect to extending some of the tax provisions that expired in 2017.

- To the extent not addressed in the lame duck session, the House and Senate might be able to reach agreement on some technical corrections to the TCJA. However, House Democrats may want to hold hearings on various aspects of the TCJA, to get a better understanding of some its provisions before agreeing to corrections or other modifications.

- It may be possible to reach consensus on innovation-related legislation; however, reaching such consensus may be difficult if the House requires revenue offsets for new or enhanced innovation incentives.

- In the health tax context, there also has been bipartisan consensus in the past on delaying, or repealing, the medical device excise tax and the so-called "Cadillac tax." Thus, it's possible that bipartisan consensus could be reached on such matters. However, it's also possible that larger politics surrounding healthcare could make movement of such legislation difficult.

- It is possible that the House and Senate might both address state taxation of online sales in light of the U.S. Supreme Court's *Wayfair* decision. This issue, however, raises difficult issues that do not necessarily break on partisan lines.

Other

It is not clear whether the change in the composition of the House might affect the use of macroeconomic scoring by the Joint Committee on Taxation (JCT) in estimating the revenue effects of tax legislation. There's a good chance, though, that House Democrats would support the continued use of such methodology (and may even expand it to some nontax applications), particularly given the work that the JCT and outside groups have done refining various models.

Also not clear is whether the current Senate impasse in approving tax treaties will be broken. A number of tax treaties continue to await Senate approval but have been unable to overcome a "hold" placed on Senate action by Senator Rand Paul (R-KY).

The lame duck session

The 115th Congress has been in recess for the election, but is expected to return the week of November 13 for a lame duck session that is scheduled to run until at least mid-December.

As indicated above, the lame duck session is expected to engage in activities associated with organizing for the next Congress. However, as explained below, it also needs to address continued funding for some government agencies. Although it is possible that it may address some tax issues (such as some technical corrections to the 2017 tax law and provisions that expired at end of 2017), whether it will do so is not certain.

“Must do” items

Funding for certain government functions is on the top of the legislative agenda for the lame duck session. Although legislation already has been enacted that funds some government agencies (such as Defense, Labor, Education, Health and Human Services, and Veterans Affairs), funding for other agencies is scheduled to expire on December 7, 2018. Thus, unless further appropriations legislation or a “continuing resolution” is enacted by that date, there would be a partial “government shutdown” in early December. This shutdown could affect agencies and departments such as the Treasury and the IRS, Agriculture, the Food and Drug Administration, the Small Business Administration, the Securities & Exchange Commission, the Department of the Interior, Transportation, Housing and Urban Development, Homeland Security, and the State Department.

Resolving these funding issues could be contentious. Some members of Congress could insist that so-called “policy riders” be included in the funding bill. These policy riders could be on topics such as immigration or funding for a physical wall at the border, certain environmental policies, abortion restrictions, or foreign aid. If large enough groups of lawmakers can rally around a policy rider, they could have the leverage to force the issue into the law or otherwise prompt a partial shutdown. These negotiations will play out in the coming weeks and the resolution may only be clear then.

One possibility is that Congress could delay the funding issue for the balance of 2018 by passing a continuing resolution (CR) which would simply fund the relevant agencies at current levels until the new Congress can convene and address the matter in 2019. Either way, the funding bill could involve “horse trading” to compile the needed votes—and history shows that funding bills can provide an opportunity for tax items to get attached.

There are other items that could attract congressional attention during the lame duck session as well, including reauthorizing the “farm bill” (which expired in September), the National Flood Insurance Program (which is scheduled to expire November 30), and the Violence against Women Act (which is scheduled to expire December 7).

Prospects for tax legislation in lame duck?

Although far from certain at this time, it remains possible that Congress could decide to address a limited number of tax issues on which bipartisan consensus could be reached during the lame duck session. This could be done as stand-alone legislation or, as noted above, perhaps more plausibly as part of the funding bill. There are a handful of tax items that could see congressional action in the lame duck.

Extenders

Some members—particularly in the Senate—may push for at least certain energy incentives to be extended during the lame duck session.

Other members, however, might not view extenders as “must pass” legislation, given that incentives that expired at the end of 2017 could be extended early in 2019 retroactively to the beginning of 2018. It has become fairly common for Congress to extend incentives retroactively that already have expired.

In addition, some members, especially several House Republicans, have expressed the view that many extenders should be allowed to simply stay expired—permanently. So while there may be support for extenders in the lame duck, some may suggest that they are better dealt with in the new Congress. Some House Democrats, however, may prefer for extenders to be dealt with before the new Congress begins—particularly if they are considering instituting “Pay/Go” rules for the next session or want to start the new session with as clean of a slate as possible.

Technical corrections

Considering the speed with which the TCJA was drafted and enacted, it is no surprise that there are pieces of the legislation that require technical corrections. Some of these technicals could come up as part of the “horse trading” with respect to the overall government funding bill—and Democrats may seek concessions if they agree to including technicals. While Congress has not yet formally released technical corrections legislation, both House and Senate members have expressed support for some of these fixes. For example, there appears to be bipartisan and bicameral support for fixing the apparent error in defining the cost recovery period for “qualified improvement property.” Nonetheless, it is also possible that some House Democrats may prefer to deal with technical corrections in the next Congress, as part of their broader examination of the TCJA.

Retirement, tax administration, and other provisions with bipartisan support

It’s possible, although not necessarily likely, that both the House and the Senate may be willing to advance “miscellaneous” tax legislation that has bipartisan and bicameral support—particularly if it can be attached to another legislative vehicle, such as funding legislation. Some retirement bills and IRS administration bills may fall into this category. Still, action on these items may be more likely to occur in the next Congress rather than in the abbreviated lame duck session.

Blue book

One last area of potential activity in the lame duck relates to the possible release by the JCT of a "blue book" describing the TCJA. The JCT staff typically releases a general explanation of significant recently enacted legislation. Congressional staff has been working throughout the year on a blue book describing the TCJA and this work appears to be near conclusion. Release of the blue book could be helpful to taxpayers in better understanding the new law, as well as to Treasury as it continues to implement the TCJA.

Note that, although blue books can be relevant in interpreting a law, they do not constitute official legislative history. See, e.g., *United States v Woods,* 134 S.Ct. 557 (2013).

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