PRO ANALYSIS

WHAT YOU NEED TO KNOW ABOUT

The Next Steps on Tax Reform

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PRO POINTS

- **The 2017 GOP tax law forces three more changes** to the tax system over the next two years, the first major revisions caused by the Tax Cuts and Jobs Act, or TCJA, since it was enacted. They will have a major effect on businesses.

- **Lawmakers prepared for those changes in December** by pushing forward some temporary tax incentives.

- **But Washington still has some time — until the end of** 2025 — before most of the temporary tax provisions in the TCJA come up for extension.

HOW WE GOT HERE

Republicans couldn't make all of their tax cuts permanent when they passed the 2017 tax law, because of congressional budget rules.

Their solution was to make major portions of the law expire at the end of 2025, essentially setting up yet another fiscal cliff which could lead to families and businesses paying billions of dollars more in taxes.

That process actually starts to heat up over the next two years, as three separate provisions either start getting phased in or go into effect. All three of those provisions are important to the business community, so they could easily play a role in driving the next congressional deal involving temporary tax policies.

If Congress doesn't act, businesses will no longer be able to immediately deduct certain research and development costs after the end of this year and instead will generally have to write them off over five years.

At the same time, companies would also face further limits on their ability to deduct the interest paid on their debt, because the deduction cap will be measured against a stricter metric for income.

And beginning in 2023, businesses will start to slowly lose their ability to immediately write off a broad range of investments, with the more favorable depreciation schedules in the TCJA phasing out entirely in 2027. Still, that's a mere appetizer compared to what expires at the end of 2025.

Republicans were able to make many of their corporate tax cuts permanent in the 2017 tax law, including the 21 percent rate. But a wide range of individual policies are scheduled to lapse in less than five years, including lower individual rates, the larger standard deduction, a more robust Child Tax Credit, the 20 percent deduction for pass-through businesses and the $10,000 cap on deducting state and local taxes.

In its most recent year-end tax deal, Congress also pushed some temporary tax incentives, commonly referred to as "extenders," generally to either the end of 2021 or all the way to the close of 2025.

Key individual income tax credits and deductions expiring in 2025

Measure	Change to occur in 2025
Itemized deductions	The cap on itemized deductions — known as the Pease limitation — will be reinstated.
Child tax credit	The increase in the refundable tax credit (from $1,000 to $2,000 per child under 17) will expire.
SALT deduction	The $10,000 cap on the deduction for state, local and property taxes will be repealed.
Charitable contributions	The increased cap on the charitable contribution deduction will revert to 50 percent of adjusted gross income.
Mortgage interest deduction	The reduced cap will increase to pre-TCJA level, to allow a deduction for interest on the first $1,000,000 of mortgage debt.

Sources: Congressional Research Service; Tax Foundation; Tax Policy Center

Overarching individual tax provisions expiring in 2025

Measure	Change to occur in 2025
Individual rates	Individual income tax rates will return to pre-2018 levels.
Standard deduction	The standard deduction will be reduced to the pre-2018 level, decreasing to $6,500 for individuals and to $13,000 for couples filing jointly.
Pass-through deduction	The deduction for up to 20 percent of pass-through income will expire.
Alternative Minimum Tax	The reduction in the AMT will expire. The TCJA raised the exemption, which reduced the number of filers who had to pay the AMT.
Estate tax	The reduction in the estate tax will expire. Under the TCJA, the exclusion was roughly doubled from existing levels and indexed for inflation.

Sources: Congressional Research Service; Tax Foundation; Tax Policy Center

WHAT'S NEXT

The Democrats' recent election victories in Georgia, allowing them to control an evenly divided Senate with Vice President Kamala Harris as tie-breaker, adds more uncertainty to what will happen on tax policy in the next two years.

A Republican Senate would have closed off any chance for tax increases on the rich and corporations. But Democrats and President Joe Biden now have a chance to push for at least some tax hikes in 2021 and 2022 by using the same budget rules that the GOP used to pass the 2017 tax law, and they are also advocating at least temporary expansions of refundable tax credits.

Still, the business lobby clearly wants to avoid the three tax law changes — all of which will hit companies' bottom lines — that will start happening over the next two years, which means they will almost certainly be in the mix for some kind of tax deal before the end of next year.

It's also true that lawmakers in both parties support heading off the less generous policies for expensing, writing off research costs and the interest deduction.

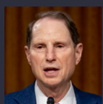
But as they were putting together last month's tax bill, some Democrats were already privately looking ahead to the next potential year-end agreement and predicting they would seek some kind of concession in return for staving off those three changes caused by the Tax Cuts and Jobs Act.

It's too soon to know what trade-offs Democrats might seek, or when a package could come together. But in addition to the tax law changes, both parties also have temporary tax incentives that expire over the next two years that they would like to extend — think clean energy provisions for Democrats, for instance.

One potential outcome, according to people monitoring this situation: All or most of the temporary tax policies that Congress might deal with over the next two years get pushed to the end of 2025, which would then line them up with all the expiring individual tax provisions from the Tax Cuts and Jobs Act.

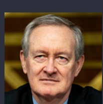
If they chose that route, the Biden administration and lawmakers wouldn't be adding all that much, comparatively, to the cost of the policies expiring at the end of 2025, which could eventually add up to trillions of dollars. It would also reinforce that, whatever happens over the next two years, the biggest negotiation over expiring tax policies almost certainly wouldn't happen until after the next presidential election.

POWER PLAYERS



Sen. Ron Wyden, *soon-to-be Finance Committee chair*

Wyden is no stranger to debates over expiring and temporary tax policies, having been a key player in those negotiations since the Obama administration. He also has already said he will seek reelection next year, meaning he is quite likely to be in the middle of the talks through 2025 over expiring TCJA policies. The Oregon Democrat has complained about the continued start-and-stop manner in which Congress deals with the tax extenders but also is a big fan of a lot of the temporary incentives — particularly for clean energy. He has also historically backed incentives for research and development, while criticizing most aspects of the TCJA.

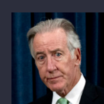


Sen. Mike Crapo, *soon-to-be Finance Committee ranking member*

Crapo will become the top Republican on the Finance Committee for the first time this year, and tax observers around Washington view him as a pretty standard-issue conservative on matters like tax cuts. Still, Crapo is also viewed as something of a blank slate on a lot of tax matters, though he was a strong supporter of the Tax Cuts and Jobs Act. The Idaho Republican also has some favorites among temporary tax incentives — one, a credit to help short-line railroads that Crapo has worked on with Wyden, just became permanent. Another variable here: Crapo is also up for reelection in 2022, and there's a decent chance he could be Finance chair when the TCJA-sparked fiscal cliff hits at the end of 2025.

Janet Yellen, *Treasury secretary-designate*

Treasury secretaries are frequently in the middle of debates about expiring tax policies — look no further than Steven Mnuchin or even Jack Lew, going back to the Obama administration. Yellen, a former Fed chair, joined other prominent economists in knocking the TCJA shortly after it was enacted for racking up more debt. But she sounds less concerned about deficits now, given the low interest rates and economic problems sparked by the coronavirus. Still, while Yellen can likely be counted on to play a key role in tax debates over the next two years, it's far from clear whether she would still be in that role come 2025 — even if Biden wins a second term.



Richard Neal, *House Ways and Means chair*

Neal, who is now entering his second term as the House's top tax writer, has long been viewed as more business-friendly than many other Democrats in Congress. (It's one of the reasons he got a prominent primary challenge last year.) And yet, Neal has also been a sharp critic of the 2017 tax law, while also being generally supportive of incentives for research and generous expensing provisions, along with extenders like the New Markets Tax Credit. As with the Senate Finance Committee, it's also far from clear who will be Ways and Means chair when the expiring TCJA provisions really escalate in 2025.

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