

# Seven Things the Senate Can Do to Salvage the Business Provisions in the House's Tax and Welfare Bill

*Preston Brashers and Richard Stern*

## KEY TAKEAWAYS

The Senate should reconsider the new spending and the retroactive and short-term tax relief in the House-passed Tax Relief for American Families and Workers Act.

To help to tame inflation, Congress should focus on permanent policies that ensure that the tax code does not punish individual saving and business investment.

Eliminating or mitigating the harmful Section 179 deduction phaseout would act like a down payment on extending key, pro-growth provisions of the 2017 tax cuts.

The House of Representatives passed a tax and welfare bill called the Tax Relief for American Families and Workers Act on January 31, 2024.<sup>1</sup> The bill cleared the House by a comfortable vote, but the legislation faces a much tougher test in the Senate.<sup>2</sup> The bill is structured so that the vast majority of the tax cuts and new outlays expire in less than two years at the end of 2025, setting up an even larger tax cliff when most of the 2017 individual tax cuts and some business tax cuts in the Tax Cuts and Jobs Act (TCJA) are already set to expire.<sup>3</sup>

Conservatives in the Senate are seeking changes to the House bill, and understandably so. The current bipartisan legislation would advance the Left's welfare agenda but would make only incremental lasting improvements to the business side of the tax code.<sup>4</sup> As it is, the bad in the House bill outweighs the good.<sup>5</sup>

This paper, in its entirety, can be found at <https://report.heritage.org/ib5345>

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## Key Provisions in the Tax-Welfare Bill

Following are the key provisions of H.R. 7024.

**Business Tax Relief.** The House-passed version of the tax and welfare bill would enact certain business tax cuts and retroactive relief for businesses and would increase subsidies to housing developers. The bill would:

- **Extend already expired “expensing” provisions**, allowing businesses to fully deduct expenses related to certain equipment, machinery, and research and experimental activities in the year they incur those costs or place the assets in service. These changes would apply for tax years 2024 and 2025 but would also retroactively reduce businesses’ 2022 and 2023 tax liability.
- **Extend more generous interest deduction limitations** for businesses. The new interest deduction cap would be 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA) instead of 30 percent of earnings before interest and taxes (EBIT). This would apply to tax years 2024 and 2025 but also retroactively to tax years 2022 and 2023.
- **Modestly increase the “Section 179 deduction”** to allow businesses to fully and immediately deduct certain tangible property, computer software, and improvements to real property, instead of requiring businesses to depreciate those costs. The bill would allow \$1.29 million of Section 179 deductions, instead of \$1.16 million, and would move the start of the phaseout from \$2.89 million to \$3.22 million. The enhancements to the Section 179 deduction would be permanent.<sup>6</sup>
- **Expand the low-income housing tax credit** for housing developers. The low-income housing tax credit has two components, both of which would be expanded by the House bill. It would relax bond-funding requirements to expand the set of developers qualifying under those rules, and it would allow state housing finance authorities to allocate more credits.

**Individual Provisions.** The bill would expand the child tax credit, and it would make more substantial changes to expand the additional child tax credit (ACTC). The ACTC is the child credit that individuals who pay no

income taxes receive as a check from the IRS. The expansion of the ACTC would weaken both work requirements and marriage. The Senate should reject or dramatically rethink the House bill's changes to the ACTC. The ACTC changes are the most problematic feature of the House legislation. This *Issue Brief* focuses, however, on recommended changes to the tax provisions in the bill, not the increases in federal welfare spending through the ACTC, which The Heritage Foundation has analyzed elsewhere.<sup>7</sup>

**Revenue Raiser.** The House-passed bill includes one revenue-raising provision. The bill's lone "pay-for" would:

- **Advance the deadline for employers to file amended tax filings claiming the employee retention credit (ERC).** The ERC is an expired tax credit from 2020 and 2021 that paid up to \$7,000 per quarter per qualifying employee kept on payroll during pandemic-related government shutdowns and certain related business challenges. The credit has attracted significant fraud. The House-passed bill moves the deadline for taxpayers to file amended claims to January 31, 2024, the date the bill passed in the House (instead of April 2024 or April 2025).

## Seven Recommendations for Senators Seeking to Salvage the House Bill

Senators looking to salvage something positive from the House bill should consider the following seven changes. The Senate should:

**1. Scrap Most or All Retroactive Business Relief.** Three key provisions in the bill—expensing of machinery and equipment, expensing of research and experimental expenditures, and the increase in interest limitations—include retroactive tax relief for businesses. Lawmakers should *not* prioritize retroactive 2022 and 2023 business relief over lasting forward-looking reforms.<sup>8</sup>

Proponents of the retroactive changes have claimed that going back to change past tax treatment of expensing for research, in particular, is important to boost the cash flow of businesses that have had to begin applying five-year amortization since the start of 2022. Proponents usually frame it as an issue that affects "Main Street" businesses, though the trillion-dollar tech companies that dominate the S&P 500 also benefit from such changes.<sup>9</sup>

If the Senate decides to keep the retroactive relief just for research and experimental expenditures, it should limit the relief to small and midsize businesses. The \$25 million gross receipts threshold under which businesses are allowed to use cash accounting would be a natural cutoff.<sup>10</sup>

**2. Use the ERC “Savings” as a TCJA Down Payment: Mitigate or Eliminate the Harmful Section 179 Phaseout.** Ideally, lawmakers would not treat the “savings” from advancing the deadline on amended ERC claims as though it is free money that must be spent and must be spent now. The ERC program has already cost at least three times what it was projected to cost over its lifetime. Using up the supposed “savings” from this program in two years on a new round of temporary relief that would add further to the nation’s \$34.3 trillion debt would be irresponsible.<sup>11</sup>

Congress *should* stop amended ERC claims, as the House-passed bill does. If Congress also insists on using the dubious, uncertain, one-time “savings” as a pay-for, Congress should at least treat it as a down payment on the *permanent* pro-growth reforms that conservatives should seek when many of the TCJA tax cuts are set to expire after 2025.<sup>12</sup> As it is, the bill’s contribution to a higher national debt and interest costs would make the math for lasting pro-growth reforms in 2025 harder, not easier.

Instead of plowing almost everything into fleeting 2024 and 2025 changes, the Senate should instead expand and improve on one of the few permanent provisions in the bill—the changes to the Section 179 deduction. Expansion of the Section 179 deduction could include a further increase in the maximum allowable deduction (especially if structures were also allowed to be deducted under Section 179 to make this deduction apply more broadly to business capital formation).

However, it would be better to first eliminate (or at least mitigate) the phaseout of the deduction. The current dollar-for-dollar phaseout of the Section 179 deduction disincentivizes business investment for companies with between roughly \$3 million and \$4 million of qualifying investments. A shallower phaseout would help to reduce this bias. Eliminating the phase-out altogether would reduce bias even more and simplify tax accounting.

This approach would be like placing a down payment on conservative tax policy wins in 2025. There is significant overlap between expensing under the Section 179 deduction and the other expensing provisions that conservatives hope to make permanent when the Trump tax cuts expire in 2025. However much expensing is permanently locked in under Section 179 in 2024 would not require a new pay-for in 2025. Therefore, expanding and improving the Section 179 deduction would reduce the cost of extending or making permanent the other pro-growth expensing provisions of the TCJA.

**3. Reject Housing Subsidies and Instead Improve Tax Treatment of Structures.** The low-income housing tax credit is at best a highly inefficient subsidy for low-income housing developers. The credit subjects burdensome federal and state rules on developers who jockey for the subsidies.

This bogs down housing markets in bureaucracy, offering little or no benefit to low-income families.

Rather than doling out subsidies to politically favored housing developers, a better approach would be to give business taxpayers the option to expense residential rental structures and nonresidential structures up to a threshold through the Section 179 deduction.<sup>13</sup> Instead of expanding bureaucratic red tape and subsidies, this approach would simplify taxes and free small housing developers and small manufacturers opening factories from having to apply convoluted multidecade depreciation schedules. This would preserve the value of the deduction, unlike current law, which forces these businesses to watch the ravages of inflation and high borrowing costs drain the real value from long-term investments.

**4. Make the Changes to Business Interest Deductions Revenue Neutral.** The House bill would temporarily allow businesses to deduct interest costs up to 30 percent of EBITDA instead of 30 percent of EBIT. In other words, businesses could add back depreciation and amortization costs to net earnings in the interest cap calculations, allowing a larger interest deduction.

Congress should strive for more consistent treatment of interest income and deductions, so a *temporary* and *retroactive* change to the interest cap should not be a top priority for Congress.<sup>14</sup>

Still, the Senate may want to follow the House bill in using an interest cap calculation based on EBITDA instead of EBIT, since it allows a larger interest deduction for companies that invest in tangible assets like equipment and machinery. To then make room for higher priority tax reforms, Congress should reduce the 30 percent interest cap, so that on net the changes to interest deductibility are deficit neutral. Any such revenue-neutral change should be made permanent, not temporary (nor retroactive).

**5. Allow Universal Savings Accounts (USAs).** All too often, Congress's first impulse is to throw money at problems instead of addressing the root issue. With the changes to the ACTC, Congress is trying to address the financial pain caused by inflation by temporarily putting more money in the pockets of low-income parents, but at the same time adding more than \$150 billion to the deficit over the next two years.<sup>15</sup> This ignores, of course, that the bout of inflation that is crushing American families is a direct result of similar short-term fiscal stimulus (on a larger scale).<sup>16</sup>

Instead of policies that stoke short-term demand, if Congress wants to help to tame inflation while allowing the economy to grow and low-income and middle-income families to prosper, Congress should allow the creation of USAs. Similar to other retirement accounts, USAs would allow Americans

to invest a few thousand dollars per year of after-tax income while allowing these modest investments to grow tax free. Unlike other types of retirement accounts, Americans would not face penalties for withdrawing from USAs if they do not use the funds at approved times for approved government uses. Instead of forcing Americans to choose from a dizzying array of alternative types of retirement accounts options, USAs would offer a simple, flexible, low-stress way for Americans of modest means to invest while controlling their own money.<sup>17</sup>

While permanent USAs would help to enable low-income and middle-income families to build their wealth, they would do so while helping to reduce inflation, rather than adding to it. Permanent USAs would help Americans to invest more, which would increase the supply of goods and services by bringing down the cost of capital for businesses. At the same time, USAs would encourage those who are able to save a few thousand dollars to do so while avoiding an extra layer of taxation. This would reduce consumer demand for goods and services in the short term and help to alleviate price pressures to the benefit of consumers, regardless of whether they invest in a USA.

**6. Cut off State and Local Governments from the COVID-19 Slush Fund.** In addition to stopping amended tax filings claiming the COVID-19-era ERC, Congress should also stop new payments from the state and local government COVID-19 slush fund known as the Coronavirus State and Local Fiscal Recovery Fund (SLFRF). There is as much as \$120 billion in unobligated SLFRF funds left over from the initial \$350 billion that Congress set aside in 2021. In November 2023, the Biden Administration, by an interim final rule, unilaterally extended the window for governments to keep spending these funds by redefining what it means for funds to be “obligated.” Congress should put a stop to this once and for all by fully rescinding the remaining balance of the SLFRF.<sup>18</sup>

There was little sense in Congress authorizing these funds in the first place. During the pandemic, state and local government tax revenues increased as the federal dollars churned through the economy. Rescinding the remaining slush fund would eliminate billions of dollars of wasteful government projects *and* provide a sensible budget offset for tax cuts.

**7. Evaluate the Tax Legislation Using Honest Accounting.** The House-passed bill would add more than \$150 billion to the deficit over the next two years, yet its supporters claim that it would be fully paid for. On paper, it comes close. Most of the tax cuts would expire after 2025, and—on paper—tax revenues would increase starting in 2026 as businesses lose temporary expensing.<sup>19</sup>

However, the revenue scores showing supposed near-balance over 10 years ignore two things: First, a large up-front deficit would increase debt-servicing costs. The government's calculations of net *revenue* changes do not account for the interest *outlays* on the extra debt accumulated in the near term or the higher interest rates that may follow short-term fiscal stimulus. Failing to account for the interest costs understates the deficit impact of the House bill by tens of billions of dollars.<sup>20</sup> Second, if Congress passes short-term expansions of provisions like the ACTC, it is very likely that Congress will later make those changes permanent, adding still further to the nation's unsustainable debt.

Given that large short-term deficits sparked the persistent inflation with which Americans are now dealing, Senators should be *more* concerned with avoiding short-term deficits than they are with the bill's technical 10-year budget score. Changes like those proposed above would lead to less-gimmicky budget scores, focusing more of the tax cuts on permanent reforms rather than short-term and retroactive relief.

## Conclusion

The House-passed bill needs substantial improvement on both the tax and welfare components before conservatives in the Senate should consider backing it. Thoughtful changes might allow the Senate to salvage something positive from the current flawed legislation. As it navigates this and future tax legislation, the Senate should take a longer view and not lose sight of the precarious fiscal situation the nation is in. The debt-ridden U.S. Treasury cannot afford haphazard temporary and retroactive tax relief.

America has yet to get inflation under control from previous rounds of deficit-financed fiscal stimulus. The Senate should ensure that any tax package it passes does not focus merely on short-term stimulus but on lasting reforms that improve incentives and expand the economy.

**Preston Brashers** is Research Fellow for Tax Policy in the Grover M. Hermann Center for the Federal Budget at The Heritage Foundation. **Richard Stern** is Director of the Hermann Center.

## Endnotes

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7. For a fuller assessment of the welfare implications of the House bill see Rector, Brashers, Stern, and Griffith, "The Tax Relief for American Families and Workers Act: Light on Tax Relief and Heavy on Welfare Expansion."
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9. The Form 10-Ks of most of America's largest technology companies discuss the effect of amortization on their financial statements.
10. 26 U.S. Code § 448.
11. U.S. Treasury Department, "Debt to the Penny," <https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny> (accessed February 22, 2024).
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13. 26 U.S. Code § 168(e)(2).
14. The ideal tax treatment for interest would be to exempt interest income from taxation and *not* allow interest to be deducted (though it would not be straightforward to transition to such a tax regime). This approach would ensure that businesses are neither incentivized nor disincentivized from borrowing and lending since loans would lead to no changes in either the borrower or lender's tax liability. In the current system, most interest income is taxable and most is deductible. Because of this inconsistency and because borrowers and lenders may face different tax rates, there are arbitrage opportunities in which borrowers and lenders can reduce their combined tax liability by increasing the amount of debt. See Curtis Dubay, "An Alternative Way to Treat Interest Properly in Tax Reform," Heritage Foundation *Issue Brief* No. 4465, September 30, 2015, <https://www.heritage.org/taxes/report/alternative-way-treat-interest-properly-tax-reform>.
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