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## WASHINGTON POLICY STRATEGY

# Potomac Perspective

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The House returns to Washington, D.C. this week. With its return, talks over the budget resolution and the reconciliation process (i.e. extending the Trump tax cuts) will pick up. We have long thought House Speaker Mike Johnson's goal of finishing the tax bill by Memorial Day was ambitious. If Congress has any hope of meeting that goal, the budget resolution must be completed within the next two weeks, before a two-week break for the Easter and Passover holidays. The pressure to meet deadlines (even self-imposed ones) might lead to a breakthrough, but we continue to believe the process will drag out beyond the holidays.

The reconciliation process will be a Republican-only endeavor, but Democratic support could be needed on other matters – possibly on the debt limit. The fallout from Senator Chuck Schumer's pivot on a recent budget bill could have implications for legislation that will need bipartisan support.

Lastly, there will be a hearing this week on key nominations for the financial regulatory agencies. One in particular could open the door to more bank mergers and acquisitions (M&A).

- **Tax/Reconciliation Update** – The timeline for passing the reconciliation bill to extend the Trump tax cuts continues to appear to be unrealistic and seems likely to slip into the summer months. Congressional leaders are scheduled to meet this week to resolve the differences between the House's and Senate's approach to their respective budget resolutions. As a reminder, a budget resolution is a prerequisite to a reconciliation bill (no budget resolution; no reconciliation bill) and must pass both chambers in the same form. The Senate has yet to pass a resolution, and the process of passing an identical resolution through both chambers probably needs to happen by April 7 in order to meet House Speaker Johnson's ambitious goal to finish the reconciliation bill by Memorial Day.
  - Speaker Johnson has been repeatedly underestimated and might achieve his goal to pass tax legislation before the holiday weekend, but our base case remains that Congress will probably finish the tax bill during the summer with a realistic chance the process could last into September.
  - On the substance of the bill, negotiations have continued over the past few weeks. While no final decisions have been made, we think there is some additional clarity on the parameters of the bill.
    - In particular, we are more confident the legislation will exempt some tip income from federal income taxes. Budget realities will probably mean that there will be a cap on the exemption, and that could complicate writing the rest of the tax bill. Exempting tip income will make remaining under the budget resolution's caps more difficult. The proposal was, however, a key promise during President Trump's campaign, and congressional Republicans seem determined to include it in some form.
    - Despite recent chatter, we think odds remain low that Congress will repeal the exemption for interest from municipal bonds. Several Republican lawmakers are former state and local government officials, and we think they are reluctant to eliminate the exemption. Unlike the situation with the cap on the State and Local Tax deduction, where mostly blue states have argued in favor of a change in the current policy,

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there is bipartisan support for the exemption of municipal bond interest. Republican lawmakers from red states are being pressured from their local governments, and we think they will want to avoid being blamed for any disruption in the local governments' finances. Congress could compromise on the issue and cap the exemption. We acknowledge the chances of a cap are higher than an outright repeal, but we still view the odds of a cap as low.

- **Potential Schumer Fallout** – The media and political analysts frequently overstate the importance of internal party fights like the ongoing debate among Democrats following Senate Minority Leader Schumer's pivot to supporting the recently passed continuing resolution (CR) that funded the government through September. This incident, however, could be different and have policy consequences. There is, undoubtedly, frustration and anger within the Democrats' base that Senator Schumer capitulated but did not receive any concessions for his support of a key procedural vote that led to the CR's passage. In the coming months, Democratic support could be needed to pass critical legislation and, consequently, Senator Schumer will be under enormous pressure to extract concessions from Republicans.
  - **Debt Ceiling** – The debt ceiling will need to be raised or suspended at some point within the next few months. Republicans would like to address the debt ceiling in the reconciliation bill, which circumvents the Senate's 60-vote requirement. Timing, however, is important. If Republicans cannot pass their tax bill before the debt ceiling must be raised, it will need to be handled separately, which would require Democratic support. Mr. Schumer will be pressured to extract concessions from the GOP. If this scenario (a debt ceiling bill outside of reconciliation) plays out, it could increase market volatility.
  - **Spending bill** – Similarly, congressional Democrats will feel pressure from their base to oppose the fiscal year 2026 spending bills. Although Democrats will be reluctant to force a government shutdown, their base will not want a repeat of the recent situation regarding the CR, so chances of a government shutdown in October have risen. We repeat our observation that government shutdowns historically have not impacted financial markets. For example, the equity market rose by over 10% during a lengthy shutdown that occurred in December 2018 and January 2019.
  - **Tax legislation** – Although Republicans are proceeding with the reconciliation process to extend the Tax Cuts and Jobs Act of 2017 (the Trump tax cuts) and intend to pass the bill with only Republican votes, we would be remiss if we did not mention the remote chance that Republicans could fail to reach an agreement amongst themselves. In this scenario, Republicans would need to turn to Democrats to secure enough votes to extend the expiring provisions of the Trump tax cuts. We think Democrats would be willing to extend the cuts on individuals in most tax brackets, but probably not the top one and would want to raise the corporate income tax rate in exchange for their support.
- **Financial Services Nominations** – On Thursday, the Senate Banking Committee will hold nomination hearings for two key appointees – Paul Atkins for Chairman of the Securities Exchange Commission and Jonathan Gould to be the Comptroller of the Currency. Mr. Gould's nomination could be particularly notable for bank M&A activity. Although Acting Comptroller Rodney Hood has full legal authority to adjudicate a bank merger application, the administration might want to wait for Mr. Gould to be confirmed before announcing a decision on Capital One's proposed acquisition of Discover. The Senate will probably vote on Mr. Gould's nomination in early May.

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