April 13, 2022

WHAT YOU NEED TO KNOW ABOUT

Tax Policy and the Midterms

PRO POINTS

- **Whether Democrats can enact a measure to raise taxes** on the rich and corporations before themidterms will have a big impact on tax policy through November and beyond.

- **If Republicans win control of at least one chamber in the** midterms, as expected, there likely won't be much in the way of tax legislating over the next two years.

- **What will be on everyone's mind in the tax world: The end** of 2025, when the individual provisions from the Republicans' 2017 tax cuts expire, which will almost certainly prompt intense negotiations over their future.

HOW WE GOT HERE

It's been a busy 15 months for Democrats since they gained full control of Washington —including passing a big coronavirus response package that, among other things, greatly expanded the Child Tax Credit.

But so far, Democrats have fallen short on the central focus of their domestic agenda — a bill that, in the most recent vision, would hike taxes on the wealthy and corporations, install new climate provisions and reduce deficits.

Senate Democrats are about to try once more to get that measure across the finish line — and if they're successful, that would clearly have ripple effects on Washington's approach to tax policy during the next Congress and beyond.

But it's also not just solely a question of if. How Democrats might finally craft that legislation could also affect future efforts at lawmaking, particularly given that Republicans could easily win control of both the House and Senate in November.

The Democrats' current budget reconciliation measure does not increase the top rate on individual income and the corporate rate, which Republicans set at 37 percent and 21 percent, respectively, in their 2017 tax law.

That's because Sen. Kyrsten Sinema (D-Ariz.) balked at the original Democratic proposal, which would have increased those rates to 39.6 percent and 28 percent, respectively. Meanwhile, Sen. Joe Manchin (D-W. Va.), who undercut the House-passed version of President Joe Biden's Build Back Better agenda late last year, has said that he would like any Democratic bill to roll back tax cuts the Republicans made in 2017.

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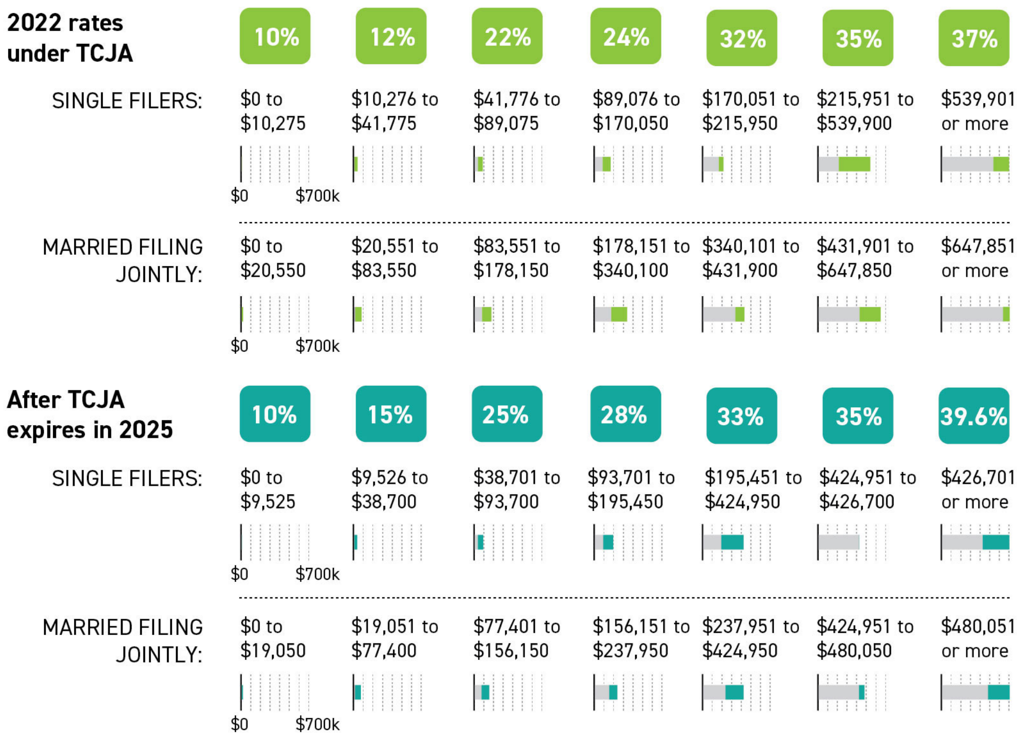
Tax Cuts and Jobs Act income tax rates expiring in 2025

Income tax rates indexed to inflation, which went into effect in 2018 via the Tax Cuts and Jobs Act, are set to expire in 2025 and revert back to pre-2018 levels.

Individual income tax rates

Rate of income tax filers pay based on taxable income level, indexed to inflation



Sources: Tax Policy Center, IRS

There's more, too. The Democrats' bill could reverse a change from earlier this year, which forces companies to write off research expenses over five years. Business advocates have been lobbying furiously to allow companies to once more immediately expense those costs, and have been eyeing a number of other potential vehicles this year, too.

And then there's the global tax deal that was struck last year, in large part due to the efforts of the Biden administration. The Democrats' bill would also update an existing global minimum tax, known as the levy on global intangible low-taxed income, or GILTI, to meet some of the new requirements put in place by that agreement.

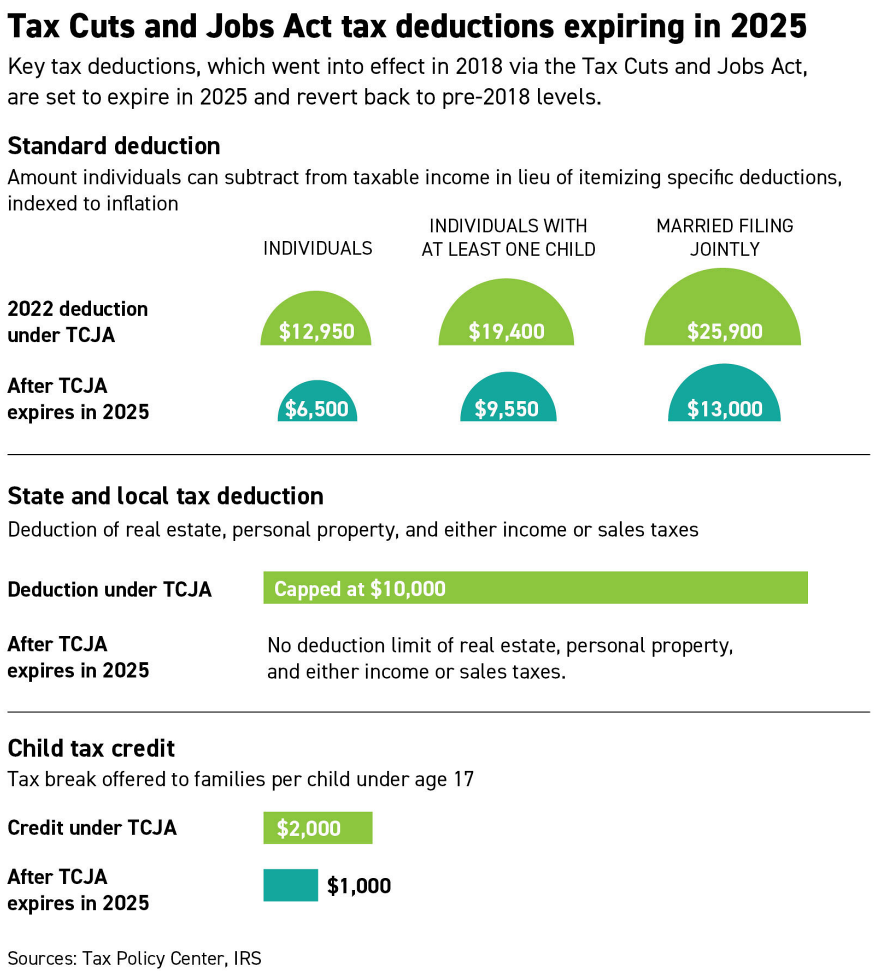
For their part, Republicans oppose basically all those proposed changes, except for allowing businesses the more generous deductions for research and development.

WHAT'S NEXT

It's not even a dirty little secret. After this year, the biggest looming piece of tax legislation will still be three years away.

Republicans crafted their 2017 tax law so that a wide range of individual tax cuts — including that top rate on individuals — would expire after eight years, something they did to help comply with the same Senate budget rules that Democrats currently are grappling with.

Other key individual provisions set to expire at the end of 2025 include a separate expansion of the Child Tax Credit, an enlarged standard deduction, limits on the federal deduction for state and local taxes, and a tax cut for so-called pass-through businesses, which pay taxes through the individual system.



That means that the 2024 election, not 2022, looks to be more important for the future of tax policy. In fact, the 2024 election could set up a situation similar to the 2012 election, in which President Barack Obama won re-election and Democrats retained control of the Senate — giving Democrats the upper hand in the fiscal cliff at the end of that year.

Biden has said that he will seek a second term in 2024, and control of Congress would be up for grabs again that year — though if the current projections hold, Republicans could enter that November with at least a healthy majority in the House.

Either way, the next three years after the 2022 elections will involve a lot of positioning between the two parties. Both Democrats and Republicans likely will agree to extend tax cuts for the middle-class, something Biden has defined as everyone making up to $400,000 a year.

The big fight, then, will be over tax cuts for higher earners. Republicans have already started making the case for extending all of the individual provisions from the 2017 Tax Cuts and Jobs Act, while the Democrats' approach to tax-hiking this year suggests that they'll push hard to let the tax cuts at the top end expire.

In the meantime, other tax issues will certainly pop up. Republicans and Democrats certainly could come together this year on a post-election tax bill, which could revive a number of the temporary tax provisions known as tax extenders. The proposal to bring back immediate expensing on research costs could end up in a year-end bill too, if the Democrats don't end up doing a major tax measure in the coming weeks.

More issues with the global tax deal could come before Congress, too, though those potential changes would face even more questions under any chamber controlled by Republicans. One big issue still to come: One part of the global agreement seeks to move away from taxing dozens of multinational corporations based on where they're headquartered, and more toward where their business is located.

Senate Republicans have said complying with that part of global tax deal requires changing tax treaties — a very difficult task, considering that takes 67 votes. Biden's Treasury Department has said it believes changing tax treaties won't be necessary.

POWER PLAYERS

President Joe Biden: The president seems likely to find himself in a weakened position after the midterms, on taxes and other issues. But that doesn't mean that Biden will necessarily moderate his approach on taxes in the next couple years, at least politically speaking. Biden hasn't wavered at all from his rhetoric on taxes, and still regularly speaks out on his desire to hike taxes on the rich and big businesses who he says aren't paying enough. In fact, his pollster and other top Democrats believe that the party will benefit if their candidates continue to pound the table for taxing the rich.

Senate Minority Leader Mitch McConnell and House Minority Leader Kevin McCarthy: Republicans have historically been the party of low taxes, and both McConnell and McCarthy continue to voice support both for the Tax Cuts and Jobs Act and against Democrats' efforts to raise taxes this year. But it's also true that taxes haven't been a particularly central topic for Republicans as they try to seize back control in Congress, with much of the party's message focusing on more cultural issues. It feels certain that Republicans will be willing to fight to extend the TCJA's individual tax cuts, but just how much of a public priority it will be over the next two years remains to be seen.

Sen. Mike Crapo (R-Idaho), Rep. Vern Buchanan (R-Fla), Rep. Adrian Smith (R-Neb.) and Rep. Jason Smith (R-Mo.): House Republicans certainly will have someone new atop Ways and Means come January, with Rep. Kevin Brady of Texas — who has been either chair or ranking member for the last almost six-and-a-half years — retiring at the end of the year. Brady has been a key messaging force behind the TCJA. But it's unclear both who will replace Brady, and how well they'll fill his shoes — particularly if Buchanan or Smith graduate straight to being Ways and Means chair. Crapo currently is in his first Congress as the top Republican on the Senate Finance Committee, and could also take over as chair in 2023 following a GOP victory. The Idaho Republican has led GOP tax writers in asking sharp questions about the global tax deal, while also working across the aisle with Democrats on proposals to incentivize semiconductor production.

Treasury Secretary Janet Yellen: Yellen has been the public face for much of the Biden administration' s work on taxes these first 15 months. She and other senior Treasury officials were in many ways the driving force behind reaching the global tax agreement, after years of trying and after the Trump administration made it clear that they took a fairly dim view of the effort. It's also possible that Yellen and the department could become more active with rules and regulations should Republicans take back some control in November. For instance, Obama's Treasury tried to target so-called corporate inversions, in which U.S. companies changed their country of residence, by regulations late in his second term.