Post-Election Tax Policy Scenario 3: A Divided Government

By **Russell Sullivan, Greg Janssen and Daniel Joseph**

Two very different tax philosophies are on the ballot this election. Republicans view tax cuts as an important tool for generating economic growth, as embodied in President Donald Trump's signature law, the Tax Cuts and Jobs Act. The Democrats favor a broader economic platform, "build back better," and candidate Joe Biden's view is that a better economy is one that addresses income inequality.

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In this three-part article, we discuss possible scenarios that will influence how tax policy unfolds after the votes are counted.

The first installment assumes that Republicans retain the presidency and the U.S. Senate, and flip the U.S. House of Representatives, gaining full control of both the legislative and executive branches. We discuss the issues that would be part of the GOP tax policy agenda, for example extending the tax cuts included in the TCJA currently set to expire, and other issue areas, as well as the dynamics of potential budget reconciliation legislation.

The second installment assumes Democrats sweep the House, Senate and the White House. We discuss Biden's economic and tax policy, what is likely to be on the legislative agenda to carry it out, and difficulties that may arise attempting to lower taxes in the wake of pandemic-related government spending.

The third installment looks at scenarios of divided government: (1) a continuation of the status quo or (2) the continuation of a Republican Senate and Democratic House, and the White House flipping to Democratic control. We discuss how this might impact tax aspects of COVID-19 relief legislation, domestic research and manufacturing, legislation to encourage retirement savings, U.S. participation in the international tax arena and infrastructure spending.

While there are several ways that the election could produce a divided government, the two most likely scenarios are as follows: the continuation of the status quo or a Biden presidency with a Republican Senate — with Democrats in control of the House in both scenarios.

In a divided government, only consensus tax legislation can be enacted. Democrats will prevent Republicans from making the 2017 Tax Cuts and Jobs Act,[1] permanent without major concessions. Conversely, Republicans will temper Democrats' ability to raise taxes for high-income individuals and corporations.

Although obstruction and the status quo may be the name of the game in a divided government, areas of common ground between the parties are possible, especially around a COVID-19 relief package, spurring domestic research and manufacturing, pension and retirement savings, the international battle against foreign-government overtaxing of U.S. companies, and infrastructure.

COVID-19 Package

Negotiators have hit pause on discussions for a COVID-19 package before Election Day. Not only do Republicans and Democrats disagree on many of the substantive provisions of COVID-19 relief, there is also disagreement on the amount of such relief, with Democrats' latest $2.2 trillion proposal dwarfing the scaled-down, skinny $500 billion Senate Republican proposal.

Since lawmakers are signaling that no deal will be reached prior to Nov. 3, the chances of a package during the lame duck session become slimmer, unless economic indicators crumble. However, a recent statement by House Speaker Nancy Pelosi, D.-Cali., highlights her hopefulness that a relief deal may be reached before the end of the year.

However, several bipartisan tax proposals are possible for an early 2021 package. Expect compromise legislation to include the following:

- Credits for hiring and retaining employees, including an expansion of the employee retention tax credit;
- Tax credits for businesses for the costs of adapting to COVID-19, such as a cleaning and workplace reconfiguration credit;
- Various liquidity proposals for businesses, including a second draw of the Paycheck Protection Program;
- Another round of economic impact payments; and
- Enhanced unemployment benefits.

Enactment of these provisions will save tens of thousands of small businesses and nonprofits that would otherwise shut down.

While it is expected that a COVID-19 relief package will also keep the unemployment rate on a downward trajectory, the ultimate amount of the relief package could play a large role, as Federal Reserve Chairman Jerome Powell and Board of Governors member Lael Brainard have noted that there is greater risk to the economy from Congress doing too little than too much, and that too little support would lead to a slower and weaker economy.

Domestic Research and Manufacturing

For some time, U.S.-based companies have arranged their business structures to conduct certain activities overseas — such as research and development and manufacturing —

causing the U.S. to lose jobs in these areas. The COVID-19 pandemic exposed America's reliance on foreign supply chains. Shortages of U.S. testing kits, personal protective equipment and medical supplies took months to rectify.

Both parties have suggested tax incentives for moving research and development and manufacturing to the U.S. Biden intends to implement tax code changes to encourage domestic production. His made-in-America tax policy would establish a 10% tax credit for companies making investments designed to create manufacturing jobs for American workers.

This 10% credit is combined with Biden's proposed 10% offshoring penalty surtax and requiring the federal government to purchase products made in the U.S.

Similarly, Trump has announced plans to create a credit for companies that bring jobs back to the U.S. from China. Republican proposals also seek to incentivize innovation by doubling existing research and development tax credits, and allowing accelerated expensing cost deductions for certain projects.

However, a stick comes with the carrot, and Trump plans to impose tariffs on companies that do not bring jobs back to the U.S. and to prohibit federal contracts for companies that outsource to China.

Although the parties differ on the appropriate tax rate for corporations and foreign subsidiaries of U.S. firms, they do agree that a plan to bolster and reshore research and development and manufacturing jobs is imperative to maintaining the nation's leadership in innovation.

This was seen most recently in May of this year through a bipartisan proposal — the Endless Frontier Act — from Sens. Todd Young, R-Ind., and Chuck Schumer, D-N.Y., which would provide funds for regional tech hubs to ensure new research investments translate into new American manufacturing and high-tech jobs, and promote investment in advanced manufacturing.

Since there is bipartisan support for addressing this issue, the larger question is whether these changes would affect business decisions beyond the margins. Companies locate their research and manufacturing on a matrix of factors, including resource and customer proximity, workforce availability and costs, regulatory environment and taxes. It is not clear that any one of those alone can persuade a company to move operations.

Pension and Retirement

There is bipartisan support for pension and retirement legislation, though there is no bipartisan agreement other than general consensus that pensions and retirement should be addressed.

In the House, Ways and Means Committee Chair Richard Neal, D-Mass., has prioritized retirement legislation. Despite passing the Setting Every Community Up for Retirement Enhancement Act — bipartisan legislation intended to help Americans prepare for retirement — in December 2019, Neal is preparing additional legislation with ranking member Kevin Brady, R-Texas.

Neal is hoping to accomplish a number of goals through the retirement legislation push, including allowing workers to carry benefits when they switch jobs and raising the age threshold for required minimum distributions from traditional individual retirement accounts — to help workers who face an increased risk of outliving retirement assets.

Bipartisan retirement legislation in the Senate is also emerging in the form of the Retirement Security and Savings Act, proposed by Sens. Rob Portman, R-Ohio, and Ben Cardin, D-Md. Some bipartisan proposals from the Retirement Security and Savings Act include a refundable version of the saver's credit for low-income taxpayers and provisions that would allow taxpayers, after reaching age 60, to contribute larger amounts to certain retirement plans on an annual basis.

There is broad congressional recognition of the retirement-savings challenge in America, so increasing financial education and strengthening retirement security continues to have bipartisan support. All of these bipartisan bills expand choices and flexibility within our nation's employer-sponsored defined-contribution plans and individual savings programs.

Organization for Economic Cooperation and Development

International negotiations aimed at implementing a global digital tax strategy stalled after U.S. Treasury Secretary Steven Mnuchin requested, in June, that negotiations be put on hold so countries could focus on responding to the coronavirus.

The request was not well received and increases the likelihood that other countries will move forward with their own digital tax proposals. In fact, France announced in October that as a result of failing to reach a global strategy, it will move forward with — and not suspend — collecting digital taxes from technology companies this year.

Biden's tax proposals to increase the global intangible low-taxed income tax and apply it on a country-by-country basis could align with the Organization for Economic Cooperation and Development's plans. Republicans have warned that an increase in GILTI would impede U.S. companies' ability to compete globally.

However, Republicans and Democrats do agree that any OECD global minimum tax proposal needs to be fair to U.S.-based companies. Although it is not expected that countries will return to negotiations before 2021, there will be bipartisan support to oppose any taxes unfairly imposed on U.S. enterprises.

Until a global solution is reached, it is expected that the U.S. will levy additional import taxes on countries that impose their own digital services tax, as the U.S. has done with respect to certain French imports in response to France's digital services tax.

Infrastructure

Historically, in crafting infrastructure legislation, Congress has responded with bipartisan and consensus-driven solutions to create jobs, and maintain the health and safety of communities. Lawmakers recently reauthorized the Fixing America's Surface Transportation Act for one year through Sept. 30, 2021.

On July 1, the House passed the Democrats' Moving Forward Act, a $1.5 trillion comprehensive infrastructure package that includes investments in schools, housing, broadband, green energy and child care, and includes financing mechanisms for reinstating Build America Bonds and advance refunding bonds.

The Senate Environment and Public Works Committee approved $287 billion for the

America's Transportation Infrastructure Act in August 2019, but this measure has since stalled because it lacks a funding title.

In light of the pandemic, infrastructure spending can create near-term employment opportunities and help attract long-term investment to blighted areas, spurring economic development. This makes infrastructure legislation a priority for potential compromise legislation in 2021.

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[1] Tax Cuts and Jobs Act, 115 P.L. 97.