Trump, GOP leaders on Capitol Hill still searching for a path forward on budget reconciliation

President Trump and Republican congressional leaders this week continued trying to firm up their strategy for using the fast-track budget reconciliation process to extend expiring provisions in the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) and make changes to energy, border, and defense policies, but key decisions – including whether that ambitious agenda is best accomplished through one large reconciliation bill or two separate packages – remain unresolved; meanwhile; the nonpartisan Congressional Budget Office (CBO) released an updated assessment of the tax, spending, and economic outlook over the next decade which is certain to play heavily into the fiscal policy debate this year.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Trump gets down to business

Wasting little time after his January 20 inauguration, President Trump called House Speaker Mike Johnson (R-La.) and Senate Majority Leader John Thune (R-S.D.) to the Oval Office the very next day for a meeting to discuss budget reconciliation strategy, as well as a crush of other time-sensitive priorities coming down the pike, including funding the government beyond March 14 when the current continuing resolution keeping the governments door's open is set to expire, lifting the statutory debt ceiling, and providing disaster aid in response to California wildfires.

Reports indicate the meeting focused just as much on these latter issues – all of which will require Democratic support – as it did on Republicans' plans to move GOP-only budget reconciliation legislation. (Technically, the debt limit can be raised in a budget reconciliation measure, but there is growing doubt as to whether Republicans, as a political matter, would be able to tackle that issue on their own given their thin majorities in the House and Senate.)

"We've got several deadlines ahead of us," Thune said after the gathering. "March 14 for some sort of funding resolution. We've got the debt limit that we have to deal with at some point and obviously reconciliation. We hope to accomplish all the things. We need to. . . extend tax relief … along with some other things on energy and the border and national security. So there's a lot to do. And part of this is figuring out how to stage it and what's the best way to get all those results."

For his part, House Majority Leader Steve Scalise (R-La.) who was present for a separate meeting between Trump and the broader GOP House and Senate leadership teams, remarked that the debt limit could be dealt with as part of bipartisan appropriation legislation to keep the government funded for the remainder of fiscal year 2025 which ends on September 30, a belief that may reflect growing Democratic aversion to tying the policy to a disaster relief measure.

"We haven't made a final decision on the debt ceiling," Scalise said. "…[T]here's possibly an avenue where we would have the debt ceiling in the government funding bill."

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Later in the week, Trump met with several other congressional Republicans at the White House, including Rep. Mike Lawler (R-N.Y.) an outspoken advocate of lifting the $10,000 annual limit on the deductibility of state and local income and property taxes put in place by the TCJA and whose support – along with other members of the so-called SALT caucus – will be critical to the success of the GOP's reconciliation efforts this year.

Reports suggest President Trump has already met with about 90 House Republicans and is endeavoring to hold small group meetings with every GOP member over the coming weeks.

One reconciliation bill or two?

This week's GOP gatherings apparently did little to resolve the now long-standing debate over whether congressional Republicans should deal with budget reconciliation in one fell swoop or instead break the effort into two phases. (For prior coverage, see *Tax News & Views*, Vol. 25, No. 34, Dec. 20, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/241220_1.html

"That is predicated on what we can get done," Senate Majority Leader Thune remarked after GOP leaders' confab with President Trump.

Thune has argued for two reconciliation bills, with tax-related changes trailing behind an initial package that would be focused on energy, defense, and border security. He and other top Senate Republicans such as Majority Whip John Barrasso of Wyoming and Senate Budget Committee Chairman Lindsey Graham of South Carolina contend that moving a nontax reconciliation bill first would allow the GOP to notch a quick policy win that would help pave the way for action on a large, complex tax package later in the year.

Speaker Johnson and House Ways and Means Committee Chair Jason Smith (R-Mo.), meanwhile, have countered that Republicans should advance one large reconciliation measure – addressing tax and nontax priorities – relatively early in 2025. Specifically, Smith has argued that the effort involved in securing an agreement on a nontax package, particularly given the extremely narrow GOP majority in the House that will require near-absolute unity on party-line legislation, could sap the momentum for a separate follow-up tax bill. (House Republicans currently hold just 218 seats in the chamber, compared to 215 for Democrats, with 2 seats vacant, leaving the GOP with the narrowest of margins on any party-line legislation that comes to the floor at least, that is, until special elections are held in the coming months to fill those vacancies.)

Another potential approach that has been discussed recently would have the House and Senate proceed on their own, separate tracks with optionality for the House to switch to a two-bill approach if needed.

"If [Trump] ever decides that because of resource constraints or time constraints that he needs a security reconciliation package that's more targeted to border and defense, then we will be able to easily peel that off and drive that on a second track," House Budget Committee Chairman Jodey Arrington (R-Texas) told reporters earlier this month.

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But first, a budget resolution

It is important to remember, however, that – regardless of whether the GOP ultimately pursues a one- or two-bill strategy – in order to even put the filibuster-proof budget reconciliation process in motion, House and Senate Republicans first must work together to adopt a joint budget resolution that includes reconciliation instructions directing congressional authorizing committees to report legislation that conforms to certain agreed-upon fiscal parameters. In short, Republicans will have to agree up front on the size of the net fiscal impacts of their proposed legislation before they can fill in the details; but if they can reach internal agreement on that, they will have the ability to pass legislation without having to secure any votes from the other side of the aisle.

Republicans still have not settled on a top line reconciliation instruction for tax – a tall order given the magnitude of the numbers involved and the current US fiscal outlook. For example, the Congressional Budget Office estimated in May of last year that the 10-year cost of permanently extending all of the lapsing provisions of the TCJA would come in at about $4.6 trillion (including additional debt service costs) and that number, when updated this year, will very likely grow even larger now that the 10-year budget window has shifted forward to include yet another year in which the TCJA is assumed to be expired under current law. And, as discussed below, the fact that individual tax receipts have been marked up by the CBO due to changes in its economic forecast could be another factor that swells the estimated cost of any TCJA extension relative to current law.
URL: https://www.cbo.gov/publication/60114

For his part, House Budget Committee Chairman Arrington – who last week saw the release of an extensive staff produced document of sometimes-controversial tax and spending options that could be considered as part of budget reconciliation – gathered together several chairs of other committees on January 22 to discuss ways that the GOP might offset the cost of any forthcoming bills. (For prior coverage, see *Tax News & Views*, Vol. 26, No. 2, Jan. 17, 2025.)
URL: https://punchbowl.news/reconciliation_wm/
URL: https://dhub.deloitte.com/Newsletters/Tax/2025/TNV/250117_1.html

At least one lawmaker who attended that meeting, however, anonymously suggested that not much progress was made.

"They were throwing out a lot of big numbers," the GOP lawmaker said. "A lot of it's not going to happen."

CBO releases new budget and economic outlook

In related news, CBO's Budget and Economic Outlook: 2025 to 2035, released January 17, anticipates that the budget deficit for current fiscal year 2025 – which runs through September 30 – will clock-in at about $1.87 trillion, or 6.2 percent of gross domestic product (GDP). That shortfall represents a roughly $100 billion decrease relative to the comparable projections released by CBO last June – the net effect of a roughly $125 billion uptick in projected revenues combined with a smaller increase in projected outlays. (For coverage of CBO's prior budget estimates, see *Tax News & Views*, Vol. 25, No. 22, June 21, 2024.)

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URL: https://www.cbo.gov/publication/60870
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240621_1.html

This trend continues over the ten-year budget window, with cumulative deficits now projected to amount to about $21.1 trillion, or about $1 trillion less than the agency projected over the same timeframe last year. Notably, the bulk of that reduction in projected deficits is attributable to higher forecasted receipts – to the tune of about $2.2 trillion – on the individual side of the tax code due to changes within the agency's economic forecast, offset in part by higher anticipated outlays, particularly those related to Social Security and Medicaid.

"The main factor contributing to a smaller projected cumulative deficit … is an increase in projected individual income tax receipts, driven by greater projections of taxable income in CBO's economic forecast," the report stated.

Of course, it is important to keep in mind that projected deficits – both in nominal terms and as a share of GDP – are still very high on a historical basis. For example, the average budget deficit registered over the past five decades is about 3.8 percent of GDP, well below the 6.2 percent level expected for this year.

Digging into the details

CBO sees federal revenues remaining at 17.1 percent of GDP in the current fiscal year (fiscal 2025), the same level they registered last year.

Over the course of the next 10 years, CBO projects revenues will rise markedly in 2026, to 17.8 percent of GDP, as major components of the TCJA are scheduled to expire (more on that below). After that time, the agency expects receipts will hover within a relatively narrow band and average 18.1 percent of GDP over the full budget window, a bit north of the 17.3 percent of GDP average over the past five decades.

Meanwhile, on the spending side of the ledger, outlays – which have fallen sharply from their pandemic-era highs – are expected to resume their steady climb due to pre-existing demographic trends that are projected to increase the ranks of Social Security and Medicare beneficiaries and thus push up spending within those programs. Healthcare cost growth is also expected to continue to outstrip economic growth, thus pushing up that budgetary component as a share of GDP. By 2035, federal outlays would equate to 24 percent of the economy well above the 50 year average of 21.1.

Inflation, interest rates, GDP: On the economic front, CBO's latest forecast suggests that inflation will continue to moderate, falling from 3.2 (actual) in 2023 to 2.3 percent – as measured by growth in the Consumer Price Index – in 2025, a level it would more or less maintain for the rest of the decade.

Annual economic growth (adjusted for inflation) is projected to fall slightly this year to 1.9 percent (from 2.3 percent as estimated for 2024) on account of, among other things, a slight uptick in unemployment, and then remain at about that level (or a bit less) over the rest of the decade.

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Debt service costs: In line with most market observers, the CBO projects that the Fed will continue to moderate its short-term, inter-bank lending rate in the coming years. However, the CBO also believes that longer-term rates will remain elevated, at least in comparison to their pandemic-era lows. For example, according to CBO, the average rate on 10-year Treasury bonds will remain around 4 percent (its actual average in 2023) over the course of the next decade.

As a result, interest payments on the national debt are projected to average 3.7 percent of GDP over the next decade, in line with last year's report but up from 3.1 percent of GDP in the year before. In nominal terms, the agency expects the government will incur almost $1.8 trillion in debt service costs in 2035 alone – almost 17 percent of total spending that year.

Publicly held debt: In its January 2020 long-term outlook (published before the coronavirus pandemic), CBO had projected that debt held by the public—that is, federal debt not held in intragovernmental accounts such as Social Security and Medicare Trust funds—would not reach 100 percent of GDP until the early 2030s.

This week's analysis, however, shows that dubious milestone will be reached this year, and that publicly held debt will climb to almost 120 percent of the economy by the end of the 10-year budget window. (Actually, debt briefly crossed 100 percent of the economy by the end of fiscal year 2020, but then fell again as pandemic-related pressures began to wane.)

'Current law' caveat

It is important to note that, by law, CBO is generally required to make its projections on the basis of "current law," or laws as they are currently in effect. (One exception is excise taxes dedicated to trust funds—for example, highway- and aviation-related taxes—which are assumed to be continued beyond any scheduled expiration).

That means this week's analysis does not account for the budget impact of any potential future supplemental spending packages (such as for disaster relief), or any potential action by lawmakers to relax the statutory appropriations cap for fiscal year 2025 with respecting to upcoming appropriations bills for that fiscal year. (A number of Democrats and Republicans have expressed a desire to lift the caps on domestic and defense accounts, respectively.)

Also inherent in CBO's projections is an assumption that the temporary tax provisions scheduled to expire over the budget window—including nearly all of the individual tax changes, estate tax changes, and the passthrough deduction under section 199A that were enacted in the TCJA and are set to lapse after 2025—will not be renewed, and revenues will be higher as a result. For example, this week's report shows tax revenues jumping more than $400 billion, or almost 1.5 percent of GDP, between 2025 and 2026 alone.

That assumption similarly applies to certain other TCJA provisions—including those affecting bonus depreciation, the business interest deduction limitation under section 163(j), the timing of research expenditure deductions, and the minimum tax on US multinationals known as the global intangible low-taxed

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income regime—that, if left untouched by lawmakers, will have (or are already having) the effect of raising revenue under current law.

This large mismatch between "current law" and "current policy" – and the bleak fiscal outlook in general – is certain to play a major role in determining the contours of any TCJA-related tax package next year.

For his part, Senate Finance Committee Chairman Mike Crapo (R-Idaho) has argued in favor of utilizing a current policy baseline to measure the budget impact of any tax reconciliation bill moved by Republicans this year (meaning that the scorekeepers would be directed to change their assumptions and ascribe a score of zero to proposals that merely extend existing tax parameters) – but it remains unclear whether that approach would garner widespread Republican support and also whether it would pass muster under the arcane rules of budget reconciliation.

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