

Public Pensions and Federal Tax Law in the U.S.

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This article stems from a presentation entitled “*Demystifying the Tax Legislative Process*,” which I made to the U.S.-based, National Association of Public Pension Attorneys (NAPPA) in February 2018 at their annual winter meeting in Tempe, Arizona.

Demystifying is the key word. Even for practicing lawyers in the United States, if you are not engaged directly in the federal legislative process on tax issues, the process of making new law is opaque. In the course of this article I will take the reader from the basic constitutional mandate through the multi-step, Congressional tax-writing process.

The Internal Revenue Code

The Internal Revenue Code (“tax code”) is the foundation of the legal structure in the U.S. related to public pension plans. While other federal statutes control the massive Social Security program and retirement programs for specific categories of federal employees and the U.S. armed forces, the over 3000 pension plans established and maintained by our states, territories, cities, counties and other governmental entities, such as tiny water and utility districts, must meet criteria set forth in the tax code in order to be a “qualified” plan.ⁱ Qualification is necessary in order for the plan to realize certain tax advantages, namely that employee and employer contributions and the earnings on those contributions are not taxed to the plan participants until pension distributions are made.

Given the fundamental role that excessive taxation played in the creation of the U.S. – No Taxation without Representation! – it is not surprising that the process for initiating a change to the tax code is contained in our most basic governing document. The U.S. Constitution states, “All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.”ⁱⁱ

The words appear simple enough. In our bicameral legislative system known as Congress, the House, not the Senate, must initiate a change to federal tax law. However, what does this mean in practice?

Absolutely, the House must originate tax legislation. Yet, there are ways in which to minimize the role of the House and enhance the role of the Senate, provided the Congressional leadership agrees to take that approach.

In an extreme case, for example, the House can pass a single-page bill to amend one section of the tax code, send the House-approved legislation to the Senate, and the Senate can then amend the House bill (keeping the House bill number intact) with a 1000-page bill that amends hundreds of sections of the tax code.

Another example would be that, prior to any House action, the Senate may consider tax legislation in committee and on the floor, take votes on amendments to the legislation, and proceed with consideration right up until a vote on final passage. The Senate, then, must stop and wait for the House to pass a tax bill. In this situation, the Senate, as long as the vote on final passage is not in doubt, has demonstrated to the House the substance of tax legislation that it is willing to accept and able to pass, thereby providing a marker for House action.

Arguments could be made that either tactic is contrary to the spirit of the constitutional requirement that the House must initiate tax legislation, yet legally each would fulfill that requirement.

In the traditional and intended process, however, the House will proceed first and substantively so. A Member of the majority party in the House, usually the Chairman of the Committee on Ways and Means,ⁱⁱⁱ introduces legislation to amend the tax code. The Committee will hold hearings on the legislation or will already have held hearings on the major subject areas covered in the bill. Next, the Committee will hold a markup of the bill, where amendments are offered to the legislation and the bill is ultimately voted on in final form and reported^{iv} to the full House. Modern historical precedent in the House is that tax bills are not amendable on the House floor. Some changes to the text may be made by a Chairman's amendment.^v

Following House passage, the Senate will then consider the legislation in its committee of jurisdiction – the Finance Committee – and proceed with a parallel set of committee hearings and a full amendment process. However, Senate floor consideration is a much more free-wheeling affair, with numerous amendments offered and voted on.

Once both chambers have passed their versions of a tax bill, agreement between the House and Senate must be reached. Each body will then have to pass the identical legislative language and conference report. Of course, the bill will then need to be signed into law by the president.

Joint Committee on Taxation

Now, what is this committee? First and foremost, please know that it is not an actual committee that meets as a body, holds hearings and reports legislation. It exists as an arm of the Congress to work closely and under the supervision of the House Ways and Means and Senate Finance Committees to provide analysis of proposed changes to the tax code and explanatory materials about existing provisions of the code.

The Joint Committee on Taxation (JCT) employs the most knowledgeable and experienced tax professionals in Congress. They sit at the witness table during the amendment process at both the House Ways and Means and Senate Finance Committees to explain existing law and proposed amendments thereto.

JCT is also responsible for analyzing proposed changes to tax law as to their implications for revenue. These 10-year projections show a year-by-year revenue loss or gain estimate from the baseline of current law and an aggregated projection for the entire 10-year period. Revenue estimates are often termed in the following shorthand: If enacted, the amendment would lose \$50 million in revenue over 10 years.

Revenue estimates can make or break a proposed change to the tax code by rendering it too expensive.

The Budget Reconciliation Process

It was said by former House Speaker Tip O'Neill (D-MA) that the House could pass a ham sandwich. That colorful expression refers to the fact that the majority party in the House, whichever party it happens to be at any given point in history, has almost unlimited control of the body. A simple majority vote is all

that is needed to pass legislation in the House, with few exceptions. Therefore, if the majority party largely sticks together, it can theoretically pass a resolution related to a ham sandwich.

The Senate on the other hand is more complicated and designed to be the institution where legislation slows down for more sober and thoughtful analysis. Protecting the rights of the minority is ingrained in Senate history and glorified in Hollywood's portrayals of Senate proceedings, where a lone Senator wages a filibuster against some unfair policy. In general, the rules in place to break a filibuster (called "cloture") require a three-fifths vote, normally 60 votes. Otherwise, one Senator or a group of Senators can control the floor indefinitely.

One way to obtain a simple majority vote in the Senate, however, is to initiate the process of budget reconciliation, which dates back in modern history to the Congressional Budget and Impoundment Control Act of 1974. The process was originally designed as a mechanism to enforce fiscal discipline through spending cuts to federal programs and agencies. However, in recent years the process has been used for other purposes, most notably to enact President Barack Obama's controversial Affordable Care Act and just last year by Republicans to enact a \$1.5 trillion tax cut.

On both of these major pieces of legislation, the budget reconciliation process was used to clear a path in the Senate for the legislation to be approved by a simple majority vote.

Executive Branch

The Department of the Treasury and the Internal Revenue Service (IRS) are the experts within the Executive Branch on tax policy and administration. The president normally weighs in at the 30,000-foot level, but the intricate details are handled at Treasury and IRS. In the Trump Administration, the Treasury Department is quick to point out that Congress tends to consult them only on questions of whether a proposed change to the law can be properly administered.

Conclusion

The procedural twists and turns and unfamiliar terminology used in the Congressional tax-writing process lead many in the U.S. to tune out the process and look no deeper than media headlines. For our fellow professionals in other countries, the process must look chaotic at best.

I hope this article has provided some clarity on how U.S. tax law is made. It is critically important to all state and local governmental pension plans in the U.S. and their active and retired members.

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ⁱ State and local governmental pension plans provide retirement benefits to teachers, firefighters, police officers, emergency medical personnel, and other state and local employees.

ⁱⁱ U.S. Constitution, Article 1, Section 7, Clause 1.

ⁱⁱⁱ The U.S. House of Representatives' Committee on Ways and Means is the oldest committee in the Congress. It dates back in some form to 1789. It is the most prestigious committee in the House, with jurisdiction not only over tax law, but also health care, international trade and Social Security. Eight future presidents, eight vice presidents, 21 speakers and four U.S. Supreme Court justices have served on the Committee.

^{iv} The term "reported" refers to the fact that the staff of the Committee on Ways and Means will write a formal report on the bill, as approved, which will contain both the text of the legislation, the disposition of amendments considered, and a section-by-section analysis of the provisions of the bill.

^v This type of amendment is commonly referred to as a floor manager's amendment. It usually makes several changes to the legislation, some minor and technical, some policy driven. It is often used to secure the necessary votes for final passage.