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Tax Extenders Are Bad Tax Policy

Adam N. Michel

KEY TAKEAWAYS

Tax extenders are corrupt subsidies that prop up politically connected industries and allow the government to pick winners and losers in the market.

Congress could once again consider retroactive reauthorization of these expiring tax subsidies at taxpayer expense.

Congress should instead capitalize on the successes of the Tax Cuts and Jobs Act by simply not extending bad policy.

For the past few years, Congress has shown restraint in its ritual reauthorization of expiring tax subsidies.[1] However, the accumulated list of expired provisions, and ones scheduled to expire at the end of this year, continue to show signs of life.

The House recently passed a wide-ranging package that included the traditional retroactive extension of these narrow credits and deductions for various types of businesses, individuals, and industries (H.R. 3301).[2] The Senate version of the "tax extenders" bill (S. 617) continues to garner speculation that some version of the two bills could be attached to a must-pass debt limit or government-funding package.[3]

Tax extenders are poor tax, budget, and economic policy. They grant economic privileges to well-connected industries and allow the government to pick winners and losers in the market. This reduces economic growth and opportunity for those individuals

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and businesses not granted a competitive advantage by Congress. Many extenders also duplicate existing programs, creating a more complicated and inefficient policy environment. Each of these temporary parts of the tax code is unnecessary; Congress should not extend them.

Temporary Taxes Are Bad Policy

Many components of America's tax code are highly dysfunctional and reward well-connected businesses and industries at the expense of all other taxpayers. Temporary and often-retroactive tax extenders are the posterchild for the dysfunction. Preceding the 2017 tax reform debate was much talk about the end of temporary tax policy.[4] Unfortunately, Congress lacked the political will to either eliminate the temporary provisions or to incorporate them permanently. While there are many positive features in the 2017 Tax Cuts and Jobs Act (TCJA), the law expanded the importance of temporary policy by creating many new extenders.[5]

A permanent tax code is the cornerstone of good tax policy. It provides businesses and investors with the certainty they need to make the critical investments that grow the economy. Policy-induced economic uncertainty ultimately slows down wage growth and productivity gains for American workers.[6]

Temporary tax policy, like tax extenders, provides an opening for politicians to request patronage from special interests on a semiannual basis and provide industry with opportunity to manipulate the tax code in their favor. Temporary reauthorizations also mask the true cost of what are effectively permanent policy features. The budgetary cost of a one-year tax credit extension renewed every year appears to be just one-tenth the true 10-year cost.

Retroactive extension of tax credits and deductions, as is customary for the tax extenders, is best described as the policy work of an economic schizophrenic. Allowing subsidies to be claimed for investments or activities that took place when the credit was not available, provides nothing but a windfall profit to investors, financed by taxpayers. Current policy cannot incent past behavior.

Congress is considering expired provisions from 2017, 2018, and soon-to-expire 2019 policies. If extended, 11 of the current tax extenders duplicate similar provisions included in the TCJA. Two may have merit, if considered as standalone policies, and the remaining 21 are simply corrupt subsidy schemes that should be abandoned. Summaries of each policy are included below and in Appendix Table 1.

Duplication: Expensing for New Investment

Unlike targeted tax credits, pro-growth tax policies allow economic growth by eliminating current disincentives to save and invest. Broadly available expensing treats investments more equally. There are seven tax extenders that allow this beneficial treatment only for certain interests, such as racehorses and biofuel property. The TCJA's expensing for short-lived assets makes all but two of the expensing provisions in the current extenders list obsolete.[7]

Full expensing allows companies to write off the full cost of some capital investments immediately, rather than using cumbersome depreciation schedules to deduct that cost over many years. Full expensing removes an artificial tax bias against investment. The TCJA allows short-lived capital investments to be fully expensed until 2022; this treatment should be expanded to all investments and extended permanently, rather than extended only for politically favored investments.[8]

Duplication: Place-Based Incentives

The TCJA included a new Opportunity Zone program to provide capital gains tax breaks for investments in disadvantaged areas of the country. This program is intended to be a more streamlined version of similar federal place-based subsidies.[9] Three place-based tax subsidies expired at the end of 2017: Empowerment Zones, employment tax credits for Indian reservations, and American Samoa economic development credits. The New Markets Tax Credit expires at the end of 2019. Congress should not extend or expand any of these programs.

The historical evidence from these expiring programs clearly shows that government-directed geographic redistribution of wealth enriches a few select individuals, usually the investors, at the expense of taxpayers more broadly. In some instances, the impoverished communities targeted for the assistance ended up worse off when real estate values artificially increased as a result of the subsidy scheme without offsetting improvements in employment or wages.[10]

Specific case studies and wide-ranging literature reviews find that place-based programs are generally unsuccessful at revitalizing distressed communities and often leave people worse off. Placed-based economic planning was tried and has failed those who need the most help. Congress should abandon the four temporary programs under consideration for reauthorization.

Subsidies: Energy and the Environment

Energy tax credits harm the economy because they redirect capital away from unsubsidized energy and technologies to ones that have been singled out by the government to receive subsidies. These transfers discourage innovation in new energy sources, and shield subsidized companies from making otherwise economically viable investments in new and more efficient technologies.

These tax credits have historically been ripe with fraud and abuse. Tax credits for biodiesel and other alternative fuels are associated with tens of billions of dollars' worth of tax fraud and unintended uses.[11] The 12 energy and environment subsidies should not be extended.

Subsidies: Health, Family, and Education

The temporary provisions included in the tax extenders to subsidize health, family, and education duplicate other more broadly available programs and poorly meet their stated goals.

The health coverage tax credit (HCTC) and the adjusted gross income (AGI) floor for the medical-expense deduction are part of several tax privileges to help people buy insurance and pay for medical expenses; other privileges include the Affordable Care Act's (ACA's) tax credits and an unlimited tax exclusion for insurance purchased through employers. There is broad agreement that the existing federal tax treatment for health insurance is a major, if not the key, defect of federal policy governing the health care markets.[12] Solutions to this overall problem should be permanent, not temporary, and Congress should solve the broader problem of the inequitable and inefficient tax treatment of health insurance.[13]

A good place to start is allowing the HCTC to expire. The HCTC is narrowly available premium support for eligible taxpayers who elect continuation coverage after loss of employment.[14] Historically, the HCTC has low enrollment, is overly complex, and has high administrative costs. Additionally, the same unemployed taxpayers eligible for the HCTC are also able to access premium supports under the ACA. (They can only use one at a time.) The country does not need two health care tax credit programs servicing the same population.

Additionally, Congress should allow the AGI floor for the medical-expense deduction to revert back to 10 percent from the current 7.5 percent. The TCJA doubled the standard deduction, moving most taxpayers away from itemizing their taxes. The same law lowered the income threshold

necessary to access the deduction for medical expenses, increasing access to the deduction. These two changes had contradictory effects. Allowing the medical-expense-deduction threshold to revert to 10 percent of adjusted gross income is consistent with weening more Americans off the itemized deduction system, a primary goal of the TCJA.

Congress should allow the health insurance policy and plan fees created by the ACA to expire. These fees finance the Patient-Centered Outcomes Research Institute, a government research center that examines the effectiveness of medical treatments, procedures, drugs, and devices. The center duplicates the many other health-related research and grant-making functions of the federal government while adding one more bureaucracy that spends taxpayer dollars to influence the kinds of health benefits, medical treatments, and procedures that Americans can access.[15]

The TCJA also created a new two-year credit for employers who offer paid family and medical leave. The temporary credit is not likely to induce new paid-leave programs. Instead, the benefit will accrue to business owners who already offer such programs as a federally subsidized windfall profit. The narrowly tailored credit rules are likely to derail the impressive expansions of privately provided leave programs, and if expanded to fully subsidize 16 weeks of paid leave (the goal of many advocates), the credit would cost well upwards of $300 billion per year, or $3 trillion over 10 years.[16]

The deduction for tuition and related expenses overlaps with two other education-related tax credits (American Opportunity Tax Credit and the Lifetime Learning Tax Credit) and adds to a long list of other federal and state subsidies for higher education.[17] The expiring deduction adds unnecessary complexity to the tax code and is just one of many education subsidies that have contributed to the rising costs of higher education.[18]

Subsidies: Industry

The tax credit for certain railroad track maintenance (known as the 45G Tax Credit) encourages investments in railroad tracks over other forms of transportation-related investment. The government should not be in the business of providing subsidies to any private industry, including railroads. Railroad investments, like all others, should be eligible for immediate expensing.

The Work Opportunity Tax Credit subsidizes employment among certain disadvantaged populations.[19] Historically low employment among each of the targeted populations is a symptom of institutional problems in other policy areas, which cannot be remedied through the tax code. Most of the

targeted workers are also eligible for many other government assistance programs, including other wage-subsidy programs, such as the Earned Income Tax Credit.

The act of excluding discharged home debt and the deductibility of mortgage insurance premiums as mortgage interest subsidizes risky lending and borrowing for potential homeowners. Discharging debt so that the borrower does not incur a tax liability on what is effectively income lowers the cost of taking out risky loans. Similarly, the deductibility of mortgage insurance premiums subsidizes payments necessary to insure loans that have small down payments against default.

Some Extenders Require a Second Look

A few of the tax extenders could have economic benefits, and they should be debated on their individual merits. They should not be lumped together with special interest tax carve-outs or other must-pass bills.

Lower excise tax rates on beer, wine, and spirits is a worthy goal. A lower effective rate for smaller producers is the goal of the excise tax credits set to expire at the end of 2019. These credits are a convoluted solution to the problem of high excise taxes on alcohol. Congress should lower alcohol taxes permanently or eliminate them entirely. Similarly, look-through treatment for controlled foreign corporations[20] may be worth making permanent to move the United States more toward a territorial tax system; but it should be done as part of a broader corrections package that addresses other glitches and unintended consequences in the new international tax system.[21]

The Road Ahead

As a policy tool, narrow temporary tax preferences are always poorly designed subsidies. They introduce unnecessary complexity and ambiguity to the tax code and do a bad job of targeting the desired activity. The myriad special interest tax provisions up for renewal are each uniquely defective, and as a whole, represent flawed policy.[22] Instead of revising the extenders, Congress can capitalize on the success of the TCJA and continue to improve the tax code by simply not extending bad policy.

Adam N. Michel is Senior Policy Analyst for Fiscal Policy in the Grover M. Hermann Center for the Federal Budget, of the Institute for Economic Freedom, at The Heritage Foundation. He thanks Travis Nix, member of the Heritage Foundation Young Leaders Program, for invaluable assistance in research and drafting.

APPENDIX TABLE 1

Tax Extenders Under Consideration in 2019 (Page 1 of 3)

Provision	Description	Estimated 10–Year Cost (Millions)	Expiration Year
EXPENSING AND DEPRECIATION			
Energy-efficient commercial buildings deduction (§179D)	Deduction of up to $1.80 per building square foot for qualifying energy-efficient improvements	$719	2017
3-year depreciation for race horses 2 years old or younger (§168(e)(3)(A)(i))	3-year write-off period for race horses 2 years old or younger, down from 7 years	$142	2017
7-year recovery period for motorsports entertainment complexes (§168(e)(3)(C)(ii) and (i)(15))	7-year write-off period for motorsport entertainment complexes, down from 39 years	$504	2017
Accelerated depreciation for business property on an Indian reservation (§168(j))	Accelerated depreciation for certain property within an Indian reservation	$1,441	2017
Election to expense advanced mine safety equipment (§179E)	50% first-year bonus expensing for mine safety equipment	$27	2017
Expensing of certain qualified film and television and live theatrical productions (§181)	Full expensing (up to $20 million) for qualified film, television, or live theatrical production costs	$433	2017
Special depreciation allowance for second generation biofuel plant property (§168(l))	50% first-year bonus expensing for in-service second-generation biofuel plants	$124	2017
PLACE-BASED INCENTIVES			
New markets tax credit (§45D)	Tax credits for investments in a “severely distressed” census tracts	$12,000	2019
Empowerment Zones (§1391(d)(1)(A)(i) and (h)(2),§1394, §1396,§1397A, and §1397B)	Tax incentives for investments in 40 designated low-income census tracts	$2,296	2017
Indian employment tax credit (§45A)	20% credit of up to $20,000 for qualified wages and employee health insurance costs	$603	2017
American Samoa economic development credit (§119 of Pub. L. No. 109-432, as amended by §40312 of Pub. L. No. 115-123)	Credits for taxes on business income attributable to American Samoa	$96	2017
ENERGY AND THE ENVIRONMENT			
Electricity production tax credit from certain renewable resources (§45 and §48(a)(5))	Production tax credit per kWh depending on facility type	$1,118	2017
Tax credit for certain nonbusiness energy property (§25C(g))	10% credit, up to $500, for residential energy purchases (furnaces, boilers, biomass stoves, heat pumps, water heaters, central air conditioners, and circulating fans)	$5,389	2017
New energy efficient homes tax credit (§45L)	Credit of $1,000 or $2,000 for each certified energy efficient new home	$3,020	2017
Alternative motor vehicle credit for qualified fuel cell motor vehicles (§30B(b))	Credit of $4,000–$40,000 depending on weight for a fuel cell vehicle	$72	2017
Two-wheeled plug in electric vehicles credit (§30D)	10% credit up to $2,500 for purchases of plug-in electric-drive vehicles with only two wheels	$12	2017

APPENDIX TABLE 1

Tax Extenders Under Consideration in 2019 (Page 2 of 3)

Provision	Description	Estimated 10–Year Cost (Millions)	Expiration Year
ENERGY AND THE ENVIRONMENT (cont.)			
Alternative vehicle refueling property credit (§30C)	30% credit for property that dispenses alternative fuels, including ethanol, biodiesel, natural gas, hydrogen, and electricity, up to $1,000 for individuals and $30,000 for businesses	$332	2017
Second-generation biofuel credit (§40(b)(6))	Up to $1.01 per gallon of second-generation biofuel (such as algae or wood-based fuels)	$306	2017
Biodiesel or renewable diesel incentives (§40A,§6426(c), and §6427(e))	Excise and income tax credits of $1.00 per gallon of biodiesel, biodiesel mixtures, or renewable diesel	$35,186	2017
Alternative fuel and alternative fuel mixtures (§ 6426(d) and (e), and §6427(e))	50-cents-per-gallon excise tax credit or payment for alternative vehicle, boat, or airplane fuel and for alternative fuels mixed with a traditional fuels	$7,109	2017
Indian coal (§45(e)(10))	A $2 per-ton credit, adjusted for inflation, for coal produced on Indian reservations	$332	2017
Special rule for sales or dispositions to implement FERC or State electric restructuring policy (§451(k))	Option for qualified electric utilities to recognize gains over 8 years if the gains are used to purchase exempt utility property	$10	2017
Mine rescue team training credit (§45N)	20% credit, up to $10,000, of mine rescue team employee training programs	$19	2017
HEALTH, FAMILY AND EDUCATION			
Deduction for qualified tuition and related expenses (§222)	Above-the-line deduction for qualified tuition and related expenses for higher education, limited by AGI	$1,689	2017
Medical expense deduction (§213)	Itemized deduction for unreimbursed medical expenses paid if the expenses exceed 7.5% of AGI, down from 10%	$14,000	2019
Health Coverage Cost Credit (§35)	Refundable tax credit equal to 72.5% of premiums for individuals in certain trade adjustment and PBGC programs	$172,000	2019
Health insurance policy and plan fees (§4375 and §4376)	Fee on each specified health insurance policy of $2 multiplied by the average number of lives covered, with a similar fee on self-insured plans	–$121,000*	2019
Employer credit for paid family and medical leave (§45S)	Credit for employers who provide paid family and medical leave to their employees	$15,000	2019
INDUSTRY			
Work opportunity tax credit (§51)	Credit to employers hiring individuals who are members of 1 of 10 special groups, from veterans to ex-felons	$36,000	2019
Railroad tax credit (§ 45G)	Credit of up to 50 cents for each dollar short-line railroad improvements, capped at $3,500 a mile	$2,066	2017

APPENDIX TABLE 1

Tax Extenders Under Consideration in 2019 (Page 3 of 3)

Provision	Description	Estimated 10–Year Cost (Millions)	Expiration Year
INDUSTRY (cont.)			
Discharge of indebtedness on principal residence excluded from gross income of individuals (§108(a)(1)(E))	Excludes up to $2 million of debt forgiveness on qualified principal residences from taxable income	$22,972	2017
Mortgage insurance premiums treated as residence interest (§163(h)(3)(E))	Qualified mortgage insurance premiums are deductible	$6,490	2017
OTHER			
Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules (§954(c)(6)(C))	Exclusion of dividends, interests, and rents from foreign personal holding company income for qualified businesses	$17,900	2019
Alcoholic Beverage Tax Cuts and Reform (§5051, §5414, §5041, §5001, §5212, and §263A(f)(4)))	Reduces excise tax burdens for certain alcoholic beverages, including beer, wine, and distilled spirits, based on production amounts	$15,000	2019

* Raises revenue.

SOURCES: Joint Committee On Taxation, reports JCX-5-18, JCX-81-18, JCX-67-17, JCX-143-15, and JCX-17-10; and Congressional Budget Office, "H.R. 1892, Trade Adjustment Assistance Reauthorization Act of 2015," May 4, 2015, https://www.cbo.gov/publication/50154 (accessed July 1, 2019).

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