FEDERAL POLICY UPDATE

AMERICAN SENIORS HOUSING ASSOCIATION

Living Longer Better

October 11, 2017

TAX REFORM IN, HEALTHCARE REFORM OUT... FOR NOW

On September 27th, tax reform finally moved to the top of the legislative agenda when, after months of closed-door meetings, Republican congressional leaders and Administration officials released a "unified framework" that proposes significant reductions in business and individual income tax rates. As discussed further below, the framework states that it is intended to serve as a template for the tax-writing committees to develop legislation "through a transparent and inclusive committee process." However, before any committee actions are taken, the next critical step in the tax reform process is passage of a FY 2018 budget. The budget is needed to authorize the future passage of a budget reconciliation bill that the Republican leaders intend to use to move comprehensive tax reform through the Senate with a simple majority.

Congressional Republicans have been working hard to advance their budget resolutions. House efforts to pass legislation had stalled this summer after a block of conservative members declined to support it without more details about the tax plan. However, the release of the unified framework sufficiently soothed their concerns, and the House passed its budget resolution on October 5th by a vote of a 219-206. The Senate Budget Committee approved its version that same day on a 12-11 vote, and the full Senate is expected to vote on the budget resolution around mid-October. Neither version received any Democratic votes. Although Republicans are upbeat about their progress, there are obstacles ahead. Most notably, it will still be necessary to resolve the major differences between the House- and Senate-passed approaches, including the tax reform instructions, before a final budget is set. For example, the Senate budget would allow tax writers to add as much as $1.5 trillion to the deficit over 10 years, while the House version would not allow a tax plan to add to the deficit and would also propose major cuts in entitlement spending programs.

Congress also is working on bills to fund the federal government for FY 2018. The stopgap funding package that was passed in September will expire December 8th. The House has already passed a $1.2 trillion omnibus spending package that would provide $510 billion for non-defense discretionary spending and $621 billion for defense spending. That package would provide $35.2 billion of funding for the National Institutes of Health (NIH), an increase of $1.1 billion over FY 2017. Included in the package is a $1.8 billion for Alzheimer's disease research and $336 million for the Brain Research through Advancing Innovative Neurotechnologies (BRAIN) initiative. The Senate has not yet passed any appropriations bills, but the Senate Appropriations Committee has approved the FY 2018 Labor, Health and Human Services funding bill that would provide $36.1 billion for the NIH, including $1.8 billion for Alzheimer's disease research and $400 million for the BRAIN initiative. Although the appropriations debates have been extremely partisan, the NIH and BRAIN initiative provisions received strong support from Senators and Representatives on both sides of the aisle.

Hurricane relief also is on Congress's immediate agenda. Congress has already passed two bills (one spending and one tax) for the ongoing recovery efforts in Puerto Rico, Florida, and Texas. The House is now expected to take up a second hurricane relief spending bill during the week of October 9th that will be based on the President's request for an additional $29 billion in emergency funding ($12.8 billion for the Federal Emergency Management Agency (FEMA) and $16 billion for the National Flood Insurance Program). The Senate would then be able to take up the aid bill immediately after returning from its recess on October 16th. Texas lawmakers are asking for an additional $18.7 billion for non-FEMA items to aid Texas as it recovers from Hurricane Harvey. However, as of now, it appears that non-FEMA aid will have to wait for a later bill that could also include funds for other affected areas.

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TAX REFORM AND REGULATIONS

Republican Leaders Release Tax Reform Framework; Pace on Tax Code Overhaul to Accelerate

The White House and Republican congressional leaders on September 27th unveiled a tax reform framework that they hope will lead to the delivery of a bill to the President's desk by year-end. The nine-page document plows little new ground from what had been rumored to be under consideration. The framework does not contain sufficient detail to evaluate the potential implications for the economy, specific industries, or individual taxpayers. Yet perhaps what is most notable is what it does not spell out – how to defray the cost of the tax cuts, which are expected to run in the trillions.

This lack of specificity, however, did not curb Republicans' enthusiasm for the framework, with even the very conservative House Freedom Caucus announcing its endorsement. Congressional Democrats, as expected, are lashing out against the framework, calling it a giveaway for the rich.

The key elements of the framework are:

Business Taxes:

- Provides for a 25% tax rate on the business income of small- and family-owned businesses conducted as sole proprietorships, partnerships, and S corporations. "Small" is not defined in the framework. The framework contemplates anti-abuse measures to prevent recharacterization of personal income into business income.

- Provides for a corporate tax rate of 20%, and "aims" to repeal the corporate AMT.

- Suggests possible consideration of other methods to reduce the double taxation of corporate dividends. This presumably is a reference to Finance Committee Chairman Orrin Hatch's (R-UT) efforts on corporate integration.

- Allows immediate expensing of new capital investments (other than structures) "for at least five years," effective for investments made after September 27, 2017.

- Envisions a more limited deduction for net interest expense incurred by C corporations.

- Retains the research and development and low-income housing tax credits.

- Anticipates that the tax-writing committees will determine whether additional credits will be retained.

- Describes a 100% exemption for dividends received from foreign subsidiaries, thus moving toward a territorial system for international taxation.

- Provides for deemed repatriation of existing foreign earnings with a "lower rate for foreign earnings held in illiquid assets" than those held in cash or cash equivalents.

- Includes unspecified rules to tax at a "reduced rate and on a global basis the foreign profits of U.S. multinational corporations." The framework also states that "the committees will incorporate rules to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies."

- Repeals the section 199 deduction for domestic manufacturing activities.

Individual Taxes:

- Provides for three individual tax brackets of 12%, 25%, and 35%; although an additional top rate "may apply."

- Repeals the alternative minimum tax.

- Roughly doubles the standard deduction.

- Eliminates personal exemptions.

- Increases the child tax credit and makes it available at higher income levels. The framework also provides a non-refundable credit of $500 for non-child dependents to help defray the cost of caring for other dependents.

- Repeals the estate tax and the generation-skipping transfer tax.

- Retains the deductions for home mortgage interest and charitable contributions. The framework notes that it envisions the repeal of many "exemptions, deductions and credits for individuals," but states that it retains tax benefits that encourage retirement security and retains incentives for higher education.

- Envisions the use of "a more accurate measure of inflation for purposes of indexing the tax brackets and other tax parameters." This would appear to be a move to using chained-CPI in making cost-of-living adjustments under tax law.

There is no specific language in the framework about the tax treatment of like-kind exchanges. In addition, the framework does not mention carried interest. However, National Economic Council Director Gary Cohn has said that the President supports eliminating the use of carried interest tax treatment for hedge funds, adding that it is "one of those loopholes that we talk about when we talk about getting rid of loopholes that affect wealthy Americans."

Despite the framework's ambiguity, however, it does provide some promising signs that some of the real estate industry's concerns are being heard. In particular, the clear statement that expensing changes will not be extended to structures responds to concerns that were raised that full and immediate expensing of structures could lead to an overheating of the real estate market. Similarly, the signal that the restrictions on the business interest deduction would not be applied to non-corporate structures partially alleviates concerns over those issues, but some restrictions on corporate interest deductions (potentially capped at a percentage of annual earnings) remain a major concern. Also, the application of the reduced tax rate on pass-through business income to real estate partnerships and REITs remains uncertain, although we understand that various options are being considered, including ones that would benefit typical real estate transactions. However, the most controversial issue in the framework involves the implicit repeal of the itemized deduction for state and local taxes (SALT). Many, but not all, real estate groups are aggressively opposing the SALT changes, arguing that they will have a detrimental impact on home ownership and home prices, especially when combined with other elements of the framework, such as the increased standard deduction.

Next Steps: It only gets more difficult from here. The framework proposes significant reductions in business and individual income taxes, but it does not address many critical details, including the size of any proposed tax cuts and whether those cuts should add to the federal deficit. In addition, the framework envisions that the House Ways and Means and Senate Finance Committees will decide which tax breaks to eliminate, but (with only a few exceptions) does not identify how many or which ones.

House Ways and Means Committee Chairman Kevin Brady (R-TX) recently said that his Committee is getting closer to holding markups on a tax reform bill, but he also acknowledged that there are disagreements among House Republicans on key issues. And, we have yet to see statutory language. Chairman Brady has stated that he will not unveil legislative text on tax reform until a budget is in place. As noted above, that timetable remains unclear so it could be a few weeks or more before the House Ways and Means Committee starts to release significant details of its draft tax reform legislation. After that, the pace of the legislation will depend on how well it is received.

So, despite the enthusiasm of President Trump and congressional Republicans for overhauling the tax code, enacting a bill by year-end remains a very heavy lift. There are fewer than 40 days left on the legislative calendar, leaving little time to sort out complex and controversial details and make innumerable critical decisions on tax reform.

Witnesses at Senate Finance Committee Hearings Discuss Real Estate Taxes and Mortgage Interest Deduction

The Senate is not likely to move on substantive tax reform legislation until it sees how the process proceeds in the House. For now, Senate Finance Committee Chairman Orrin Hatch (R-UT) continues to hold hearings on tax reform. Most recently, the Committee examined ways to improve the tax system for individuals and businesses.

The Real Estate Roundtable (RER) testified on tax issues affecting housing at the Finance Committee's September 19th hearing on business tax reform. That testimony largely tracked the themes presented in an earlier letter signed by a cross-section of real estate industry groups, including ASHA. The RER testimony stated that properly designed tax reform can spur job creation, encourage business expansion, and result in an increase in the GDP, but also cautioned that there is the potential for unintended consequences. The RER emphasized (1) that the business interest deduction should not be limited; (2) that immediate expensing is not wise for structures, but that true economic depreciation justifies somewhat faster depreciation for real estate; (3) that the pass-through rules should be structured to work for real estate; (4) current law like-kind exchange rules should be retained; and (5) the importance of the SALT deduction. In addition, the RER called for repeal of the Foreign Investment in Real Property Tax Act (FIRPTA).

At a September 14th Finance Committee hearing Members also heard testimony from witnesses on issues affecting individuals, including a strong statement from a representative of the National Association of REALTORS in support of retaining the mortgage interest and SALT tax deductions.

Treasury Department to Withdraw Proposed Estate Tax Valuation Regulation

On October 4, 2017, the Department of the Treasury released a report that, among other things, recommends the withdrawal of the controversial proposed regulation that would restrict the application of valuation discounts to interests in closely-held businesses or other entities for purposes of estate, gift, and generation-skipping transfer taxes. The report is in response to an executive order signed by the President in April that directed the Treasury Department to undertake a review of significant tax regulations issued on or after January 1, 2016, and to identify those that are unduly burdensome or unnecessarily complex. As we reported previously, Treasury issued an interim report that identified eight such tax regulations, including the proposed estate tax valuation regulation. That report stated that Treasury would propose reforms to mitigate the burdens of the identified regulations in a final report to the President. The final report was released on October 4th and a press release with a link to the report can be found here.

The report states that Treasury and the IRS agree with commentators who said the proposed regulations' approach is unworkable and that they plan to publish a withdrawal of the proposed regulation shortly. ASHA has been monitoring this regulation since its release in August 2016 and this past August joined with other real estate organizations to send a letter to Department of the Treasury Secretary Steven Mnuchin requesting that the regulation be rescinded.

OBAMACARE REPEAL EFFORT FALTERS AGAIN

After the Senate parliamentarian ruled that the Senate had to act on its health care reform budget reconciliation bill by the end of September, Senate Republicans made one last push for passage of a bill to repeal and replace ObamaCare while it still only required 50 votes. That effort was based on a draft released by Senators Lindsey Graham (R-SC) and Bill Cassidy (R-LA) that would have (1) repealed the penalties associated with the ObamaCare health insurance mandates on individuals and employers; (2) replaced the ObamaCare Medicaid expansion and health insurance premium tax credits with block grants to the states; and (3) made potentially dramatic changes in federal and state insurance responsibilities. On the tax front, the Graham-Cassidy proposal would have eliminated the medical device tax and substantially improved the Health Savings Account (HSA) rules, but it would have left other ObamaCare tax provisions unchanged.

Initially, Senate Majority Leader Mitch McConnell (R-KY) said that the Senate would vote on the Graham-Cassidy proposal in September. However, that plan was abandoned when it became clear that the measure did not have enough votes to move forward. As a result, ObamaCare repeal efforts have once again been moved to the back burner. Senators Graham and Cassidy have said they hope that some or all of their reforms will be considered during the tax reform process. Others have begun to speculate that Congress might authorize a separate new budget reconciliation bill for health care reform after the tax reform process is completed. There are also ongoing efforts in the Senate to reach bipartisan agreement on temporary measures to deal with time-sensitive issues under ObamaCare, although the prospects for House action (or White House approval) of any Senate compromise remain uncertain. Regardless of the process, the problems with the health care system, including especially the instability in the individual health insurance market, will need to be addressed at some point.

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