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WASHINGTON POLICY STRATEGY

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A second reconciliation bill might be back on the table as Republicans figure out how to approve additional funds for defense and reopen the Department of Homeland Security. If Republicans pursue reconciliation, then additional tax cuts could also be on the table. So could offsets. In anticipation of upcoming negotiations over a reconciliation bill, we list a few “pay-fors” that might be floated. Even if these proposals are not adopted, investors should expect increased headline risk in the coming weeks and months.

- **The path to reconciliation is hard** – The reconciliation process allows Congress to bypass the Senate’s 60-vote hurdle. This would allow Republicans to pass legislation, without Democratic support to provide supplemental appropriations for the Department of War to pay for the conflict in Iran and to fund the Department of Homeland Security (including Immigration and Customs Enforcement). Even though the bill would be Republican-only, **the GOP would have to thread the needle to pass it. A divided Republican Party might be unable to agree to it.**
 - This effort will be different from passing the One Big Beautiful Bill Act (OBBBA), at a time when Republicans faced a fiscal cliff of expiring tax cuts. No such lever exists now. Also, 36 House Republicans and seven Senate Republicans are retiring from Congress at the end of 2026. Many of them will be shielded from White House pressure.
- **Taxes could also be included in the legislation** – Although the bill’s primary purpose would be defense and homeland security funding, a reconciliation bill could also include tax cuts. We do not anticipate that the bill will reduce marginal tax rates, but the bill could contain cuts that address affordability issues ahead of the midterm elections. Examples of proposals that might be considered include:
 - Stimulus checks for individuals (up to a certain income threshold)
 - Relief from capital gains taxes on the sale of a residential home
- **Headline risk from pay-fors** – Republicans will look at revenue raisers and spending cuts to offset the reconciliation bill’s spending increases and tax cuts. Although the process of drafting the legislation is just beginning, reasonable starting points for pay-fors are those items that were cut from the OBBBA. We expect there will be considerable opposition to all of these proposals. **We are skeptical about prospects for the reconciliation bill but, as it takes shape, we expect to see these ideas floated again. Therefore, investors should be prepared for increased headline risk.** Possible offsets include but are not limited to:
 - An increase in the stock buyback excise tax;
 - Limiting the municipal finance exemption;
 - Limits to Section 1031 (like-kind exchanges of property);
 - Changes in carried-interest tax rules;
 - Unfair foreign tax rule – Section 899 (n.b.: although this was dropped from the OBBBA after an agreement with the G7 countries, it is possible that a new version of the proposal emerges); and
 - The Tackling Predatory Litigation Funding Act.

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