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WASHINGTON POLICY STRATEGY

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Meetings taking place this weekend between President-elect Trump and Congressional Republicans could shape the future of tax legislation. These talks will focus on process, which make some eyes glaze over, but the discussions will ultimately impact the substance of legislation. We explain some of the political risks that are at stake and discuss some of the possible takeaways from this weekend's gatherings.

Ongoing talks between Congressional Republicans and the incoming Trump administration on how to proceed with President-elect Trump's top legislative priorities underscore the difficulties facing Republicans in passing this legislation.

Senate Republicans met with President-elect Trump on Wednesday, and three groups of House Republicans will meet with him over the weekend in Florida. The talks are intended to reach an agreement on a legislative strategy. While some investors will roll their eyes at "Washington process," these arcane issues often influence a bill's substance.

Congress will use the "budget reconciliation" process to pass the Trump agenda. Republicans are debating among themselves whether to break the legislation into two bills or pass one massive bill. Both approaches carry political risks which could cause the effort could fail.

Reconciliation is typically used to pass a bill through the Senate by a simple majority vote, thereby circumventing the Senate's normal 60-vote requirement. Given House Republicans' narrow majority and the fractured state of their conference, passing legislation through that chamber will be challenging.

Mr. Trump's top legislative goals include extending the 2017 tax cuts, passing border security legislation, and an energy bill. The two-bill approach would lead with immigration, energy, and defense. The second bill would be the tax bill and probably an increase in the debt ceiling. Proponents of the one-bill approach want to achieve a quick legislative victory. The one-bill supporters argue that border security and energy legislation are needed as an inducement for some Republicans who oppose increasing the debt limit and who also want large spending cuts to offset the cost of extending the Tax Cuts and Jobs Act (TCJA).

The weekend meetings with House Republicans will underscore how fractured the group is, especially on tax policy and the debt ceiling.

- The first group Trump will meet with will be the Freedom Caucus. This was the group that bucked Trump in December and voted against the spending bill. They want deep spending cuts to offset the cost of extending the tax cuts. They oppose changes to the cap on the State and Local Tax (SALT) deduction. Also, some of them have never voted to increase the debt limit, but they support Trump's immigration plan.
- The second group meeting with Trump will be SALT Republicans who want to significantly raise the cap. This group is generally made up of members from New York, New Jersey, and California who tend to be more moderate and would oppose some of the deep spending cuts that the Freedom Caucus wants.
- The final group will be House committee chairmen, who run the ideological gamut and will be responsible for writing a reconciliation bill.

Ultimately, it's likely there will be a tax bill that extends most of the TCJA tax cuts, but the details of the bill remain in flux. This weekend's talks could shed light on how Republicans might proceed and what the parameters of the bill will be. At that point investors can start filling in the blanks regarding the details. These details will include the obvious tax extensions, but possibly also other revenue-related items such as the future of the Inflation Reduction Act tax credits, mortgage finance, and other proposals.

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