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Washington's Fight Over Taxes Is Only Beginning

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By JIM TANKERSLEY
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WASHINGTON — Never mind that "once in a generation" tax bill that just passed last year. Congress is headed for years more of big fights over taxes, particularly those for individuals.

That tax battle is a byproduct of America's polarized political climate and of the go-it-alone choices Republicans made to speed the 2017 law through Congress in less than two months.

It is already complicating tax planning for companies and workers around the country, particularly in high-tax states like New York, Maryland and California, where lawmakers are actively pursuing workarounds for some provisions of the new federal law that limit state and local income and property tax deductions.

It's only going to get messier.

"This legal regime is very unstable; Congress has created many, many problems," both in the substance of the bill and the exclusion of Democrats in enacting it, said Rebecca Kysar, a professor and tax expert at Brooklyn Law School. "All of those dynamics are going to make for a very uncertain landscape going forward."

Democrats are evaluating how to "repeal and replace" the law, very likely by trying to keep breaks for the middle class but rolling back those for the rich and corporations. Party strategists expect that a replacement tax bill would be a top priority for Democrats if they manage to retake Congress in the fall, and a common cry for the party's 2020 presidential contenders.

"If Democrats run from this fight, they will end up regretting it," said Nicole Gill, executive director of Tax March, an advocacy group that is rallying Democrats and voters to oppose the law. "The fundamentals are on our side on this, and we need to talk about it."

Even if the law survives those challenges, trouble lurks in the years to come. Nearly all of the law's tax changes for individuals — including a nearly doubled standard deduction and the $10,000 cap on state and local tax deductions that has outraged blue-state legislators — are set to expire at the end of 2025, and so are some major provisions for businesses. Others won't adjust for inflation, resulting in growing tax pain for some families in the years ahead.

Republicans have already discovered drafting errors in the law that will need to be fixed by Congress or the Internal Revenue Service's rule-makers. And as annual federal budget deficits rise toward $1 trillion, a threshold they could cross this year, pressure may mount on both parties to tweak the tax code further to avoid adding more to the national debt.

It all adds up to an uncertain future for any company or worker trying to plan around their tax liabilities for the next few years, at least.

“This is anything but tax simplification,” said Jeffrey C. LeSage, the Americas vice chairman of KPMG’s tax practice. “I don’t personally see us coming back to the rates that we’ve had, historically, on the corporate side. On the individual side, who knows?”

An old Washington axiom is that Congress passes a major tax overhaul once every 30 years. By that logic, the sweeping 2017 tax law, which was raced through Congress by Republicans before it was signed in late December by President Trump, was right on time. It came 31 years after the bipartisan tax reform of 1986.

But the similarities between the two efforts end there.

Bipartisan majorities in a divided Congress passed the 1986 law and, with plenty of Democratic support, President Ronald Reagan, a Republican, signed it. That legislation reduced individual tax rates by closing loopholes and raising corporate taxes, and it was designed not to add to the deficit.

By contrast, Republicans pushed the 2017 law through without a single Democratic vote, making use of a parliamentary maneuver called budget reconciliation. The law cuts the corporate rate to 21 percent from a high of 35 percent, while closing relatively few business loopholes.

It limits the amount of state and local taxes that workers can deduct, particularly workers in highly taxed, traditionally liberal states.

The new law creates ambiguities with a special deduction for some — but not all — so-called pass-through businesses, whose profits are distributed to owners and taxed under the individual code. That provision allows some professionals, like architects, to claim a 20 percent deduction on income earned through a pass-through — but it doesn’t allow lawyers or accountants to claim it. Tax professionals are nowhere close to consensus on who qualifies for it.

Furthermore, the law does not reduce America’s growing national debt. To the contrary, the Joint Committee on Taxation estimates that the law will add more than $1 trillion to federal deficits over 10 years.

All of those factors raise questions about the law’s future, particularly if Democrats retake control of Congress. In January, only a few days after Mr. Trump signed the law, a leading economist, Jason Furman, told an audience in Philadelphia that now, more than ever, the country needed real tax reform. Mr. Furman, who was chairman of the Council of Economic Advisers in the Barack Obama administration, has since written an op-ed calling on Democrats to “repeal and replace” the law.

For individuals, a repeal push could add confusion to an already murky transition to the new law.

The Trump tax overhaul eliminated personal exemptions that taxpayers may claim for themselves and their dependents, but it added a larger standard deduction and an expanded child tax credit. It reduced the cap on the mortgage interest deduction for newly purchased homes, and it limited state and local tax deductions to $10,000 a year — a number that will not rise with inflation.

As the law is written, those changes are set to vanish at the end of 2025 — reviving the old system and tax rates for individuals — unless Congress extends them.

But lawmakers in several states are trying to effectively invalidate some parts of the law well before then. They are pushing legislation that could allow higher-earning individuals to bypass the limits on state and local tax deductions.

One proposal would allow individuals to give “charitable contributions” to schools or other branches of government and see their taxes reduced accordingly. Another would convert state income taxes to an employer-side payroll tax, which would still be deductible on federal tax returns.

The state and local tax deduction seems particularly ripe for congressional fighting in the months to come. Many conservatives still want to eliminate it entirely. Many Democrats — and some blue-state Republicans — want to restore it in full. The outcome matters most for upper-income taxpayers in higher-tax states, some of whom may be tempted to move if the deduction is scrapped permanently.

Prominent conservative Republicans in the House have already introduced legislation that would affect a much broader spectrum of taxpayers by making the individual cuts in the new law permanent.

“American families deserve better than the uncertainty that comes along with waiting for future solutions,” Representative Mark Meadows of North Carolina, who heads the conservative House Freedom Caucus, and Representative Rodney Davis of Illinois wrote in The Hill after introducing that bill. “It’s on the current Congress to pass legislation now to give working families the long-term security they need.”

Democrats had a chance to vote for amendments on the 2017 bill that would have made those cuts permanent, but did not.

It’s not clear if Congress can even agree to fix glaring problems in the new law, including a provision that unintentionally gave agricultural cooperatives a big advantage over their larger competitors.

It’s also not clear how much leeway the I.R.S. will have to close loopholes in the law, such as one recently discovered by hedge fund managers, who may use it to reduce their liability for the “carried interest” paid to them from investment fund returns.

“Over the next year, or more, there’s going to need to be more guidance,” said Joseph Perry, the tax and business services leader at the accounting firm Marcum. “I think it’s going to be very interesting.”

Interesting for tax professionals, yes. But for workers and companies, it could prove infuriating — and endlessly so.

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