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FEDERAL TAX REFORM AND HEALTH CARE STILL ON THE AGENDA

The President's trip to the Middle East and Europe has dominated the headlines in recent weeks, but the biggest news to hit Washington in May was the release of official estimates of the House-passed health care bill that would repeal major elements of Obamacare. The key conclusions made by the official nonpartisan congressional scorekeeper were that the House bill would: (1) decrease the federal budget deficit by $119 billion over ten years; (2) cause 14 million people to lose health insurance coverage in 2018, rising to 23 million in 2026; and (3) result in higher insurance premiums, especially for older Americans not yet eligible for Medicare. The health care saga has now moved to the Senate where Republican leaders will try to bring at least 50 of the 52 disparate Senate Republicans together on a revised bill that addresses at least some of the concerns raised by the coverage and premium estimates of the House bill.

At the same time, the enactment of tax reform remains among the highest priorities of the President and the Republicans in Congress. As a result, the debate continues to heat up, especially in the House where the first hearings on the topic were held in May. Still, before significant progress on that legislation is possible, the White House and congressional Republican leaders will need to resolve some very significant differences in their objectives and proposals. Even then, as evidenced by the difficulties that have arisen on passage of the health care legislation, it will be a tall order to hold enough of the House and Senate Republicans together on an already controversial tax reform bill.

In the meantime, other pressing issues could well distract the Congress from its work on tax reform. For procedural and political reasons, a tax reform bill is not likely to make significant progress until the health reform bill is resolved. Congress will also have to deal with the need to increase the debt limit as early as August, much earlier than expected because tax receipts are down (ostensibly because taxpayers deferred income from 2016 into 2017 in hopes that Congress would lower tax rates).

Also, before October 1st, an agreement on federal spending levels and priorities will have to be reached. The President's budget, released last month, is not likely to help in resolving spending disputes since it calls for massive domestic spending cuts that many congressional Republicans have decried as unrealistic, and it also relies on improbable economic growth assumptions (and $2.1 trillion of questionable double counting). Overall, Republicans are still far apart on spending issues and Democrats have not yet been brought into the negotiations even though their votes will be needed in the Senate. As a result, spending issues could dominate the congressional calendar through at least October, and potentially beyond.

Other items on the "must do" congressional agenda include the need to extend the national flood insurance program and extend certain children's health benefits. And, as expected, issues requiring 60 votes in the Senate that do not have a hard deadline are making even slower progress. That includes housing finance reform, which was the subject of a Senate Banking, Housing, and Urban Affairs Committee hearing on May 11th. Committee Chairman Senator Mike Crapo (R-ID) says he hopes to continue to build bipartisan support for a bill resolving the future of Fannie Mae and Freddie Mac, but for now he is waiting for input from the White House, which has ordered a series of reviews of financial regulations that are due in June and October.

HEALTH

Health Care Reform: Senate is Between a Rock and a Hard Place

On May 24, 2017, the Congressional Budget Office (CBO) released its official estimates of the American Health Care Act (AHCA), the Obamacare "repeal and replace" budget reconciliation bill that narrowly passed the House in early

May. Major changes in the House bill include:

- Repealing of almost all Obamacare tax increases (generally effective for 2017, although the so-called Cadillac tax on high-cost health plans would only be delayed from 2020 to 2025, and the 0.9% Hospital Insurance payroll tax for high-income taxpayers would be repealed in 2023);
- Reducing the threshold for the itemized deduction of medical expenses of all taxpayers to 5.8%, down from the 10% level adopted in Obamacare;
- Nearly doubling the maximum HSA contribution (effective in 2018);
- Replacing Obamacare's income-based tax credits with less generous credits that increase with age (generally regardless of income);
- Winding down Obamacare's Medicaid expansion; and
- Allowing states to define minimum essential health coverage, under certain conditions.

The Senate could not proceed directly to the House bill until official CBO estimates showed at least $2 billion of deficit reduction over 10 years (as required under the budget resolution that authorized the reconciliation bill). In that respect, the CBO estimates were good news for congressional Republicans. The House version of the AHCA was estimated to reduce the federal deficit by $119 billion over the next ten years (consisting of $1.1 trillion of reduced spending, offset by $992 billion of tax reductions).

That deficit reduction score will allow Senate Majority Leader Mitch McConnell (R-KY) to bring the House-passed bill directly to the Senate floor, avoiding potentially time-consuming and contentious Senate Committee markups. The bill would then be subject to a maximum of 20 hours of debate on the Senate floor, with the Republican Leader likely to immediately offer a complete substitute with provisions that he hopes to work out in advance within his conference.

To start the Senate process, the Majority Leader appointed a 13-member Republican working group. All of the group's meetings are behind closed doors and no public hearings are expected. The Majority Leader appears to be using the working group as something akin to a focus group, after which he and key committee chairmen will try to put together an initial draft bill.

Still, without any prospects for Democratic support, Senator McConnell faces the seemingly herculean task of winning the support of at least 50 of the 52 disparate Senate Republicans (with Vice President Pence breaking the tie, if necessary). To pass a bill, the Senate will need to balance two directly opposite objectives. First, the budget rules that apply to the Senate version of the reconciliation bill require that the bill achieve the same deficit reduction as the House bill (i.e., about $120+ billion over 10 years). However, the Senate also has to deal with the troublesome implications of CBO's estimates of the impact of the bill on health insurance coverage and cost.

CBO's budgetary savings attributed to the House bill are, to a significant extent, the result of (1) reduced Medicaid coverage ($834 billion cut over 10 years) and (2) the changes to premium tax credits ($290 billion net over 10 years). Those savings offset the cost of the tax cuts and other changes in the bill. As a result, a significant portion of the positive overall budget impact under the House bill is related to fewer people having health insurance (some voluntarily, others because they cannot afford it). CBO estimates that the House-passed AHCA would mean that 14 million more people would be uninsured in 2018, a number that would increase to 23 million in 2026. Moreover, CBO estimates that premiums for those purchasing insurance will increase more quickly, especially for older Americans (those between ages 50 and 64) with lower income.

TAXES

Tax Reform Hits First of Many Expected Speed Bumps, But Efforts Continue

Despite a strong declaration by the Trump Administration and congressional Republican leaders that Congress will pass a tax reform bill in 2017, there still is no consensus on a tax package that could pass both the House and Senate and be signed into law by the President. Major roadblocks continue to be the issue of revenue neutrality and the increasing opposition to major revenue-raising components of the House Republican tax reform blueprint.

Speaker of the House Paul Ryan (R-WI), House Ways and Means Committee Chairman Kevin Brady (R-TX), and Senate Majority Leader Mitch McConnell (R-KY) have said the tax reform package must not increase the deficit while a number of the President's advisers have questioned a need for revenue neutrality. Treasury Secretary Steven Mnuchin has sidestepped the question, saying only that the Administration's tax reform plan will in part pay for itself by unleashing economic growth. Senate Finance Committee Chairman Orrin Hatch (R-UT) has stated that he is "not so sure that it's absolutely crucial that it be revenue neutral."

The Administration and congressional leaders are also not yet on the same page over main components of the House Republican tax reform blueprint that would help offset the revenue cost of reducing tax rates. These include three major issues that are currently generating controversy: the border adjustable tax (BAT); repeal of the business interest expense deduction; and elimination of the individual itemized deduction for state and local taxes. Each of these provisions is under assault by stakeholder groups and key Senate Republicans. For example, Senate Majority Leader McConnell has repeatedly said he does not think the BAT could pass the Senate, and Finance Committee Chairman Hatch told reporters it would be difficult to end interest deductibility because "people are used to it and almost everybody is borrowing."

Mnuchin has repeatedly expressed concern about the proposal, but when asked about the BAT at a recent Ways and Means Committee hearing, he noted that the Administration is working. So far, Democrats in both chambers have coalesced around a simple tax reform message. Democrats have called for a tax reform package that is permanent; is revenue neutral; benefits the middle class and not the wealthy; and is developed in a bipartisan manner that does not take advantage of the 50-vote budget reconciliation process. Those conditions are not ones Republicans are willing to accept, and Democrats have not been included in the process to date.

Despite the slow progress to reach consensus, extensive work on tax reform continues, albeit largely behind closed doors at the Treasury Department and the congressional tax-writing committees. On May 18th, the Ways and Means Committee kicked off a series of tax reform hearings with testimony from business executives who supported permanent corporate tax reform that would promote economic, job, and wage growth. A second hearing, focused on American competitiveness and specifically the BAT proposal, was held on May 23rd, and Secretary Mnuchin testified on the President's FY2018 budget on May 24th. Additional hearings on selected tax code topics, such as energy, are expected to be scheduled in the summer months.

The attention of the Finance Committee has been somewhat diverted from tax reform, with Committee Chairman Hatch and some of his Republican Committee colleagues serving on the task force created by Majority Leader McConnell to draft an Obamacare replacement bill. To date, the Senate Finance Committee has not scheduled any hearings on specific tax reform issues, although members did receive testimony on May 25th from Secretary Mnuchin regarding the President's FY2018 budget proposal and tax reform proposals.

Anxious to avoid some of the problems that arose in the health care reform debate, the Administration has been meeting weekly with top congressional Republicans on tax reform and has ramped up its "listening sessions" with Republican members of Congress (including members of the centrist Tuesday Group and the conservative House Freedom Caucus); both Republican and Democratic members of the tax-writing committees; and stakeholders from all industries. Secretary Mnuchin continues to promise more specific details on the Administration's tax plan to supplement the one-page fact sheet released in late April, most recently promising to provide Congress with "a very detailed, drafted tax plan" when they get back from the August recess in September.

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