Brownstein

Implications of the Election on the Tax Agenda for End-Of-Year Lame-Duck Session and 118th Congress

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Election Results

Results are accurate as of 2 p.m. ET.

Following record-breaking turnout in yesterday's midterm elections, control of the 118th Congress remains unknown. Even as polling in the two weeks leading up to Election Day suggested Republican victories in both the House and Senate, the long-predicted red wave did not come to pass.

On the House side, prior to Election Day, Republicans were confident of a sizable victory, though Democratic leadership warned that several key races were still in play. While Republicans still appear poised to take control of the House, it will be by far smaller margins than previously expected. With a number of races still too close to call, Democratic leadership has indicated there may still be a path to a continued, but very narrow, majority.

On the Senate side, as of this writing, the races in Arizona, Nevada and Georgia are all too close to call. However, Arizona seems to be leaning toward a victory for incumbent Sen. Mark Kelly (D) and Nevada seems to be leaning toward Adam Laxalt (R), who is challenging incumbent Sen. Catherine Cortez Masto (D). As a result, control of the Senate once again seems to run through Georgia, where neither incumbent Sen. Raphael Warnock (D) nor Herschel Walker (R) have reached the 50% threshold needed to avoid a Dec. 6 runoff.

Either way, it seems that Congress will either be under divided control, or will be under Republican control, with very narrow margins. Even if Republicans control Congress, they will not be able to pass significant partisan policy until at least 2025, given the Senate's legislative filibuster. Instead, any legislation enacted into law in the upcoming end-of-year lame-duck session or 118th Congress will require considerable compromise from lawmakers on both sides of the aisle.

In both situations, the Biden administration will likely have to curb its congressional agenda, as the president turns to executive action and the regulatory process to enact meaningful change.

Given that control of Congress is still unknown, this alert discusses the implications on tax policy in the lame-duck session and during the 118th Congress under the two most likely scenarios as of this writing: (1) a Republican-controlled Congress, with narrow margins in both chambers; or (2) divided control of Congress, with a Democratic majority in the Senate and a Republican majority in the House.

Looking Forward: Lame-Duck Agenda

[**Note:** Based on the final election results, Republicans may wait until next year to exercise more leverage over a deal on various outstanding items. However, this section discusses the dynamics of how a year-end package may come together, assuming there is a deal.]

The House and Senate return to session on Nov. 14 and Nov. 9, respectively, kicking off a sprint to the end of the year. While preparing for the organizational changes in the next Congress, lawmakers must also address the two must-pass items that remain outstanding: funding the government via another continuing resolution (CR) or potentially an omnibus package, and enacting the National Defense Authorization Act (NDAA). Work on these packages will dominate the remaining congressional calendar, leaving little room for other items to move except as riders to a CR/omnibus or NDAA. Items that may be incorporated into one of these packages include a host of expiring authorizations and programs, and a range of issues with relatively bipartisan support. The Senate Democrats are also expected to dedicate any other available time to processing judicial and other Biden administration nominations.

Must-Pass Items. The following measures must be addressed before the conclusion of the 118th Congress to provide stable funding for the U.S. government and national security.

- *Government Funding.* The CR enacted earlier this year will fund the government through Dec. 16, giving lawmakers roughly one month to prepare a full-year funding bill. Circumstances may warrant the need for Congress to pass a second, short-term CR to extend the funding cliff further into December and allow additional time to negotiate a final deal. Both the chair and ranking member of the Senate Appropriations Committee are retiring this year, and with Rep. Rosa DeLauro (D-CT) completing her first term at the helm of the House Appropriations Committee, the group is eager to achieve passage of a full-year funding bill. An omnibus bill also would present an opportunity for lawmakers to attach a range of expiring authorizations and priority policy proposals to the package. If they fail to reach an agreement on a long-term funding package, lawmakers will be forced to approve another CR to keep the government operational into 2023, which effectively would punt the range of policy issues into next year. Given the organizational hurdles presented by a new session, the CR would likely extend existing funding levels into February or March 2023.

- *National Defense Authorization Act (NDAA).* The Senate will resume its work on the 2023 NDAA next week. The House passed its version earlier this year, but the Senate is in the final stages of approving its counterpart. A substitute amendment was offered to the bill by Senate Armed Services Committee leaders during the recess, setting up floor consideration in mid-to-late November. Over 900 amendments were filed on the bill, but only a fraction of those were included in the Senate managers' package. Senate committee staff continued to wade through amendments and negotiate with House counterparts while lawmakers departed for their districts in the hope of expediting the completion of a bipartisan, bicameral NDAA in the lame-duck session. The bipartisan NDAA has been enacted each year for over 60 consecutive years, and retiring Sen. Jim Inhofe (R-OK), the top Republican on the Senate Armed Services Committee, is eager to enact his final NDAA. Like an omnibus funding bill and with similar limitations, the NDAA is a moving vehicle to which lawmakers will try to attach other priorities, but the window for including extraneous provisions is expected to close before members return to Washington.

Expiring Programs and Authorizations. Should Congress adjourn without enacting extensions of these items, there would be repercussions for various agencies, programs and businesses. However, the functioning of the government would not be compromised.

This alert deals primarily with the tax items on the lame-duck agenda, other provisions are covered in a general alert that can be accessed here.

Tax Agenda in the Lame Duck. Though Democrats control Congress during the lame duck, they will still need support from at least 10 Senate Republicans to meet the 60-vote threshold required to invoke cloture on a potential filibuster. Any provisions included in an end-of-year package will require bipartisan support.

Democrats' top priority remains the Child Tax Credit (CTC), while Republicans are primarily interested in securing extensions for several expiring business tax provisions initially enacted by the 2017 Tax Cuts and Jobs Act (TCJA), as well as other priorities. The chances of a deal coming together will likely depend on whether Democrats continue to insist that any business tax provisions must be paired with a broad-based expansion of the CTC or whether Republicans and Democrats can reach a compromise that includes a modest CTC extension. Some experts believe that a deal on tax legislation may be possible without the inclusion of the CTC, if other major Democratic priorities are included in the bill. Another alternative possibility is that a lame-duck tax bill could be limited to retirement savings reform only.

Major items that could be included in a year-end package are discussed in detail below.

EXPANDED CHILD TAX CREDIT

Several lawmakers on the left have said they would be unwilling to support any of the requested incentives for businesses in a tax-extenders deal without the inclusion of aid for families in the form of a CTC expansion. President Joe Biden has remained a strong supporter of CTC legislation, meeting with lawmakers, including Sen. Michael Bennet (D-CO), to renew efforts to pursue the expanded credit. House Ways and Means Chair Richard Neal (D-MA) has since echoed Bennet's support, publishing a statement supporting extensions to COVID-19-era CTC thresholds. On the same day, a group of bicameral lawmakers, including Sens. Sherrod Brown (D-OH) and Cory Booker (D-NJ), as well as Reps. Rosa DeLauro (D-CT), Suzan DelBene (D-WA) and Ritchie Torres (D-NY), published a joint statement in support of CTC legislation.

Though the CTC is likely a top tax priority for many Democrats, efforts have already been made to attach this provision to several previous legislative vehicles. Most recently, attempts to pass CTC reform through reconciliation were thwarted by Sen. Joe Manchin (D-WV), who requested that work requirements and means testing stipulations be attached to any potential CTC provisions.

Even if all 50 Democratic senators were to reach consensus on a prospective CTC agreement, it would still require the support of at least 10 Senate Republicans. Providing some hope to Democratic efforts, earlier this year, Sens. Mitt Romney (R-UT), Steve Daines (R-MT) and Richard Burr (R-NC) announced their proposed Family Security Act 2.0. The bill includes a simplified CTC worth up to $350 monthly per child or $4,200 annually, which would be paid for by eliminating several other federal entitlement programs, as well as the child portion of the child and dependent care tax credit. The bill also includes changes to the Earned Income Tax Credit (EITC) and a repeal of the state and local tax deduction to pay for the credit. A repeal of the SALT deduction is a non-starter for Democrats and for several House Republicans.

If CTC reform is included in a year-end tax bill, it is unlikely that the credit will be expanded to the full American Rescue Plan Act (ARPA)-era (2021) amount of $3,000 per child aged six and over and $3,600 for children under the age of six. The annual cost of this provision would be about $100 billion. At best, a one-year extension of the CTC at a more modest amount is the likely outcome in a year-end deal.

Any CTC expansion through a bipartisan tax deal would require significant concessions to Republican-supported business tax extenders. If an expanded CTC is not passed in the lame-duck session, assuming divided congressional control or a Republican-controlled Congress, it is unlikely the proposal would receive any consideration next year.

OTHER EXPIRING BUSINESS TAX INCENTIVES

In the upcoming extenders discussion, Republicans will seek to extend several expiring business incentives originally passed through TCJA. Before 2022, the deduction for net business interest expenses under section 163(j) was limited to a maximum of 30% of a taxpayer's earnings before interest, taxes, depreciation and amortization (EBITDA). This year, the provision reverted to allow taxpayers to deduct only net business interest expenses up to 30% of their earnings before interest and taxes (EBIT)—not taking into account depreciation or amortization. Republican lawmakers will likely insist on a retroactive extension of previous law to avoid the investment decline that could result from the shift to EBIT.

Also of note, beginning in 2023, the current 100% bonus depreciation on certain fixed assets will decrease by 20 percentage points annually until 2027. Republicans will likely request a delay on this phase-out process to incentivize businesses to continue purchasing tax-favorable assets.

While there is some support among Democrats for these two business tax incentives, they will likely be included in a year-end bill only if Republicans allow significant concessions on CTC expansion or other critical Democratic priorities. If a deal does not come together during the lame-duck session, Republicans are expected to pursue these objectives in the 118th Congress.

BIPARTISAN BUSINESS TAX PROVISIONS

There are also a few tax proposals that have broad bipartisan support. These include a modification allowing businesses to restore the immediate deductibility of research and development (R&D) costs.

The TCJA required that R&D expenses be amortized over five years, starting on Jan. 1, 2022. Prior to the TCJA and until the end of 2021, taxpayers could choose either to deduct these Sec. 174 expenses immediately, capitalize the expenditures and amortize them over five years or elect a 10-year amortization of expenditures under the alternative minimum tax rules. A provision in the House-passed Build Back Better budget reconciliation bill would have delayed the TCJA's change from Jan. 1, 2022, to Jan. 1, 2026. However, this proposal never made it into the Inflation Reduction Act. If this proposal is not adopted before the end of this tax year or adjusted retroactively subsequently, taxpayers will be required to amortize R&D expenses over five years starting in 2022.

Another bipartisan proposal that has received strong support from lawmakers in both chambers would grant relief to domestic companies that utilize the last in, first out (LIFO) method of accounting. The proposal would allow taxpayers not to recognize recapture income solely attributed to auto dealers' inability to restore their inventories due to supply disruptions caused by COVID-19, while temporarily extending the inventory replacement period. The current proposal has 56 co-sponsors in the Senate and 152 co-sponsors in the House.

RETIREMENT SAVINGS

Retirement-savings legislation is one of the most bipartisan proposals under consideration for a year-end tax deal. Even if an agreement on the other tax provisions falls apart, retirement savings could still be attached to a potential omnibus.

Negotiations around retirement-savings legislation continue, with lawmakers from the four committees of jurisdiction over the issue looking to finalize the language in the coming weeks. The "eight corners," as the negotiators call themselves, include negotiators from the House Ways and Means Committee, the House Education and Labor Committee, the Senate Finance Committee and the Senate Health Education Labor and Pensions (HELP) Committee.

Currently, the eight corners are working to reconcile differences between a March 2022 House-passed bill—the Securing a Strong Retirement Act of 2022; the June 2022 Senate Finance Committee bill—the Enhancing American Retirement Now (EARN) Act*; and the June 2022 Senate HELP Committee* bill—the RISE and SHINE Act. While the House bill cleared the chamber through an overwhelming 414-5 vote, the Senate Finance and HELP versions have several key differences.

One of the biggest issues for negotiators to resolve is the saver's credit. While the House and Senate Finance versions both include an expansion of this retirement tool, the Senate version would go a step further in making the credit fully refundable. Another difference between the two bills is that the House version requires employers to enroll their employees automatically in 401(k) plans at a savings rate of at least 3% and then increase it each year until the worker contributes 10% of their pay, unless the worker opts out. The Senate proposal has no such 401(k) auto-enrollment mandate. Apart from these significant differences, there are several minor variances between provisions in the Senate Finance and House bills, such as the age at which catch-up contributions can be made.

Another area of difference is emergency savings. A provision included in the Senate HELP bill, but not included in the Senate Finance or House bills, would permit contributions of up to $2,500 per year to a "sidecar" emergency savings account as part of a 401(k) plan, and allow matching contributions based on those contributions. This provision is a priority of HELP Committee Chair Patty Murray (D-WA). The Senate Finance bill would address emergencies by liberalizing the existing hardship distribution rules, allowing withdrawals of up to $1,000 per year. The provisions are not mutually exclusive, and it is possible that both could be included in the final legislation.

Negotiators are determined to get a retirement savings bill across the finish line during the lame-duck session. House Ways and Means Ranking Member Kevin Brady (R-TX) signaled last month that he intends to enact the legislation before his retirement at the end of the 117th Congress.

Echoing this sentiment, Sens. Rob Portman (R-OH) and Ben Cardin (D-MD) drafted a joint op-ed for *The Hill*, expressing support for the retirement bill. Importantly, Portman has been a strong advocate for the legislation, and because he is retiring at the end of the 117th Congress, this will be his last chance to pursue the effort. The senators referenced several ongoing retirement savings issues exacerbated by the COVID-19 pandemic in their article. Like Brady, the lawmakers do not believe there are any differences between the House and Senate versions of the legislation that cannot be easily reconciled.

If retirement legislation is not passed in this session of Congress, there will likely be more attempts at reform in 2023. However, these efforts may become significantly more difficult with the upcoming retirement of champions such as Portman and Brady.

Leadership in the 118th Congress

SENATE

Senate leadership is not likely to undergo significant shifts next session, regardless of party control. On the Democratic side, Sen. Chuck Schumer (D-NY) is expected to continue leading the chamber's Democrats, accompanied by Sen. Dick Durbin (D-IL) as whip. Sen. Patty Murray (D-WA) will also return as assistant Democratic leader after defeating a Republican challenger this cycle. Sen. Debbie Stabenow (D-MI) is expected to retain her role as Democratic Policy Committee chair.

None of the following members of Senate Democratic leadership are in cycle: Sens. Amy Klobuchar (D-MN), chair of the Steering Committee; Sen. Bernie Sanders (I-VT), chair of Outreach; and Sens. Joe Manchin (D-WV) and Cory Booker (D-NJ), vice chairs of the Policy and Communications Committee. However, outgoing Sen. Patrick Leahy (D-VT) will have to be replaced as president pro tempore of the Senate. This is traditionally the most senior member of the chamber's majority party—likely either Sen. Dianne Feinstein (D-CA) or Chuck Grassley (R-IA).

Similarly, Sen. Mitch McConnell (R-KY) is expected to continue leading his party in the minority or majority with the support of Sen. John Thune (R-SD) as whip and Sen. John Barrasso (R-WY) as conference chair. There will be some movement on the Republican Policy Committee, as the current chair, Sen. Roy Blunt (R-MO), is retiring this year. The position will likely go to the current conference vice chair, Sen. Joni Ernst (R-IA), making her the fourth-ranking member of the Senate Republican Leadership team. Sen. Steve Daines (R-MT) is expected to secure a spot as chairman of the National Republican Senatorial Committee, replacing Sen. Rick Scott (R-FL). Sen. Shelly Moore Capito (R-WV) is expected to make a run for a leadership post as well.

HOUSE OF REPRESENTATIVES

With Republicans poised to win control of the chamber, the leadership shifts in the House will be considerable. Minority Leader Kevin McCarthy (R-CA) is expected to secure the speakership. The Freedom Caucus, which has been a thorn in the side to top House Republicans in the past, is lobbying its conference leadership on an array of issues, ranging from committee appointments to policy positions to procedural rules. However, Rep. McCarthy has improved relationships with the Freedom Caucus in recent years, recently describing Rep. Jim Jordan (R-OH), the caucus' founder, as his "biggest advocate."

The race is also on for majority whip, with current whip Rep. Steve Scalise (R-LA) expected to move up as majority leader. Reps. Jim Banks (R-IN), chair of the Republican Study Committee; Drew Ferguson (R-GA), chief deputy whip; and Tom Emmer (R-MN), chair of the National Republican Campaign Committee; are competing for the role.

Conference Chair Elise Stefanik (R-NY) and Policy Committee Chair Gary Palmer (R-AL) will likely retain their current roles, while Rep. Mike Johnson (R-LA) is hoping to become vice chair of the conference, and while Reps. Richard Hudson (R-NC) and Darin LaHood (R-IL) are squaring off for NRCC chair.

The three most senior members of House Democratic leadership—Speaker Nancy Pelosi (D-CA), Majority Leader Steny Hoyer (D-MD) and Majority Whip Jim Clyburn (D-SC)—are all returning next session. The trio have led Democrats in the House from various senior positions for decades. While they have not directly commented on their plans for the 118th Congress in recent months, Speaker Pelosi previously indicated that the 117th Congress would mark her last at the helm of the Democratic Caucus. Still, some combination of Pelosi, Clyburn and Hoyer may seek the minority equivalents of their current positions—leader, whip and assistant leader, respectively—on the grounds that they are best equipped to lead the party through the forthcoming transition. The key dilemma Democrats now face is that the minority party has one less position available for its top six leaders.

The field of up-and-coming Democrats likely will seek continued leadership roles next session, including Rep. Katherine Clark (D-MA), assistant speaker, Rep. Hakeem Jeffries (D-NY), chair of the House Democratic Caucus, and Rep. Pete Aguilar (D-CA), vice-chair of the House Democratic Caucus. Should Pelosi, Hoyer and Clyburn all retain their leadership roles, Rep. Jeffries, who is term limited as caucus chair, or Rep. Clark, may move to challenge one of them. Alternately, Rep. Clark could face off with Rep. Aguilar to become caucus chair. Rep. Adam Schiff (D-CA), who rose to national attention during the impeachment trial of former President Donald Trump, also is seriously contemplating a bid for a House leadership slot next session. The four co-chairs of the House Democratic Policy and Communications Committee (DPCC) are additional contenders for continued or future leadership roles—Reps. Matt Cartwright (D-PA), Debbie Dingell (D-MI), Ted Lieu (D-CA) and Joe Neguse (D-CO). Notably, Cartwright, Dingell and Lieu are all term-limited in their roles on the DPCC. Neguse has expressed interest at chairing DPCC or running for vice-chair. Reps. Chrissy Houlahan (D-PA) and Adriano Espaillat (D-NY) have declared intentions to run for seats on DPCC.

Ultimately, the extent of the churn within House Democratic leadership in the next session rests on whether Rep. Pelosi decides to remain in leadership

Congressional Tax Committee Membership

Given that control of Congress is still unknown, this section explores the two most likely scenarios as of this writing: (1) a Republican-controlled Congress, with narrow margins in both chambers; or (2) a divided control of Congress, with a Democratic majority in the Senate and a Republican majority in the House. If the House remains under Democratic control, as noted in the chart below, no changes to leadership are expected.

COMMITTEE	CURRENT LEADERSHIP	118TH CONGRESS REPUBLICAN LEAD	118TH CONGRESS DEMOCRATIC LEAD
WAYS AND MEANS	CHAIR: R. NEAL (D-MA) RANKING: K. BRADY (R-TX)	Rep. Vern Buchanan (R-FL); Rep. Adrian Smith (R-NE); or Rep. Jason Smith (R-MO)	REP. RICHARD NEAL (D-MA)
FINANCE	CHAIR: WYDEN (D-OR) RANKING: CRAPO (R-ID)	Sen. Mike Crapo (R-ID)	SEN. RON WYDEN (D-OR)

HOUSE WAYS AND MEANS COMMITTEE UNDER GOP CONTROL

With a majority in the chamber and retiring committee members, Republicans will need to fill a number of seats on the committee, assuming the size of the committee remains the same. On the Democratic side, current Chair Richard Neal (D-MA) will likely stay on as ranking member of the committee.

The three Republicans vying for their party's top spot on the committee are Reps. Vern Buchanan (R-FL), Adrian Smith (R-NE) and Jason Smith (R-MO).

Early on, Buchanan, the current ranking member of the Health Subcommittee, was generally considered the frontrunner. While Buchanan is technically the second-most senior Republican behind Brady, he joined the committee at the same time as Adrian Smith. In this case, seniority was determined alphabetically by last name. In the internal advocacy for the chairmanship, Buchanan has highlighted his business experience garnered through the chain of auto dealerships he opened across Sarasota, Florida. These enterprises contribute to his ranking as one of the wealthiest members of Congress. Buchanan is also outraising his opponents in the chairmanship race significantly by some accounts.

While Buchanan was an early favorite in the race, Jason Smith appears to be gaining ground. The fourth-most-senior Republican committee member, Jason Smith has served on the committee since 2015 and is the current ranking member of the House Budget Committee. Like Buchanan, Jason Smith has extensive private-sector experience and served as majority whip and speaker pro tem in the Missouri House of Representatives before his election to Congress. Jason Smith is viewed as a strong advocate for conservative priorities.

The final contender for the chairmanship of the committee is Adrian Smith, the current ranking member of the Trade Subcommittee. Compared to the other two contenders, Adrian Smith has maintained a relatively low public profile but is generally regarded as a policy expert and an effective advocate for conservative tax reform. Most recently, Adrian Smith has been a strong proponent of efforts to limit the use of new IRS funding.

The next committee chair will be officially announced in December before the start of the 118th Congress.

SENATE FINANCE COMMITTEE

In the Senate Finance Committee, if Democrats retain control of the chamber, the status quo will likely remain relatively unchanged. Current Chair Ron Wyden (R-OR) will serve as the leader of the committee, and Ranking Member Mike Crapo (R-ID) is expected to remain the top Republican on the committee for another term.

If Republicans take control of the chamber, then Ranking Member Mike Crapo (R-ID) is expected to remain the top Republican on the committee, assuming the chairmanship in the new Congress. Current committee chair Sen. Ron Wyden (D-OR) is likely to stay on as ranking member of the committee.

Regardless of committee control, based on election results as of this writing, while the committee will likely retain its current ratio of party membership, there will be several high-profile vacancies on the GOP side of the committee created by the upcoming retirements of Sens. Richard Burr (R-

NC), Rob Portman (R-OH), Ben Sasse (R-NE) and Patrick Toomey (R-PA).

Though Democratic Senate Finance Committee Sens. Catherine Cortez Masto (D-NV), Maggie Hassan (D-NH) and Michael Bennet (D-CO) all faced tough reelection races, Hassan's and Bennet's seats remain safe. It is unclear if Cortez Masto will need to be replaced. The rest of the Democratic roster will likely remain unchanged.

Tax agenda in the 118th Congress, Scenario 1: Republican-Controlled Congress

Under a Republican Congress, the GOP is likely to pursue a tax agenda that will focus on issues they have been campaigning on for months. Many of these items have been previewed in current House Republicans' Commitment to America agenda.

In the tax space, tackling inflation will be a central theme. Republicans will focus on issues with the supply chain, reversing regulations they perceive limit domestic energy production, creating new and bolstering existing tax incentives for hard-hit industries such as real estate that did not receive aid in pandemic relief legislation, and enabling small businesses to thrive, especially with the forecast economic downturn. Other issues that Republicans may tackle through the tax code include school choice and scaling back IRS funding provided through the Democrats' Inflation Reduction Act.

These efforts will unfold through numerous congressional hearings, legislative proposals, and a potential budget reconciliation effort (*discussed in greater detail below*). Through this agenda, Republicans will also leverage their control over the chamber to heavily scrutinize the full spectrum of bills passed in the 117th Congress, specifically focusing on the potential economic ramifications of the Inflation Reduction Act.

EFFECT OF LAME-DUCK LEGISLATION

Tax legislation in the 118th Congress will largely depend on whether lawmakers can reach a deal on extenders and retirement savings legislation during the lame-duck session and the scope of any final package.

If tax items are not included in a lame-duck package, some provisions are more likely than others to receive serious consideration during the 118th Congress. In a Republican-controlled Congress, retirement savings reform and the various business tax provisions will likely receive the greatest consideration. While a continuation of the Democrats' broad expansion of the CTC is unlikely to pass, there is long-standing support in the Republican conference for the CTC, which could lead to a modest expansion along the lines of the temporary expansion in TCJA of the CTC threshold, especially if Republicans advance a tax-focused budget reconciliation bill (*discussed in greater detail below*).

TAX-FOCUSED BUDGET RECONCILIATION BILL

With control of the tax-writing and budget committees, Republicans may devote significant time and resources to the passage of a tax-focused budget reconciliation bill. While this bill will likely be vetoed by President Biden ultimately, it will provide Republicans with a tax-policy platform to campaign on in 2024, conveying a roadmap to voters of potential GOP priorities under a unified

Republican government. Conversely, a reconciliation package would be a major blow to congressional Democrats and Biden, who would end up on the record publicly rejecting proposals to reduce taxes for individuals and industry, potentially in the midst of an economic downturn. This effort may prove especially useful for tax writers with higher political aspirations, like Sen. Tim Scott (R-SC), a member of the Senate Finance Committee who could use a budget reconciliation legislative exercise to bolster his national image in preparation for a future presidential run.

TCJA PERMANENCE

In both committees, Republicans would begin the reconciliation process by holding hearings on proposals to reduce federal taxes on individuals and corporations and the economic effects of the Democrats' reconciliation packages enacted in the 117th Congress. This would likely include a focus on making several expiring TCJA provisions permanent. Currently, most of the individual tax incentives are slated to expire after 2025, including the reduced individual tax income rates, the limitation on the deductibility of state and local taxes (commonly known as "SALT"), and expanded standard deduction. Additionally, for pass-through businesses, Sec. 199A also expires in 2025. While a reconciliation effort will likely fail to extend these provisions in the 118th Congress, the expected slate of hearings and legislative efforts may well set the stage for serious extension discussions at the start of the 119th Congress.

IRS FUNDING

Under Republican control, the House and Senate tax committees will focus much of their oversight agenda on hearings on proposals to rescind or recalibrate the $80 billion of additional IRS funding provided in the Democrats' Inflation Reduction Act. Specifically, Republicans will likely advance proposals to: (1) limit the hiring of new IRS auditors; (2) curtail the ability of the agency to audit small businesses; (3) prohibit additional resources from being used to audit taxpayers with annual income below $400,000; and (4) rebalance the funding accorded to customer service and technology modernization.

While the inclusion of these proposals in reconciliation would be largely symbolic, there is a possibility that Republicans can attract enough Democrats to support IRS funding legislation outside of the reconciliation process. This may include bills designed to limit the use of IRS funding to audit low- and middle-income taxpayers. If Republicans pass piecemeal legislation along narrower lines, some moderate Democrats may feel pressure to support the legislation to avoid the public backlash that would emerge from rejecting these proposals. The same is true for efforts to reallocate some of the funding for IRS enforcement in favor of improvements to taxpayer service.

However, if these changes are included in a broader tax-focused budget reconciliation messaging bill, it is unlikely to gain any traction with Democrats.

ENERGY—RENEWED FOCUS ON OIL AND GAS

Republicans will likely seek to soften domestic content requirements and undo the labor regulations associated with energy tax credits in the IRA. This may also attract limited Democratic support, most likely in the House, especially if U.S. energy prices remain high in 2023. If Democrats choose to reject either proposal, they risk being accused of hurting the U.S. job market, exacerbating inflationary pressures and threatening domestic energy security.

In his recent policy agenda, Kevin McCarthy (R-CA) also committed to decreasing U.S. reliance on foreign energy through the expansion of domestic fossil production. While this pledge will most likely include proposals to open new swaths of federal land for drilling operations, it may also include tax provisions to incentivize domestic extraction and refining of oil and natural gas. In a budget reconciliation bill, Republicans may push for investment tax credits for new drilling equipment, additional tax incentives for the use of enhanced oil recovery or an enhancement for current oil and natural gas exploration incentives. Proposals to expand or renew the current bonus deprecation for property and equipment (*more information above*) will also be a crucial element of Republicans' support for domestic fossil energy.

DOMESTIC MANUFACTURING INCENTIVES

A Republican reconciliation effort also is likely to include tax incentives for domestic production across a range of manufacturing sectors that are perceived to be critical to U.S. national security. A model of this concept was seen in the recent passage of the CHIPS and Science Act that incentivizes the production of domestic semiconductors. Republicans would message these provisions as an effort to limit foreign influence in key U.S. production sectors. Ultimately, while Democrats will not support these efforts in a comprehensive legislative vehicle, individual domestic stimulus tax legislation could receive bipartisan consideration.

INTERNATIONAL TAX REFORM

The reconciliation bill may also include efforts to address the taxation of both foreign and U.S.-based multinational corporations, especially in the wake of the stalled global minimum tax promoted by the Treasury Department and the Organization for Economic Cooperation and Development (OECD). While the Biden administration was ultimately unable to attract sufficient congressional support for U.S. adoption of a new OECD international tax regime, several European countries appear to be moving forward unilaterally with parts of the proposed regime. If this occurs, Republicans may feel pressure to support U.S. multinational corporations that would be disproportionately burdened by foreign taxes under a global minimum-tax system.

SMALL BUSINESS INCENTIVES

In years past, the Republican party has been equated with big business. However, in recent years, Republicans have shifted their focus more toward helping small businesses thrive. A key element of a GOP reconciliation proposal will likely be tax incentives to allow for a renewal of so-called "main street America." McCarthy has signaled this effort will include improving the efficiency of the supply chain for small businesses that have been hard-hit by persistent shortages over the last two years. As noted above, Republicans are expected to push for an extension and possible expansion of the current 199A deduction for passthrough businesses. A reconciliation bill may also allow for expanded tax incentives to foster small- and mid-size businesses, especially with regard to R&D expenditures.

REAL ESTATE

Throughout the 117th Congress, Democrats advanced new tax proposals to limit the tax-favored status of many real estate transactions, including proposals to limit Sec. 1031 like-kind exchanges, as well curtail the tax treatment afforded to carried interest. Under Republican control, Congress may explore new tax incentives to support the real estate sector, especially if housing prices remain high and the commercial real estate market remains depressed after the COVID-19 shutdowns. In a reconciliation bill, this could include expanded depreciation allowances, as well as more favorable treatment for capital gains or passthrough income, both of which are crucial tools in the real estate industry.

Republicans may also support the expansion of incentives for the development of new low-income housing. A likely target would include an expansion of the low-income housing tax credit (LIHTC), especially the basis boost for housing developments that cater to extremely low-income tenants. These proposals may also receive bipartisan consideration if advanced outside of a reconciliation bill.

SCHOOL CHOICE

School choice will also be a major theme for Republicans. During the pandemic, Republicans attacked Democrats for school shutdowns and virtual schooling, blaming them for learning loss. While some of these issues cannot be addressed through tax incentives, a reconciliation bill could include tax-credit scholarship programs and other incentives, which would allow taxpayers to receive credits when they donate to nonprofits that provide private-school scholarships to eligible students. Several states currently have similar programs.

OVERSIGHT

With the House and Senate in GOP control, the tax agenda will depend on who leads the committee and how much the party is controlled by the far right's agenda, versus centrists in the party. Regardless, Republicans will assuredly pursue a broad oversight agenda.

On the House side, under Democratic control in the 117th Congress, the Ways and Means Committee conducted investigations and held hearings targeting industry practices of the fossil fuel sector and multinational pharmaceutical companies.

Under Republican control, the committee's oversight priorities will shift. Instead, the Ways and Means Committee will likely increase oversight hearings and congressional investigations on various issues, including: tax-exempt entities, such as private universities; tax practices of donor-advised funds and broad monetization allowances afforded to certain direct pay and transferable credits in the IRA. Ways and Means Republicans are also expected to focus attention on the policy objections and economic effects of the new book-minimum tax and stock buyback tax included in the Inflation Reduction Act. Additionally, House Republicans are likely to open congressional investigations into the alleged criminal tax practices of Biden and his family, as well as challenge Secretary Janet Yellen's representation of U.S. interests in recent negotiations over the proposed global minimum tax.

On the Senate side, the Finance Committee is unlikely to pursue an oversight agenda independent of the House. Sen. Mike Crapo (R-ID) will instead pursue several targeted investigations against the IRS, likely to include a continuation of ongoing inquiries against the agency for a security breach in 2021 that allowed ProPublica to gain access to a trove of private taxpayer information. Crapo may also continue his investigations into current IRS auditing practices, with a particular focus on scrutinizing a proposal that would allow the treasury secretary broad authority to create a new comprehensive reporting regime for financial institutions and third-party payment providers. Like the Ways and Means Committee, however, Crapo is expected to continue the committee's oversight of the Biden administration's international tax agenda and international negotiations.

Additionally, both House and Senate Republicans are also likely to question Gary Gensler, the chairman of the Securities and Exchange Commission (SEC) for ESG guidance released earlier this year. Specifically, in March, the SEC proposed rule changes to enhance and standardize climate-related disclosures for investors. The SEC was slated to release guidance on new human capital disclosure requirements. However, the initiative has been stalled, likely until next year. Republicans have criticized the rules as having a chilling effect on businesses and have accused Democrats of using the regulations to fight "culture wars" on climate change and other social issues. Republicans may also scrutinize the actions of states that use the services of big investment advisors that have made investment decisions to advance the fight against climate change.

CONFIRMATION HEARINGS

In the 118th Congress, with control of the Senate, Republicans will be able to slow or block several key nominations. Biden will not be guaranteed expedited Senate confirmations in the latter half of his term. Instead, Senate Republicans will have the power to outright reject any nominees they do not support. Senate Republicans will likely only support proposed nominees with substantial bipartisan records. Rumors have recently surfaced that current Treasury Secretary Janet Yellen may retire within the next few months. If her retirement occurs after the lame duck, the Biden administration may struggle to confirm her successor under intense scrutiny from Senate Republicans, with compounding effects if Biden nominates another cabinet secretary like Commerce Secretary Gina Raimondo to succeed Yellen.

Overall, the result will be a significant slowdown in the appointment process, leaving several long-term vacancies in executive agencies as well as in federal courts. Of note, this may also severely limit the power of the expanded IRS as Biden will have an increasingly difficult path toward confirming a new commissioner of the Internal Revenue Service and possibly a new IRS chief counsel to oversee the $80 billion in additional funding provided by the IRA.

Tax agenda in the 118th Congress, Scenario 2: Republican-Controlled House, Democratic-Controlled Senate

GOP-CONTROLLED HOUSE WAYS AND MEANS AGENDA

With split control of Congress, Republicans will have fewer tools at their disposal to pursue tax legislation. Without control of the Senate, budget reconciliation legislation will no longer be possible. Instead, House Republicans will pursue many of the same items through piecemeal legislation and hearings.

As discussed in the previous section, House Republicans' Commitment to America plan will still be the foundation of the tax agenda, with a focus on tackling inflation, addressing issues with the supply chain, addressing high energy prices, helping small businesses, and creating new and bolstering existing tax incentives for hard-hit industries.

The Ways and Means Committee will likely hold hearings on various proposals to tackle these issues, potentially stitching various proposals together into a package that addresses affordability and inflation—this will include many of the issues discussed in the previous section on a potential tax-focused budget reconciliation bill under a Republican-controlled Congress.

A GOP-controlled House will also focus on many of the same oversight issues discussed in the previous section. This includes tax-exempt entities, such as private universities, tax practices of donor-advised funds and broad monetization allowances afforded to certain direct pay and transferable credits in the IRA. The committee will also examine the economic effects of various new policies in the IRA, from the new book-minimum tax to the domestic content and apprenticeship requirements in the energy tax provisions. The committee will also focus much of their attention on various proposals to recalibrate the $80 billion of new IRS funding provided in the IRA. Kevin McCarthy (R-CA) has signaled that limiting use of these funds will be an early and major priority. Apart from oversight hearings related to the IRA, Republicans will also go after ESG guidance released earlier this year, though the House Financial Services Committee will have primary jurisdiction over this issue. All of these issues are discussed in greater detail in the previous section.

One of the biggest focal points for the committee under Republican control will be investigations into the alleged criminal tax practices of Biden and his family, as well as challenge Secretary Janet Yellen's representation of U.S. interests in recent negotiations over the proposed global minimum tax. Leading up to the 2024 elections, this will likely increase in intensity as attempts are made to uncover more alleged abuses of power for use as political fodder.

DEMOCRATIC-CONTROLLED SENATE FINANCE AGENDA

With Democratic control of the Senate, Republicans will be precluded from fully passing their legislative tax agenda through Congress. However, Democrats will likely be unable to pursue the remainder of Biden's partisan tax objectives in the 118th Congress. Instead, they will primarily focus on investigations and confirmation hearings.

ONGOING TAX INVESTIGATIONS

Under the control of current Chair Ron Wyden (D-OR), the Senate Finance Committee will continue to scrutinize the profits of fossil fuel companies, pharmaceutical manufacturers and the perceived unfair tax practices perpetrated by insurance providers, private equity and multinational corporations across several sectors. Wyden is also likely to continue to hold hearings to consider implementing a global minimum tax, a tax on the wealth of high-income individuals or levies against highly profitable oil and gas companies. However, without control of the House, there is no chance that this legislation will receive serious consideration in the 118th Congress.

Several committees in the chamber will also hold hearings to highlight the successes of the IRA, Infra-structure Investment and Jobs Act and other legislation passed in the 117th Congress. These hearings may help in the development of strategies for agencies allocating the funding provided by these bills.

CONFIRMATION HEARINGS

Without control of the House, the Democrat-controlled Senate is likely to increase focus on confirming federal judges and members of executive agencies. Notably, the recent influx of funding to the IRS and Treasury Department will require several new confirmations of high-level positions. Control of the Senate will ensure that these positions can be filled in a timely manner. Speculation has also arisen over the possibility of Secretary Yellen retiring in the next year. If this occurs, Democratic control over the Senate will allow for a simple transition of power to a new Treasury secretary.

POTENTIAL BIPARTISAN LEGISLATION

Apart from the proposals that will be considered in the upcoming lame duck (*see section 2 above*), there are a few policy objectives that a divided Congress may pursue in the new year. While Leader Chuck Schumer (D-NY) will seek to pass less controversial bills on a bipartisan basis, similar to what he accomplished with the CHIPS Act, the Infrastructure Investment and Jobs Act and gun control legislation, with a split government, Republican leadership will be hesitant to support any legislation that may give the Biden administration an economic victory before the 2024 presidential elections. As a result, there is unlikely to be any significant bipartisan fiscal or tax legislation that is signed into law in the 118th Congress. Discussed below are a few opportunities that the committees may pursue.

TAX PROVISIONS IN THE FARM BILL

The Farm Bill generally focuses on funding for crop insurance, conservation, energy and many other agricultural program areas every five years. Farm bills, however, can include a tax title. If the 2023 bill does include agricultural tax provisions, lawmakers might look to expand on initiatives like the Rural Energy for America Program (REAP) that helps farmers and rural small-business owners to pay for renewable and energy efficiency technology. States like Ohio are also looking at creating new "Beginning Farmer Tax Credits," a concept that may be proposed on the federal level through the upcoming Farm Bill. Members of Congress on both sides of the aisle may be willing to support domestic tax credits for farming equipment to reduce U.S. reliance on foreign crop production and foreign supply chain, issues highlighted by the ongoing war in Ukraine.

ECONOMIC STIMULUS BILLS

If the United States enters into a recession as many experts anticipate, Republicans may be willing to support targeted support for taxpayers. This could include mortgage debt relief for a potential downturn in the housing market. If energy prices remain high, both parties also may support bipartisan permitting reform.

DOMESTIC PRODUCTION INCENTIVES

Republicans may be willing to pursue tax legislation designed to incentivize sectors of the U.S. economy that are perceived to be significant to U.S. national security. A model of this concept was seen in the CHIPS and Science Act, a bill passed almost entirely to incentivize the production of domestic semiconductors. This bill included a new investment tax credit for taxpayers that invested in new equipment to outfit U.S. semiconductor production facilities.

Both parties have already demonstrated a willingness to pass new tax incentivizes for myriad industries, and this type of legislative effort could be messaged as an attempt to limit Chinese influence in key U.S. production sectors. Through this lens, there may be sufficient bipartisan support to at least consider tax credits for domestic research and production in various sectors.

Shift to a Regulatory Agenda for the Biden Administration

Unless Democrats maintain control of both chambers, which is looking highly unlikely, without control of both chambers of Congress, the Biden administration will be largely unable to pursue the remainder of its partisan policy objectives through legislation. In lieu of legislative action on tax policy, Biden will likely increase focus on providing policy through executive orders and new Treasury Department and IRS guidance. This approach mirrors the Obama administration's shift to executive rulemaking after Democrats were locked out of Congress following the 2014 midterm elections.

On Nov. 4, Treasury Assistant Secretary for Tax Policy Lily Batchelder published the agency's Priority Guidance Plan for the 2022-2023 tax year, previewing the administration's tax regulatory agenda for the 118th Congress. Included in the 205 proposed guidance objectives were projects to renew focus on limiting aggressive estate planning tactics, as well as to clarify the taxation of digital assets, including cryptocurrency. The plan also includes a host of projects to implement the new Inflation Reduction Act energy provisions, providing an opportunity to press the boundaries of the Treasury Department's regulatory authority and resolve ambiguities in favor of the administration's climate-change agenda. On Oct. 14, the IRS also announced the start of 2024 as the tentative deadline to publish all final regulations concerning provisions included in the Setting Every Community Up for Retirement Enhancement (SECURE) Act that was signed into law as part of the 2020 federal budget.

Of course, the Treasury Department's ability to pursue a broader regulatory agenda may be somewhat curtailed by the fact that it must also release guidance on a host of recent legislation including the new energy tax credits, the new corporate book profits minimum regime, and the new stock buyback excise tax, all while struggling with staff shortages. To date, the Treasury Department has released almost no information on a potential timeline for when the public may expect guidance concerning the majority of the IRA's tax provisions.
