Some progress on tax deal, government funding pact, but challenges remain

As Congress returned this week from its holiday recess, there were some signs of progress on separate negotiations for a deal on a modest tax-relief package and on funding of federal government operations for fiscal year 2024, although by week's end both efforts still faced challenges from some rank-and-file lawmakers.

Familiar proposals—and some new details—on tax relief

Following months of negotiations on a potential tax deal that would reverse certain taxpayer-unfriendly business provisions in the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) and make the child tax credit more generous, House Ways and Means Committee Chairman Jason Smith, R-Mo., and Senate Finance Committee Chairman Ron Wyden, D-Ore., on January 10 briefed their respective panels' majorities on the contours of their emerging agreement.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Although specific details of the potential deal have not been officially released, press reports indicate that Smith and Wyden are homing in on an approximately $70 billion accord that would retroactively renew expensing of some research expenditures and a more generous limitation on business interest deductibility (both of which lapsed after 2021), reinstate 100 percent expensing of certain capital investments (which phased down to 80 percent in 2023 and 60 percent in 2024), and make assorted enhancements to the child tax credit. All of these changes would apply through 2025, when a host of provisions under the Republican-drafted TCJA—including the vast majority of those on the individual side of the tax code—are scheduled to expire. (A complete list of those provisions—and all the other temporary tax provisions that will sunset between 2024 and 2034—was released by the Joint Committee on Taxation staff on January 11.)
URL: https://www.jct.gov/publications/2024/jcx-1-24/

These general contours came as little surprise to most tax observers, as they have been the primary levers in tax talks for many months now. But some additional policy details under discussion also emerged this week, including the possibility that, under the deal, retroactive research expensing would apply to domestic research costs but not to foreign expenditures. (Under the TCJA, beginning in 2022, research expenditures not otherwise applied toward the R&D tax credit cannot be deducted currently, but must be amortized over either five or 15 years, depending upon whether the research was conducted in the US or abroad.)

With respect to the child tax credit, reports this week suggested that the potential deal would boost the credit's value for families with multiple children, gradually increase the refundable portion of the credit, allow parents to use prior-year income to qualify for the credit, and index the maximum credit amount for inflation.

It is anticipated that the expanded child tax credit would apply to tax year 2023 and run through 2025. Chairman Wyden has repeatedly suggested that he would like to see any tax deal signed into law prior to the January 29 kick-off of the 2023 tax filing season so that, in theory, eligible taxpayers could claim the benefit on their upcoming tax returns. (See discussion below for why that timeline may be ambitious, even if a final deal is inked. See separate coverage in this issue for more on the IRS's announcement about the upcoming tax filing season.)

Wyden eyes ERTC as a (partial) offset: Also reportedly under discussion as a possible revenue offset for the package is an accelerated deadline for claiming the pandemic-era Employee Retention Tax Credit (ERTC), which critics say has been plagued with fraudulent claims since its enactment as part of the 2020 Coronavirus Aid, Relief, and Economic Security Act (CARES Act, P.L. 116-136). (The current deadline for claiming the ERTC is April 14, 2024 for tax year 2020, and April 15, 2025 for tax year 2021.)
URL: https://www.congress.gov/116/plaws/publ136/PLAW-116publ136.pdf

"There is a good argument for using some of those dollars from cleaning up the [ERTC] abuses," Chairman Wyden said January 9.

The next day, at Wyden's invitation, IRS Commissioner Danny Werfel met with Finance Committee members to discuss ways to tamp down on fraud in the program. Coming out of that meeting, Werfel told reporters that he suggested lawmakers take steps to prohibit promoters from charging contingency fees with respect to ERTC claims and to penalize preparers who file fraudulent claims.

For his part, Senate GOP taxwriter Thom Tillis of North Carolina, disputed the logic of counting ERTC changes as budgetary savings (though, to be clear, it is not yet known how much money the ERTC modifications under discussion would raise in the eyes of congressional budget scorekeepers).

"People up here should not be viewing that money that was allocated in the CARES Act as some pay-for for something else," Tillis said. "Most of the money that we associated with the CARES Act we knew was debt. We were in a crisis, so it feels fake to consider that 'found' money."

Progressives want more on the child credit: Though substantial, the emerging deal's proposed changes to the child tax credit would be relatively small compared to the enhancements Democrats made as part of the pandemic-era American Rescue Plan (P.L. 117-2), which applied only for tax year 2021. Under that law, the credit was increased from $2,000 per child to $3,600 per child up to age 5 and $3,000 for children up to age 17. For that year only, the credit was also made fully refundable (rather than partially refundable, depending in part on an individual's earnings, as under current law); moreover, many taxpayers could elect to receive the benefits as advanceable monthly payments rather than waiting to claim them when filing a tax return in the following year.
URL: https://www.congress.gov/117/plaws/publ2/PLAW-117publ2.pdf

As a result of that apparent disparity, reports suggest that progressive taxwriters in the House gave Ways and Means Committee ranking Democrat Richard Neal of Massachusetts an earful during a closed-door meeting on January 10, arguing that their party should not accede to what, in their view, amounts to a watered-down child tax credit expansion. (At roughly half of the current $70 billion package, or $35 billion, the Smith-Wyden child tax credit boost currently under discussion is indeed relatively small compared to Democrats' 2021 expansion, which ran north of $100 billion in that year alone.)

Ranking member Neal has not yet tipped his hand as to whether he backs the Smith-Wyden deal as it currently stands, though he did sound a sour note on the proposed child tax credit changes when talking to reporters this week.

"They're not talking about full refundability, and that's a big deal," Neal said January 10.

For her part, Rep. Rosa DeLauro, D-Conn., who is playing a large role in current spending talks as ranking Democrat on the House Appropriations Committee and has been a long-time advocate for an expanded child tax credit, also criticized the tax deal in no uncertain terms.

"It is time to get to work moving policy that will actually improve [lower-income Americans'] lives, not watered-down policy for the sake of making a deal," she said. "Because of the way this deal is currently structured, I am opposed and will vote 'no' should it ever come to the floor for consideration."

Other tax-relief items in the mix?: It has been rumored in recent weeks that some Democratic taxwriters—particularly in the Senate—have been eyeing the tax package as a way to move certain enhancements to the low-income housing tax credit, though it is very unclear whether the GOP would accept that demand. (Incentives to promote affordable housing appeared to enjoy bipartisan support during a Senate Finance Committee hearing last year. For prior coverage, see *Tax News & Views*, Vol. 24, No. 9, Mar. 10, 2023.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/230310_3.html

Reports this week also suggested that some lawmakers in the House may push to include disaster-relief provisions similar to those approved by the Ways and Means Committee last November. (For coverage of the Ways and Means mark-up, see *Tax News & Views*, Vol. 24, No. 37, Nov. 3, 2023.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231103_5.html

Deal not yet final: Wyden and Smith, meanwhile, have been clear that the deal is not yet final and that further changes are still possible.

"This isn't final and there are a few issues still under discussion, but we're hopeful about getting this done in time for the upcoming filing season," Wyden said January 10.

Or, as a staffer involved in the negotiations remarked: "We're not pencils down."

Johnson comes under fire for 'topline' spending agreement with Schumer

But importantly, it would be hard to overstate the extent to which any tax deal's fate is tied to other dynamics in Washington—especially those surrounding government funding for fiscal year 2024, which began last October 1.

House Speaker Mike Johnson, R-La., is coming in for heavy criticism from conservative Republicans for striking a deal with Senate Majority Leader Charles Schumer, D-N.Y., announced January 7, that largely adheres to the

fiscal 2024 appropriations levels agreed to by President Biden and then-Speaker Kevin McCarthy, R-Calif., as part of the Fiscal Responsibility Act of 2023 (FRA, P.L. 118-5) that Biden signed into law last June.
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

In fact, during a series of meetings on January 11, a number of House conservatives urged Johnson to renege on his deal with Schumer—an action that would greatly increase the risk of a government shutdown when one tranche of government funding expires on January 19 under the stopgap funding measure currently in place—and many of them came away thinking he would do just that.

But the speaker denied that he made any commitments in that regard.

"We're having thoughtful conversations about funding options and priorities," Johnson said. "We had a cross-section of members in today. We'll continue having cross-sections of members in and while those conversations are going on, I've made no commitment. So if you hear otherwise, it's just simply not true."

The FRA placed statutory caps on appropriations for fiscal years 2024 and 2025, with those caps set at about $886 billion for defense discretionary and $704 billion for nondefense discretionary spending. Importantly, however, Biden and McCarthy also agreed on the side (that is, not as part of the FRA itself) that nondefense accounts would be increased by tens of billions of dollars above the statutory cap through a series of adjustments, including by reallocating $10 billion in each of fiscal years 2024 and 2025 from the $80 billion mandatory funding stream provided to the Internal Revenue Service as part of the Democrat-drafted Inflation Reduction Act of 2022 (P.L. 117-169).
URL: https://www.congress.gov/117/plaws/publ169/PLAW-117publ169.pdf

That "side agreement" has always faced strident opposition from House conservatives, but the topline spending agreement between Johnson and Schumer enshrines it, pegging nondefense funding in fiscal 2024 at $773 billion, $69 billion above the $704 billion FRA cap.

Rep. Chip Roy, R-Texas, a member of the conservative House Freedom Caucus, called the Johnson-Schumer deal "terrible" and wrote in a social media post that it "gives away the leverage accomplished in the (already not great) [spending] caps deal" between Biden and McCarthy.

Rep. Tim Burchett, R-Tenn., declared he was "currently a 'no'" shortly after the topline deal was announced. "I'd like to see some real cuts . . . and maybe cut back on all the . . . spending that we've been doing. And until we do that, we are falling off a fiscal cliff," he said.

Johnson claims win on accelerated IRS cuts: With Democrats in charge of the Senate and the White House and the parameters for fiscal year 2024 appropriations largely set in the Fiscal Responsibility Act last summer, it could be argued that Speaker Johnson had very little leverage in his negotiations with Majority Leader Schumer.

For his part, however, Johnson is claiming that he did secure some additional spending cuts, most notably through the acceleration into fiscal 2024 of the $10 billion cut to the IRS's mandatory Inflation Reduction Act money otherwise scheduled to occur—under the Biden-McCarthy side deal— as part of the fiscal year 2025 spending process. Thus, if the current spending accord is enacted into law, the $80 billion tranche of mandatory spending provided to the IRS by the Inflation Reduction Act—funds which the agency has indicated it plans to use to bolster tax enforcement, taxpayer services, and business systems modernization—would be reduced to roughly $60 billion. Success on this front could also encourage Republicans to seek additional reductions as part of future spending talks.

Johnson and Schumer also agreed to rescind about $6 billion of unspent COVID-relief funding provided as part of previous legislation.

"This is not what we all want, it's not the best deal that we could get if we were in charge of both chambers and the White House," Johnson told reporters January 9. "But it's the best deal that we could broker under the circumstances."

Much work left to do: Of course, all of this—the IRS funding rescission, the COVID relief rescission, and, most importantly, the underlying appropriations measures themselves—still needs to drafted, passed through both chambers, and signed into law by the president in short order to avoid a shutdown of government operations.

Under the "laddered" continuing resolution (CR) currently keeping the government's doors open—a conceit of Speaker Johnson that was enacted late last year shortly before the scheduled expiration of a prior CR on November 17—government operations are continued at fiscal 2023 funding levels through January 19 for some departments and agencies and through February 2 for others. (For prior coverage, see *Tax News & Views*, Vol. 24, No. 39, Nov. 17, 2023.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/231117_1.html

That means Congress now has just one week to avoid a partial government shutdown, and three weeks to avert a full government shutdown.

Senate Appropriations Committee Chairman Patty Murray, D-Wash., alluded to the narrow timeframe during a January 9 press conference.

" [M]ake no mistake: negotiating final funding bills is no walk in the park," Murray said. "We are working nonstop right now to get this done, but we are obviously crunched for time."

Murray also ruled out Democratic acceptance of any so-called "poison pill" policy riders demanded by Republicans and included in many of the appropriations measures considered by the House during the current funding cycle.

Schumer tees up another CR: All of this has made it obvious to much of official Washington—including Senate leaders from both parties—that another continuing resolution will be required to prevent a government shutdown while work on more durable, full-year appropriations legislation continues.

In fact, Senate Majority Leader Schumer on January 11 teed up action on a “shell” bill designed to carry another CR through the upper chamber. A procedural vote on that legislation is expected on January 16. At this point, it remains unclear what the contours of a Senate CR will be, including its duration and whether it will maintain a “laddered” structure.

Across the aisle, Senate Minority Whip John Thune, R-S.D., told reporters this week that it was “unrealistic” to expect appropriations work to be finalized in advance of the upcoming January 19 and February 2 deadlines and that any new CR might have to run until March after considering the congressional calendar and scheduled recesses.

“We ought to allow some time to do some work on the other bills and, if there is a CR, maybe in the March timeframe,” Thune said.

Johnson boxed in: Speaker Johnson, for his part, stated that he was “done with” any additional short-term CRs after Congress approved his laddered measure last November.

But he may have to change course if a government shutdown is to be averted.

Johnson is also down to an extremely narrow, two-seat GOP majority in the House—meaning that, for all practical purposes, he likely will again have to rely on substantial Democratic support to pass funding legislation given the near certainty of multiple Republican defections on his right flank.

Furthermore, with three members of the House Freedom Caucus effectively holding veto power on the powerful House Rules Committee—the panel that sets the terms for debating bills on the House floor—it is increasingly likely that Johnson may have to bring any CR or appropriations bills (or other nonfunding legislation, for that matter) straight to the floor under an expedited process known as “suspension of the rules” that provides for limited debate, no amendments, and a two-thirds vote for passage (rather than the usual simple majority that is needed to pass legislation under a “rule”).

This process is normally reserved for noncontroversial bills, but may become more commonly employed by House Republican leaders given the fractures in their caucus—a reality that could further anger conservatives.

Crapo wary of approps package as a tax vehicle: As it relates back to tax policy, Sen. Mike Crapo, R-Idaho, the ranking Republican on the Finance Committee, sees the continuing cloudy outlook on appropriations as the primary reason he has not yet lent his support to the emerging Smith-Wyden tax framework.

“There is concern about both the vehicle, which impacts the politics of putting the [tax] deal together, and some concerns about substance,” Crapo said. “The absence or presence of a vehicle impacts the ability to put together the substance of a deal.”

And, of course, any extension of the fiscal 2024 appropriations process by way of a CR would negatively impact Congress's ability to get a tax package to President Biden's desk in advance of the January 29 start of the tax filing season as desired by Sen. Wyden.

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