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TAX REFORM TIMELINE

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KEY TAKEAWAYS

We believe that Republicans are highly motivated to get tax reform done and that pragmatism will ultimately win the day.

The House would have to pass its version of the bill by Thanksgiving to keep Christmas in play, but we think passage of just the House version by the end of the year is more realistic.

Reconciling the House and Senate versions will be one of the biggest challenges to getting a bill to the president's desk.

House Republicans released the initial version of their tax reform bill on Thursday, November 2. After months of aspirational outlines and frameworks devoid of detail, this was the real thing: 400+ pages of proposed legislation covering all of the details, including difficult decisions about eliminating some existing tax benefits so that the bill would not add more than \$1.5 trillion to the current deficit—the limit set previously in the budget bill. While the final bill will look different from the House's first effort, this was an important step forward. Here's our look at the path ahead.

STEPS TO PASSING TAX REFORM

The steps to passing tax reform will follow the typical path of how a bill becomes a law, but likely on an accelerated timeline. The main battles will continue to be over the "pay-fors," current tax breaks that are reduced or eliminated to offset revenue lost due to new tax cuts. For each "pay-for" removed as part of negotiations, either a new one will need to be introduced elsewhere, one of the new tax cuts must be decreased or eliminated, or some accounting maneuver must be introduced that provides legislative cover.

The Senate will not wait until a House version is passed before starting the process on its own version. In the next two weeks, we will likely see the Senate release its initial version of its bill, much like the House did last week.

FROM BILL TO LAW

A bill only becomes a law when both houses of Congress pass identical bills. Because the bills from the House and the Senate will likely look quite different, one of the most challenging steps in the process will be reconciling the two versions. Once we get to a final single bill, progress should be smoother: Republicans should have worked out all of the compromises needed to secure the necessary votes, although nothing is guaranteed until the votes are in.

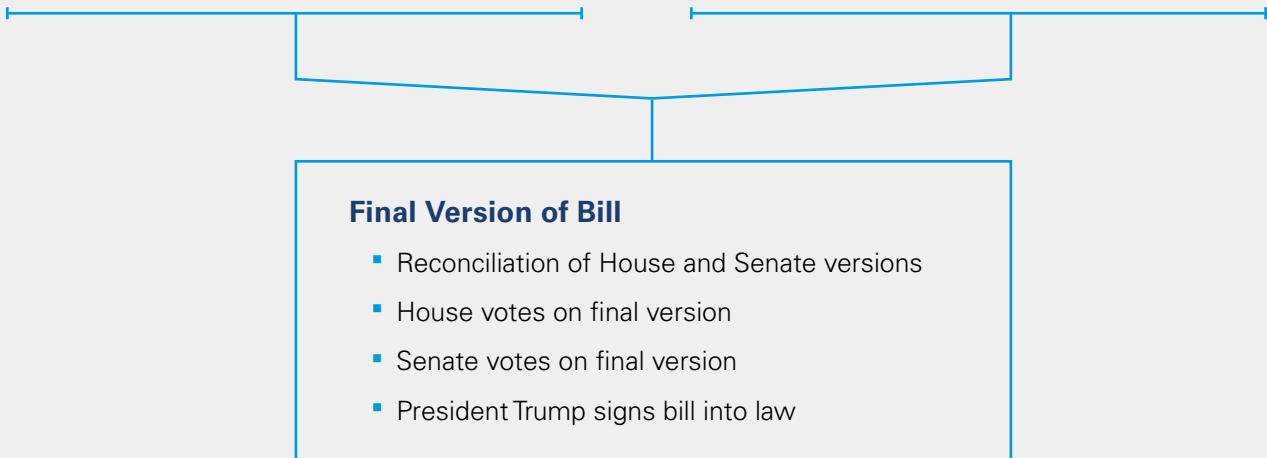
PATH TO TAX REFORM

House Bill

- Release of initial House Committee version (took place Thursday, November 2)
- Mark-up of House bill in the House Ways and Means Committee
- Debate and amendments in the House
- House passes its version of the bill

Senate Bill (early stages concurrent with House bill)

- Release of initial Senate Finance Committee version
- Mark-up of Senate bill in the Senate Finance Committee
- Debate and amendments in the Senate
- Senate passes its version of the bill



A CHRISTMAS MIRACLE?

President Trump has said he wants to sign the bill by Christmas. While we believe that we are likely to see some kind of bill passed in the first half of 2018, and possibly even in the first quarter, we view passage by Christmas unlikely.

We'll get a quick read on whether Christmas remains a possibility next week. In order to stay on track, the bill would need to make it out of the House Ways and Means Committee during the week of November 6, debate would need to be completed during the week of November 13, and the House would need to pass its version of the bill by Thanksgiving.

While completing the entire process by Christmas seems unrealistic, passage of the House version by the end of the year could still be considered reasonable progress and would keep the first quarter in play for final approval. Even if it's not signed until 2018, the final bill will likely be retroactive to the start of the year.

LOW HURDLES, HIGH HURDLES

While we believe that a shared commitment to tax reform among Republicans, the need for a political win, and likely relatively little pushback from constituents makes passage very likely, there is

no single bill that would satisfy all stakeholders and compromise is never easy. Here are some of the potential hurdles that may lower the chances of a bill finding its way to the president's desk:

- **Congressional Republicans (■ high hurdle):**

With majorities in both the House and Senate, congressional Republicans' ability to achieve a compromise is the only hurdle that really matters. In a two-party system like ours, there's a wide range of views within each party and common ground on the details may be hard to find. With a narrow majority in the Senate in particular, the bill needs to satisfy multiple wings of the party to get the necessary votes, making the path to acceptable compromise navigable but narrow. Political views aside, members of Congress will also try to defend the regional interests of their constituents. For example, the provision to eliminate the deduction of state and local taxes (SALT) is not popular among House Republicans from high-tax states. (Democrats dominate high-tax states in the Senate.)

- **Reconciliation instructions (■ high hurdle):**

According to the budget reconciliation instructions, the bill may not add more than \$1.5 trillion to the deficit in the next 10 years, and it may not add to the deficit at all after year 10. The House draft meets the first requirement; it may not meet the second. While even this \$1.5 trillion was a concession by deficit hawks, it means that the bill will have losers as well as winners as the proposed cuts far exceed this total. While limiting the impact on the deficit is a virtue, it will create the battles that are most likely to sink the bill.

- **K Street (■ high hurdle):** Washington, D.C.'s K Street is the geographical heart of the nation's lobbyists and advocacy groups, and they will all be trying to advance their constituents' interests. Groups that have already announced opposition to the House bill include the National Federation of Independent Businesses, the

National Association of Homebuilders, and the National Association of Realtors. K Street starts out as a medium hurdle, as some concerns may be addressed as the bill advances, but becomes a higher hurdle as groups have more time to pressure lawmakers.

- **President Trump (■ low hurdle):** There are two plausible ways that the president can make the bill more difficult to pass. He can undermine its support with distracting or confusing messaging as the bill grinds through the legislative process, as he did at times in the effort to repeal the Affordable Care Act. He can also add to Congress' legislative burden with items like renegotiating the Iran nuclear deal or responding to the defunding of insurance subsidies. Nevertheless, we don't expect either of these to derail the process and they can be partially offset by the president's ability to act as an advocate.
- **Government shutdown (■ low hurdle):** Back in September, the president struck a deal with Congressional Democrats to fund the government and temporarily suspend the debt ceiling. Those provisions expire at midnight on December 8. When it comes to the debt ceiling, the government can make use of extraordinary measures to continue to pay its bills without further borrowing, likely pushing a showdown to sometime in March. But funding the government still has a December 8 deadline and requires passing a new spending bill, which will require 60 votes in the Senate, to avoid a shutdown. While shutdowns tend to become unpopular as they become more extended, Democrats could delay progress on tax reform with a temporary shutdown and use the leverage for concessions in the spending bill. This certainly could be a factor in pushing the bill into 2018 but will not derail the entire process.
- **The Mueller investigation (■ unlikely hurdle):** The Mueller investigation has the potential to become a hurdle, though we believe it to be

unlikely since these types of investigations are slow moving and will probably provide only minor distractions within the timeframe of the bill.

WHEN WILL THE BILL BE DEAD?

The longer the bill takes to pass, the more it will be watered down with compromises and influenced by lobbyists, even if it still satisfies its broad intentions. Congress also has other business to attend to. But bills can be kept alive longer than one might expect. The bill could easily enter the second quarter of 2018, a more typical timeline for many bills, and still be viable. Things start getting sketchier after that.

Mid-term campaigning will become a distraction as we move toward late summer. Current reconciliation instructions, which allow the bill to be passed with a simple majority in the Senate, expire in September 2018. A new budget could be passed with updated instructions, but we're moving into

unlikely scenarios. Mid-term elections take place on November 6, 2018. The next Congress, the 116th, will begin meeting as early as January 3, 2019. In short, the bill goes on life support in the third quarter, but could be passed as late as the fourth, although it is unlikely.

CONCLUSION

Based on areas of the market that have tended to move with the changing odds of tax reform, and to a lesser extent the bill's potential impact on earnings, we believe that markets are underpricing the likelihood of tax reform passing and its potential impact. Passing a bill by the end of 2017 remains a long shot, but the first quarter of 2018 is plausible and by the end of the second quarter is very likely, in our view. At that point odds start to decline. There are challenges ahead, but the cost of failure is high. We think they'll get it done. ■

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