Alert
May 24, 2022

COZEN O'CONNOR

Cozen Currents: Democrats Continue to Face Uphill Battle Despite GOP's Unforced Errors

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The Cozen Lens

- The 2022 midterm elections are so far unfolding as one would expect for a referendum on the party in control of power. But intra-party dynamics and the prevalence of Trumpism could leave Republicans making unforced errors in key races.
- Sixteen months into Joe Biden's presidency, his biggest legislative accomplishment is the passage of the $1.2 trillion bipartisan Infrastructure Investment and Jobs Act. Implementation of the law is now in full swing. Funding is flowing and the Biden administration is developing rules promoting the president's labor and "Buy American" priorities in infrastructure spending.
- Whether or not Democrats can get a reconciliation package over the goal line this year, there are several meaningful tax provisions, some new and some extensions of ones set to expire, that still have a reasonable chance of passing on a bipartisan basis.

What Have We Learned from the Primaries So Far?

The House: National dynamics leave Democrats looking to salvage what they can in the House as intra-party fights continue apace.

- Democrats are playing musical chairs on a sinking ship. Rep. Sean Patrick Maloney (D-NY), the chair of the Democratic Congressional Campaign Committee, switched to running for reelection in his Biden +8.5 district to a new Biden +10.1 district last week. You know Democrats are in trouble when the campaign chief is worried about his reelection in a Biden +8.5 district.
- The Republican establishment can influence elections, but there's a limit. The scandal-plagued Rep. Madison Cawthorn (R-NC) last week lost his primary against an establishment-backed challenger. House Minority Leader Kevin McCarthy (R-CA) has had success in recruiting and supporting top-tier candidates in open and competitive districts. But success is far from 100 percent. Republicans were unable to stop a controversial candidate from winning the Republican primary in NC-01. A Republican who supports QAnon conspiracies and was at the Capitol Insurrection won the nomination for OH-13. Both are competitive districts that Republicans could win with generic candidates, but face challenges with controversial ones.
- The presidents don't have the final say in a race. President Trump endorsed Cawthorn, who lost. President Biden endorsed the moderate Rep. Kurt Schrader (D-OR), who is very likely to lose to a progressive challenger when all the votes are counted.
- Trumpism is here to stay as Democrats continue to fight over their direction. Republican primaries are battles over different gradients of Trumpism as the "progressive" vs. "moderate" battle among Democrats continues. While moderates have a better track record than progressives, the latter have scored real wins this year. More importantly, it's the moderate House Democrats who are retiring and facing the biggest reelection

The Senate: The national dynamics plaguing House Democrats also are hurting Senate Democrats. But individual races and candidate quality are larger factors to determine control of the upper chamber.

- There are no "Biden Democrats" winning in the Senate this year. Democratic incumbents have made a point to put distance between themselves and the president. Lt. Governor John Fetterman (D-PA) beat the more Biden-esque candidate in Rep. Conor Lamb (D-PA) in the Pennsylvania primary. Despite being shunned by the Democratic Senatorial Campaign Committee six years ago in the Senate primaries, Fetterman this year is being hailed as a populist brand that can play well where a Biden brand can't.

- There are only Trump candidates winning in the Senate this year. Former football star and Trump-ally Herschel Walker will decisively win the Georgia primaries today. In Pennsylvania, the vote count between Mehmet Oz and David McCormick remains too close to call. Both Oz and McCormick sought to be in Trump's good graces, with the former president choosing Oz in the end.
- The Republican establishment has gotten lucky (so far). Senate Minority Leader Mitch McConnell (R-KY) breathed a sigh of relief when the controversial conservative Kathy Barnette was running a distant third to Oz and McCormick. Democrats can't win 2022 but Republicans can lose it with controversial candidates. To that end, Republicans aren't out of the woods yet, with potential challenges in Arizona and Missouri and the opposition playbook against Walker in Georgia being fully unleashed.

The States: Trump's unsubstantiated grievances around the 2020 elections are playing a central role in the 2022 midterms. But what Trump cares about, many voters shrug or oppose.

- The states are ground zero for Trump's "Big Lie." It's state legislatures, governors, and secretaries of state holding sway over election administration.
- Trump is going to face his biggest loss in Georgia (again). After losing Georgia in 2020 and the two Trump-backed incumbents losing the Georgia Senate runoffs in 2021, his endorsed candidate for governor, David Perdue, is on track to handily lose to incumbent Governor Brian Kemp (R-GA) today. This will be the third gubernatorial primary a Trump-backed candidate has lost after Nebraska and Idaho.
- Democrats are leaning into running against Trumpism. In Pennsylvania, Democratic Attorney General Josh Shapiro ran ads against (or rather for) state Sen. Doug Mastriano (R-PA) before last week's gubernatorial primaries. Shapiro is eager to run against the "stop the steal" Mastriano, who is causing heartburn among Pennsylvania Republicans.

How Goes the Buildout of the Bipartisan Infrastructure Law?

Update on Funding. About six months after the passage of the Infrastructure Investment and Jobs Act (IIJA), federal spending is well underway.

- To mark the law's six-month anniversary, the White House shared last week that over $110 billion in funding has been announced so far for over 4,300 projects. This funding total includes $52.5 million on federal highway spending in FY22, $20.5 billion on transit spending in FY22, $27 billion for bridges over the next five years, and $3 billion for airports this year, among others. The Departments of Transportation and Energy have announced $5 billion in funding over the next five years to support electric vehicle (EV) charging infrastructure. The White House has also released a guide to funding and projects by location.
- The Biden administration's kickoff of the law's new grant programs continues. In addition to the approximately $110 billion in funding that's been announced so far, the White House said last week that there is another $100 billion in the pipeline in the form of requests for information and notices of funding availability (NOFOs). The Commerce Department released NOFOs for broadband buildout earlier this month through the approximately $42.5 billion Broadband Equity, Access, and Deployment (BEAD) Program and a $1 billion program for middle-mile broadband.

Biden's Labor Agenda. The Democrats' major labor legislation, the Protecting the Right to Organize (PRO) Act, is stalled in the Senate. The Biden administration is looking to advance the president's pro-labor priorities though in part through federal infrastructure spending.

- The "vast majority" of IIJA spending will be subject to Davis-Bacon wage requirements, per a Department of Labor (DOL) fact sheet. The Davis-Bacon Act mandates that employers pay locally prevailing wages to construction workers assigned to projects on federal contracts. At an event hosted by Washington Post Live last week, Labor Secretary Marty Walsh highlighted the role of Davis-Bacon in his vision of job creation. "I think these projects are going to be projects that are going to create good jobs, good middle class jobs, good-paying jobs. There's prevailing wage in Davis–Bacon with these jobs. So, we want to make sure that workers working these projects get a good wage. So, I think we'll see that."

- The Labor Department has proposed a new rule that would change how the federal government determines the "locally prevailing wage" under Davis-Bacon. Currently, the DOL considers a wage to be prevailing if over 50 percent of workers surveyed earn it. In the absence of enough information, it takes an average of wage rates. The new rule would revert to the method used from 1935-1983, which had a 30 percent threshold to calculate the prevailing wage. Walsh said in a March press conference that the rule change would increase pay for approximately 1.2 million workers.
- In addition to wages, the proposed rule would also change other aspects of DOL's enforcement of Davis-Bacon. It would widen the types of work that fall under the law's purview to encompass solar panels, wind turbines, and installation of broadband and EV charging stations. The proposal would also make transportation within and between worksites covered by Davis-Bacon requirements. Finally, the new rule, if finalized, would expand the definition of "site of the work" to cover offsite locations where "significant portions" of a project take place, not just the primary worksite.
- These changes have the potential to increase costs of construction for infrastructure projects receiving federal dollars. DOL's Davis-Bacon proposal is encountering GOP pushback. A group of 14 Republican senators sent a letter to Walsh last week objecting to the changes.
- In February, Biden issued an executive order mandating that certain federal construction projects use project labor agreements, which involve the government or a contractor negotiating terms with organized labor prior to breaking ground. The Wall Street Journal reported that the executive order would apply to $262 billion in federal contracts and approximately 200,000 workers.
- The Wall Street Journal has also reported that the Departments of Transportation and Labor are collaborating to develop guidance that would favor projects that give workers the opportunity to join a union when selecting applications to receive IIJA funding. The competitive grant programs established by the law give the Biden administration discretion in choosing how to allocate federal dollars.

Biden's "Buy American" Agenda. The Biden administration has also established "Made in America" requirements for material used in infrastructure projects funded under the law.

- "Buy American" is a top priority for the president and reflects a provision of the IIJA. During his first week in office, Biden issued an executive order to promote government procurement of products made domestically, and he emphasized this issue again during an April speech in Greensboro, NC. "From Day One, every action I've taken to rebuild our economy has been guided by one principle: Made in America," the Associated Press quoted Biden. "It takes a federal government that doesn't just give lip service to buying American but actually takes action." The IIJA gives Biden an opportunity to do just that.
- Last month's memorandum released by the White House Office of Management and Budget (OMB) indicates that to meet the "Buy American" requirement, all iron, steel, and construction materials must be produced domestically. Manufactured products must also be produced domestically and the costs of the components made in the United States must exceed 55 percent of the cost of all components.
- The memo includes three exceptions to allow waivers: (1) if following the guidance "would be inconsistent with the public interest," (2) if the items to be procured "are not produced in the United States in sufficient and reasonably available quantities or of a satisfactory quality," and (3) if buying American "will increase the cost of the overall project by more than 25 percent." The OMB memo recommends that agencies tailor waivers to specific cases and requires that waivers be open to public comments, among other guidelines.
- The waiver categories seem as if they could be interpreted fairly broadly, potentially limiting the impact of this policy. Made in America requirements are an attempt to bolster US domestic manufacturing. Yet rising inflation at home could also lead suppliers to turn to cheaper foreign-produced materials and seek waivers on the basis of cost.

What Tax Changes Can Congress Really Pass This Year?

Reconciliation: Tax Hikes and SALT. There are not 60 votes in the Senate for any of the approximately $1.5 trillion in tax revenue raisers still under consideration by Democrats through the budget reconciliation process, meaning the only way these move forward is if all 50 Senate

Democrats can agree on a party-line package, particularly Senators Joe Manchin (D-WV) and Kyrsten Sinema (D-AZ).

- If reconciliation still happens, these provisions are the most likely to pass with these revenue estimates, and would garner $1.074 trillion - $1.267 trillion in tax revenue to offset the spending in the package:
  - ***Closing the tax gap ($127B-$320B)***: This would increase funding to the IRS by $80 billion to help reduce the tax gap. Even Republicans want to close the tax gap, but they oppose increasing funding for the IRS, which is not a problem for Democrats.
  - ***International reforms ($335B)***: Among other things, this would increase the global intangible low-taxed income tax (GILTI) from 10.5 percent to 15 percent, limit qualified asset exemptions, and change the calculation to a country-by-country basis. The international provisions are complex and there has been pushback to pare down the provisions among moderate Democrats, yet this is a major priority for Treasury Secretary Janet Yellen and the White House. Democrats need this policy included, otherwise the OECD/G20 deal on base erosion and profits shifting they spearheaded will fall apart.
  - ***3.8 percent NIIT for active income ($252B)***: This would extend the 3.8 percent net investment income tax (NIIT) to the ordinary course of a trade or business for taxpayers with greater than $400,000 in taxable income ($500,000 for joint filers) For one of the largest offsets, there has been little noise on extending the NIIT for active income. No news is good news, making it an ideal offset to keep in reconciliation.
  - ***Excess business loss limit ($160B)***: This would make permanent the disallowance of a deduction of business losses in excess of $250,000 ($500,000 for joint filers) for non-corporate taxpayers, with disallowed losses to be carried forward to the next taxable year. Similar to the NIIT, there has been little desire to make the excess business loss limit permanent. It's something both Republicans and Democrats have extended in the past, making it something of a revenue gimme.
  - **5/8 percent AGI surtax ($200B)**: This would apply a five percent tax on adjusted gross income (AGI) above $10 million ($20 million for a married individual filing separately) and an additional three percent tax on AGI above $25 million. Sinema did not want to raise the top income tax rate from 37 percent to 39.6 percent, but she did support an AGI surtax. Another politically appealing item but could again be subject to carve outs, including from Sinema, who may want to exclude pass-through income, for example.

- Other tax pay-fors on the table if there is either more room for spending in a reconciliation package or some of the above offsets are nixed include the below:
  - ***1 percent corporate buyback tax ($116B)***: This would impose a one percent excise tax on publicly-traded US corporations for the value of any of its stock that is repurchased by the corporation during the taxable year. Progressives and some conservatives like to chastise corporate buybacks, making it politically appealing in some circles. There is potential for it staying in if Democrats need the revenue, especially as a way to signal opposition to corporate profits during a time of high inflation. But if the revenue is not needed, it probably won't be worth its inclusion.
  - ***15 percent corporate AMT ($300B)***: This would impose a 15 percent alternative minimum tax (AMT) on adjusted financial statement income for domestic corporations with income in excess of $1 billion and for $100+ million of US subsidiaries to $1+ billion multinationals. Another provision that sought to assuage the "no rate hike" stand of Sinema, the corporate AMT is politically appealing but massively complex. A minimum book tax was tried in the 1980s but scrapped because of its complexities. There are already many questions and carve outs being sought this time around.
  - ***Section 1202 ($6B)***: This would end the special 75 percent and 100 percent exclusion rates for gains realized from certain qualified small business stock (QSBS) for those with an AGI above $400,000, reverting back to baseline 50 percent exclusion.

- Finally, if Democrats do not include an expansion of the $10,000 cap on the state and local tax (SALT) deduction in reconciliation, there will be no SALT relief elsewhere. What was once a top topic of conversation, SALT negotiations are now on the backburner. If reconciliation does come together, SALT likely would once again come to the forefront. The most important figure to watch is Senator Bob Menendez (D-NJ), a SALT champion who is not afraid to drive a hard bargain with his fellow Democrats.

If Reconciliation Fails. Some reconciliation tax provisions (and their reconciliation costs) could find a bipartisan path to passage in the interim if a partisan package fails to come to fruition.

- ***Clean energy tax credits ($325B)***: This included the extension and expansion of production tax credits (PTCs) and investment tax credits (ITCs) for clean energy projects and properties, the creation of an ITC for advanced manufacturing facilities and equipment, and the expansion of the EV income tax credit. While the universe of clean energy tax credits is smaller than $325 billion in a world without reconciliation, there is bipartisan support for extending and creating new provisions. The macro politics of clean energy is partisan, but several individual provisions attract Republican support based on jurisdictional and geographical interests.
- ***R&D expensing ($4B)***: This included delaying the start of amortization of R&D expenditures from after December 31, 2021 until after December 31, 2025. Reinstating R&D expensing is not a matter of if but when. If reconciliation fails, there's critical mass of bipartisan and bicameral support to extend it.
- ***Low-income housing development ($18B)***: This included strengthening and expanding the Low Income Housing Tax Credit and creating the Neighborhood Homes Credit to benefit developers and rehabbers of homes in distressed neighborhoods. Both of these provisions were included in the now stalled Build Back Better package and came from bipartisan bills.

Other Tax Provisions with Some Momentum. While by no means exhaustive, the following are tax policies worth watching for potential passage this year.

- ***Retirement tax benefits***: The House-passed Securing a Strong Retirement (SECURE 2.0) Act of 2022 expands automatic enrollment in retirement plans, raises the age for required distributions from 72 to 75, increases the amount and age limit for IRA catch-up contributions, and expanding options for annuities in retirement plans. The SECURE 2.0 Act passed the House on a 415-5 vote last month. It was a bipartisan and multi-committee collaboration spearheaded by House Ways and Means Committee Chair Richard Neal (D-MA) and Ranking Member Kevin Brady (R-TX). Bipartisan efforts are underway in the Senate Health, Education, Labor, and Pensions (HELP) Committee and Senate Finance Committee, with Senator Richard Burr (R-NC), the ranking member of HELP and committee member of Finance, taking a keen interest. Brady and Burr are retiring this year and see this legislation as a legacy marker for them. Some compromise version will likely pass the Senate this year, either as a standalone measure or attached to year-end tax extenders.
- ***Gig economy 1099-K***: Democrats and Republicans have introduced legislation to increase the reporting threshold requirement for payment vendors to send and gig workers to fill out Form 1099-Ks. The American Rescue Plan (ARP) lowered the threshold from $20,000 to $600, with no limit on the number of transactions. Frontline Democrats most in peril in this fall’s midterm elections are leading the charge to increase the limit from $600 to $5,000 while Republicans want to return the limit to $20,000. The measure in the ARP was opposed by all the major gig economy companies. However, the measure took effect this year, meaning it won't come front-and-center until tax season next year. This makes action unlikely until the lame duck session after the midterms. Unless Democratic leadership sees a need to ameliorate frontline members post-election (several of whom probably will be lame ducks themselves), we don't see leadership including this in a tax extenders package. Republicans could have greater leverage next year if/when they hold the majority.
- ***Interest deductibility***: Five Senate Republicans and four House members (two Democrats and two Republicans) have introduced a bill to keep the limit on net interest expenses at 30 percent of EBITDA, rather than 30 percent EBIT, which changed to the lower limit this year. Despite the TCJA provision switching to the lower EBIT limit this year, it's common for tax extenders legislation to be retroactive. This gives hope for supporters of a higher interest limit to push for an extension (albeit not permanent) of the EBITDA limit. As of now, though, there is not the critical mass of support to push its way into a tax extenders package.
- ***Bonus depreciation***: Republicans in the House and Senate have introduced the Accelerate Long-Term Investment Growth Now (ALIGN) Act to make permanent full and immediate expensing from the Tax Cuts and Jobs Act (TCJA) that will begin to phase down next year. The 100 percent bonus depreciation provision in TCJA is often one of the most heralded parts of the legislation by Republicans who are open to keeping it. However, making it permanent would cost hundreds of billions of dollars. The more feasible option is a temporary extension.

It is a priority for Republicans but Democrats probably wouldn't agree to it without a real progressive concession. The bonus depreciation decreases by 20 percent each year until it sunsets at the end of 2026. Republicans may decide to wait to make their push until they have greater leverage, likely when they hold the majority. It is possible this could become a provision that hibernates until 2025.

Check Back in 2025. There are some tax policies that just don't have the room to be negotiated and enacted, even if there's bipartisan interest.

- Democrats had high hopes for extending the enhanced Child Tax Credit (CTC) passed in ARP. But Manchin opposed its inclusion in reconciliation. Democrats are still holding out prospects that they could leverage their current majority or President Biden to force Republicans to agree to an enhanced CTC in exchange for Republican priorities, but that sort of bipartisan cooperation has been hard to come by.
- Instead, there needs to be a major forcing mechanism for action. The next one comes at the end of 2025, when the TCJA's individual tax provisions expire. That includes the TCJA's enhanced CTC and the $10,000 cap on SALT deduction. But what does or does not happen depends on the control of the government. If a Republican trifecta holds unified control after the 2024 elections, the GOP will have little interest in working with Democrats and once again will use reconciliation on tax policy. The CTC would probably be extended as is while the SALT deduction may be completely eliminated. A divided government (likely Biden presidency and Republican Congress), however, would open the door to some compromise on the CTC and SALT.