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WASHINGTON POLICY STRATEGY

Potomac Perspective

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A recent split decision in a key cryptocurrency lawsuit could push Congress to consider legislating rather than hanging back and letting the SEC regulate most of the sector. However, the political process could last beyond next year, as the pathway to reaching an agreement on legislation will be difficult.

House Republicans continue to work on a corporate tax bill but hang ups over the state and local tax (SALT) deduction and the Child Care Tax Credit (CCTC) could push the bill into the fall or even tank it altogether.

The risk of a government shutdown remains. For investors, expect a selloff in late September if a shutdown appears imminent. Given past experience, the market will likely bounce back quickly once the political standoff is resolved.

CRYPTOCURRENCY POLICY: RIPPLE EFFECTS

Last week, a federal judge delivered a split decision in a key case pertaining to the legal status of cryptocurrencies. **The decision in Ripple Labs v. SEC could eventually lead to congressional legislation, but rule making for the cryptocurrency industry remains a heavy lift and the process could last into the next Congress.**

The politics surrounding crypto legislation have always been complex. Republicans, generally, want to clarify rules regarding digital assets. Democrats have been split – somewhat along generational lines – with younger Democrats being more supportive of digital assets and interested in legislating, while older Democrats have been more skeptical of the industry and willing to let the regulators, especially the SEC, handle things.

There are also jurisdictional disputes among members of the Senate Banking Committee, House Financial Services Committee, and the House and Senate Agriculture Committees over which agencies get to regulate various assets (i.e. SEC or Commodities and Futures Trading Commission).

There were moments in 2022 when it appeared that momentum was building in Congress to legislate on digital assets, but last fall's bankruptcy of FTX destroyed that momentum. The split decision in the *Ripple* case might reinvigorate the legislative effort.

The *Ripple* case delivered an odd policy outcome in which sophisticated institutional investors were afforded more legal protections than retail investors. The outcome might not sit well with crypto critics (and populists) on Capitol Hill and could catalyze negotiations over legislation. This does not mean that it will be a slam dunk to pass crypto legislation, and there are several reasons why it could take Congress a few more years to pass it.

There seems to be a lack of consensus about what legislation should look like, so negotiations over a crypto bill could be lengthy. Also, the appeals process in the *Ripple* case could last several years and lawmakers might decide to see how that process plays out. Furthermore, it is already relatively late in the congressional cycle so by the time any agreement is reached, a crypto bill might be competing with other higher priority bills.

In the near term, the House Financial Services Committee could consider bills on a digital asset regulatory framework (aka market structure) and on stablecoin regulation. Passing legislation through the committee (and possibly through the full House) could be an important step in laying the groundwork for legislation in 2025 and beyond. Investors should follow the committee's action and related bills in the Senate in case momentum builds more quickly than we anticipate. **The Ripple case will likely increase interest in passing crypto currency legislation whether than happens in 2023, 2024, or beyond.**

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CORPORATE TAX BILL

Last month the House Ways and Means Committee passed a bill that would temporarily suspend changes in the formula used to calculate the business interest deduction, allow for the immediate expensing of research and development expenditures, and allow for bonus depreciation.

The bill has yet to be scheduled for a House floor vote because a group of northeast Republicans are threatening to vote against it unless changes are also made to the cap on the SALT deduction. Democrats, who also might otherwise support the bill, want to increase the ok, CCTC in exchange for their support. We expect negotiations over the bill will last through the summer and that the House will probably not vote on it until September at the earliest. We see broad support for the underlying tax bill, but holdouts over the SALT and CCTC could tank the legislation.

ANNUAL SPENDING BILLS AND A POSSIBLE GOVERNMENT SHUTDOWN

The risk that disagreements in Congress over spending bills could lead to a temporary government shutdown in October seems to be growing.

Congress continues to work on the annual appropriations bills, and some House Republicans are pushing for spending to be set at fiscal year 2022 levels, which are below the cap set in the recent debt ceiling bill. Any spending bill at the fiscal year 2022 levels would likely to be dead on arrival in the Senate. This could lead to either a Continuing Resolution to keep the government open or a government shutdown when the new fiscal year starts on October 1. Also, failure to satisfy a group of conservative Republicans on the spending bills could lead to a move to oust House Speaker Kevin McCarthy (R-California) from the speakership. This outcome could limit the ability of the House to negotiate a compromise on the spending bills, providing another route to a possible shutdown.

Markets continue to ignore the shutdown risk and will likely continue to do so until the end of the fiscal year (September 30). If an imminent shutdown appears likely, equity markets will probably selloff. Prior experience suggests that markets are likely to recover quickly once an agreement to reopen the government is reached.

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