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Rush To Pass Tax Reform Likely To Leave Years of Fixes

By **Alex M. Parker**

Law360, Washington (December 1, 2017, 5:27 PM EST) -- The madcap pace of tax reform's dash toward passage has astonished even the savviest Hill watchers, but the entire process is likely to take much longer.

Lobbyists, accountants and lawyers have already found ambiguities and apparent contradictions in the language of the Senate's Tax Cuts and Jobs Act, but expect to find scores more with a bill that has been public for only a matter of weeks. The "technical corrections" phase, when those issues are resolved through later legislation, is expected to dwarf what followed the 1986 tax reform bill — which took years.

And it could set up the Trump administration for a series of showdowns and negotiations with Democrats.

“People are getting really anxious — ‘is this a technical correction or not a technical correction?’” said Danielle Rolfes, a partner at KPMG LLP's Washington national tax practice and a former U.S. Treasury official, speaking during a tax conference sponsored by George Washington University in Washington, D.C., on Thursday.

“I think we will see an onslaught of interim guidance, I hope, to help make sense of these rules,” she said. “But some of it is just statutory disconnects. I'm not sure what they can do.”

The lack of a final bill text has left interested parties scrambling to contact tax writers or biting their nails, waiting for the final product in the Senate or fixes in a conference committee between the House and Senate.

Treasury officials and legislators spent years resolving questions in the 1986 tax reform bill, mostly through annual legislation resolving largely noncontroversial topics. In legislative parlance, “technical corrections” normally means issues everyone agrees were oversights — although getting taxpayers and the tax administration to agree on a change to the code can be tricky.

“People can disagree about what Congress intended,” said Steve Rosenthal, a senior fellow at the Brookings Institution and a former legislative counsel to the Joint Committee on Taxation. “Sometimes people can like what Congress didn't intend.”

This is a normal interplay among Congress, the Department of Treasury and taxpayers. But the breadth of the tax reform bills in both chambers of Congress and the complexity of many of the provisions have left many predicting that much more consequential issues will build up than in previous tax overhauls.

“There were lots, and lots, and lots of issues under every title of the bill,” Mary Bennett of Baker & McKenzie's tax practice group, who served in the Treasury in the years after the 1986 reform, told Law360. “The one difference between then and now is in that case, the actual legislation that was enacted had been around for quite some time before it was finally voted on. And there had been hearings and lots of opportunity to examine the legislative language. We don't have that situation here.”

Much of the pending bill is effective as of Jan. 1.

David Lewis, vice president of global tax for Eli Lilly & Co. also speaking at the GWU conference, imagined a "two-track" process in 2018, as taxpayers approach the Department of Treasury for clarifications, while others approach Congress or the Joint Committee on Taxation to propose potential fixes.

That's where the lines between honest flukes, unintended effects and mysterious intentions could get blurred.

“The rest of us will be going to the Hill to say, ‘We'll need to fix this — we'll call it a technical issue, but it's really a substantive issue,’” Lewis said. “Or we'll have both.”

As the issues pile up, so do the political dynamics.

“I can't predict how the politics would go,” said Rosenthal, noting that congressional Republicans did not agree to corrections on the Affordable Care Act. “Even in the best of circumstances it takes quite a while to get technical corrections through.”

A true technical correction could receive a retroactive budget scoring from the JCT, negating the need to find an offset but also requiring a 60-vote Senate majority, because it would not be applicable to the 50-vote reconciliation process reserved for budgetary matters.

“That's going to raise a really interesting issue, because if you're at 60 votes, the only way you get them is there's got to be a good reason for the Democrats to come to the table,” Lewis said. “And that's either going to be that the Republicans have identified an issue that he Democrats would get on board with or the law of unintended consequences has kicked in at such a degree that you can muster 60 votes to fix something that we can't currently contemplate.”

Flukes that do create a significant revenue effect — either as a loophole or an unintentionally harsh measure for taxpayers — could bring further negotiations to find revenue offsets or demands about where to spend extra revenue.

“Whose ox am I going to gore to raise the money to fix what everyone agrees is an unintended problem?” said Patrick Brown, a tax director for General Electric, also speaking at the conference.

One of the diciest areas in the law could be the international provisions, which introduce complex formulas as backstops to the territorial system. The Senate bill's tax on global intangible low-taxed

income, or GILTI, and its base erosion and anti-abuse tax, as well as limitations on interest, include mixes of ratios and deductions that seem bound to produce unintended-consequences questions.

In one example, the GILTI provision appears to target all potential taxpayers with offshore income related to intangible assets, using a formula based on tangible income. But the law would also use a deduction to lower that income by half, as part of the design of a global minimum tax. But the deduction appears to apply only to corporations, potentially leaving pass-through entities or S-corporations double-charged.

“If so, it would have serious ramifications for the international competitiveness of S-corporations,” said Warren Payne of Mayer Brown LLP in Washington, D.C.

The bill's deemed repatriation of $2.6 trillion in deferred income and its participation exemption system, which would leave most future foreign earnings untaxed, also leave many practical and transactional questions.

And yet the provisions will likely determine the international allocation of billions of dollars. The situation is reminiscent of 1996, when the Clinton administration released entity allocation rules — the “check-the-box” rules — which many saw as enabling the tax havens used by large multinationals. The issue was quickly identified, but changes could not be made because it became politically untouchable.

Critics of the bill see the rushed process as a fatal flaw.

“In a sense we have three new international systems to figure out: the participation exemption system, the GILTI system and the anti-base erosion system,” Victor Fleischer, a University of San Diego law professor and former Democratic legislative counsel to the Senate Finance Committee, said in an email to Law360. “You can’t just say that Treasury will figure it all out later. Companies will have to start making big decisions right away, and no one fully knows how this works.”

Fleischer said the bill ventured into the mathematically impossible by including ratios, including denominators with values that could be zero.

“What are people supposed to do with that? File a tax return that says ‘undefined’ income?” he asked.

--Editing by Vincent Sherry.

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