Tax Outlook for 2016

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Laying the foundation for comprehensive tax reform

The chairmen of both tax-writing committees—Ways and Means Committee Chairman Kevin Brady (R-TX) and Senate Finance Committee Chairman Orrin Hatch (R-UT)—as well as House Speaker Paul Ryan (R-WI) (himself a former Ways and Means Committee chairman)—have indicated that 2016 will be critically important in laying the foundation for comprehensive tax reform. While there is a general consensus that tax reform legislation will not be enacted in 2016, much activity is expected in the two tax-writing committees to set the foundation for a significant legislative effort in 2017.

As part of the return to "regular order," both Speaker Ryan and Chairman Brady have indicated their intention to solicit the input of Republican members of the Ways and Means Committee and the House Republican Conference as part of a "bottom-up" process of agenda-setting on how tax reform should be advanced this year. This process will likely present members with difficult, but core, tax reform policy issues, including (1) revenue neutrality, (2) distributional neutrality, (3) budget scorekeeping conventions (an issue alleviated in part by the enactment of several expensive tax extenders on a permanent basis) and (4) the rate structure for noncorporate "pass-through" business entities.

In early 2016, likely sometime in February, Chairman Hatch is expected to release a proposal to reduce taxes on U.S. corporations by granting companies a deduction for dividends paid to shareholders, effectively negating corporate income taxes. However, the chairman's plan would not include lowering the corporate tax rate, according to sources. Such a proposal is unlikely to pass this year, but, as stated above, it could provide a policy basis for reform in 2017.

International tax reform

In particular, renewed attention to international tax reform is expected this year. In 2015, we witnessed an evolution in what appears to be an emerging consensus that the current U.S. international tax rules are out of date and should be revised. While legislative remedies and proposals vary in significant respects, a bipartisan consensus seems to have emerged that the current tax rules (especially the current corporate tax rate structure and worldwide system of international taxation) have contributed to a significant increase in corporate inversion activity. These concerns were highlighted in a bipartisan report of the Senate Finance Committee's International Tax Reform Working Group, co-authored by Sens. Charles Schumer (D-NY) and Rob Portman (R-OH) in 2015. That report was followed by important negotiations in 2015, between Sen. Schumer and then-Chairman Paul Ryan, in the context of the federal highway bill (subsequently enacted for a five-year period with no changes to the current international tax rules). Importantly, current Ways and Means Committee Chairman Kevin Brady has indicated his intention to re-engage with Sen. Schumer on international tax reform this year.

In addition, renewed focus is expected on the issue of a U.S. “patent box,” advanced as a discussion draft in 2015 by Reps. Charles Boustany (R-LA) and Richard Neal (D-MA), to provide tax incentives for U.S.-based research and the development of U.S.-based intellectual property. Thus, international tax reform appears to be of significant interest in both tax-writing committees, and renewed policy attention to this issue is expected this year.

The tax extenders

The 2015 PATH Act addressed the approximately 55 tax provisions (the so-called “tax extenders”) that had expired at the end of 2014. A significant number were made permanent, some extended for a five-year period and the vast majority extended for a two-year period (through 2016).

While many of the “political drivers” of past tax extender packages have been permanently resolved (such as the R&D credit, small business expensing and the deduction for state sales taxes), new political imperatives may have emerged—such as the two-year moratorium imposed by the 2015 PATH Act on several excise taxes enacted in the 2010 Affordable Care Act (ACA), including those imposed on medical devices and so-called “Cadillac” health plans.

If, in fact, the ACA taxes become new drivers for the tax extenders, it is important to note that, unlike the prior political drivers, the operative expiration dates of the remaining tax extenders and the moratoria on the ACA taxes are now out of legislative sync (although the excise tax on Cadillac health plans is an important consideration in current benefit negotiations and health plan pricing decisions).

It is also possible that a "technical corrections" bill may be developed to address certain issues related to the 2015 PATH Act, including the extension of certain renewable energy incentives.

The unpredictable need for revenue raisers: cherry-picking the Camp draft

At this time last year, few would have predicted that two features of the tax reform draft advanced in 2014 by former Ways and Means Committee Chairman Dave Camp would be successfully advanced and enacted in 2015. However, two important features of the Camp draft—those dealing with large partnership audits and REIT spinoffs—were, in fact, enacted (with modifications) in 2015, surprising many in the tax community. Enactment of these two provisions is an apparent sign that the Camp draft is viewed as a policy resource that may be cherry-picked again as new revenue offsets are needed.

Airport and Airway Trust Fund taxes

The excise taxes funding the Airport and Airway Trust Fund are due to expire on March 31, 2016. These taxes include federal excise taxes on aviation fuel, cargo and passenger tickets, and they fund improvements to the nation's airports and air traffic control system. Legislative action by Congress prior to April 1, 2016, is anticipated. It is unclear whether this bill might serve as a vehicle for any tax priorities that emerge in the early months of the session (e.g., technical corrections to the extenders/omnibus package passed in December, 2015).

2016 State of the Union

In his final State of the Union address to Congress, President Obama largely ignored tax-related issues. However, the president did extend an "olive branch" to Speaker Ryan, noting that he would welcome discussion on ways to ease the tax burden for low-income workers without children (Speaker Ryan has made addressing poverty one of his key priorities). A number of Republicans (including Speaker Ryan) and most Democrats are interested in lowering the eligibility age of the Earned Income Tax Credit from 25 to 21 and doubling the amount that those who are eligible would receive from $500 to $1,000. Speaker Ryan has proposed paying for the increased credit through fraud savings, while the president has indicated that he would pay for the $60 billion, 10-year proposal by changing the taxation of carried interest and eliminating a tax break that self-employed professionals use to avoid payroll taxes.

Treasury regulatory activity

1. Corporate inversions

In the absence of legislative action by Congress, the Treasury Department issued regulatory guidance in September 2014 and November 2015 addressing various tax rules associated with corporate inversions. Treasury has made clear that it does not have the regulatory authority to "stop" inversion activity, but, through its regulatory guidance, intends to discourage inversion activity. Importantly, in issuing its guidance, Treasury has indicated that additional guidance may be issued dealing with the issue of "earnings stripping," a central feature of many inversion transactions, and that any such guidance may be made retroactive to the issuance of its initial guidance in September 2014.

2. OECD BEPS project

Ongoing congressional interest in the recently released recommendations of the OECD Base Erosion and Profits Shifting (BEPS) project and its implementation "action plan" is anticipated, with a particular focus on Treasury's recently released country-by-country reporting regulations.

Tax proposals of various presidential candidates

Various presidential candidates are advancing substantive tax reform proposals as essential elements of their campaigns. While there is clearly no consensus as to substantive design or approach, several of these reform proposals focus on flat taxes and consumption-based taxes, which, if legislatively pursued, could have a significant and fundamental impact on a wide variety of current tax provisions, including the widespread use of itemized deductions by individuals and the tax treatment of interest and capital investments by U.S. businesses.

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