Coming Down the Home Stretch on Tax Reform

The House and Senate passed their own versions of a tax reform bill surprisingly fast. But now the hard work starts, as they need to turn those two bills into one. The trick is to produce a bill that can pass both chambers again, meaning a bill that appeases some powerful interest groups while still making the budget math work.

In some respects, this conference process may be easier than we think. Once lawmakers have come this far with such a big bill — when stakes are this high — it's hard to imagine them not doing everything they can to cross the finish line. Helping in the process is the fact that their bills aren't so vastly different in terms of philosophy and provisions that it makes reconciling differences impossible.

For instance, both bills would permanently lower the corporate income tax rate to 20 percent. They would get rid of the state and local tax deduction but retain a $10,000 exception for property taxes and make changes to the mortgage interest deduction. They both would improve investment taxes and allow 529 college savings accounts to apply to some primary and secondary education expenses.

Yet they aren't identical. Some differences are small, such as the date of implementation of the corporate income tax reduction; the House chose 2018, and the Senate bill says 2019. Also, the Senate bill would sunset many of its provisions, including the child tax credit expansion and the reductions in individual rates, and the House bill wouldn't. But most people agree that this is a budget gimmick to make the math work in the Senate and that most of the sunset provisions would be extended when the time comes.

Other differences are big. For instance, both chambers adopted very different treatment of pass-through income (for businesses such as partnerships, sole proprietorships, S corporations and limited liability companies), with the Senate bill making it so generous that it could lead to further problems down the road. Another major difference to overcome has to do with the monstrous alternative minimum tax. Created in 1969 to prevent wealthy taxpayers from using deductions and credits to avoid paying federal income taxes, the AMT has expanded over time to hit middle-income people it was never intended to tax. The House bill would repeal both the corporate and the individual AMT, but the Senate version wouldn't.

It's worth considering some worst- and best-case scenarios resulting from this conference process. Worst-case scenario, the final bill would water down the investment provisions and entirely preserve many tax preferences currently targeted in both bills. It would also preserve the House version's individual rates, including a 12 percent bubble rate for top income earners, which effectively would impose a marginal tax rate of 45.6 percent, as opposed to the current 39.6 percent.

It would expand the child tax credit value beyond the levels passed in the House ($1,600) and the Senate ($2,000). That change would remove a large number of taxpayers from the tax rolls, which would be problematic because Republicans also refuse to cut spending. This also would shift more burden to the top 10 percent (taxpayers making above $138,000), who already pay 70 percent of the total federal income tax. If members of Congress also were to expand the refundable part of the credit, it would dramatically increase government spending, too.

The cherry on a very unsavory tax cake would be if lawmakers adopted the House's tax base erosion provisions, which include an idiotic excise tax that resembles the dreaded border adjustment tax, which was killed in recent months.

To finish on a positive note, allow me to dream a little. My best-case scenario would maintain the permanent 20 percent corporate tax rate. It would also delay the adoption of anti-tax avoidance provisions until lawmakers get to assess the full impact that cutting the corporate tax rate has on avoidance behaviors by companies. Congress would adopt the Senate version of the individual tax rates or even cut the top marginal rate further.

It would get rid of the alternative minimum tax and the state and local tax deduction — including the $10,000 exemption — and it would go ahead with eliminating all the tax preferences to special interests targeted in the House bill. Finally, lawmakers would start working on shrinking the deficit by paying for tax reform with serious spending cuts. Throw in a repeal of the death tax and be done with it.

Now that's a tax reform bill I could cheer, but I don't plan on holding my breath!

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