ISSUE BRIEF
No. 6030 | DECEMBER 4, 2020
GROVER M. HERMANN CENTER FOR THE FEDERAL BUDGET

Lame Duck and Beyond, Tax Extenders Are Still Bad Policy

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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 will face pressure to reauthorize these expiring subsidies, along with temporary coronavirus tax provisions.

Congress should focus on stable pro-growth tax policy and let the tax extenders expire.

The COVID-19 pandemic has given some in Congress an added sense of urgency to extend the multitude of expiring tax provisions that come up for review every year. Historically, Congress waits to extend these temporary provisions retroactively after they expire. A new list of time-limited provisions from the spring's coronavirus relief legislation is adding additional pressures to the standard process.[1]

As the pandemic and economic hardship continue into the winter, the confluence of an additional coronavirus relieve package, the regular expiring tax provisions, new coronavirus provisions, and a lame-duck omnibus spending package creates a high risk of another temporary extenders package. Temporary tax extenders are a failure of fiscal policy and poor economic policy, regardless of the urgency of the moment. None of the 55 provisions expiring in 2020 or 2021 should be cause for passing a temporary extenders package. Most should be allowed to expire permanently. The ritual extension of these temporary provisions ensures that the worst and most narrowly targeted subsidies endure year after year.

Tax Extenders Are a Failure of U.S. Fiscal Policy

Few policies encapsulate the dysfunction in the U.S. tax code as well as temporary and often-retroactive tax extenders. Despite broad bipartisan consensus in 2019 to allow the 34 temporary tax provisions to expire permanently,[2] Congress renewed the package of narrow tax subsidies as part of a big end-of-year spending package.[3] Similarly, the 2017 tax reform was supposed to end the practice of tax extenders, but the final law expanded the importance of temporary policy.

A permanent tax code is a cornerstone of good fiscal policy. It provides certainty to businesses, investors, and individuals who want to know what their tax burden will be when their long-term investments begin to bear fruit. This certainty supports the decisions and investments that ultimately produce the most economic growth.[4] Retroactively extending temporary tax credits and deductions, as often occurs in tax-extender legislation, can only be described as the work of an economic schizophrenic. Extending taxpayer-funded subsidies for activities performed in previous years, when the credit or deduction was unavailable, does nothing to incentivize desirable investments, as it largely provides a windfall for investors.

Temporary tax policy also breeds corruption. Tax extenders empower politicians to request patronage from special interests on a semiannual basis and, in return, extend their narrow subsidies while hiding the budgetary cost. One-year and two-year temporary extensions misrepresent the true 10-year revenue reduction of the effectively permanent policy and make it harder to maintain a fiscally responsible tax code.

Most Extenders Are Subsidies or Duplication

Among the 37 traditional, non-coronavirus-related extenders expiring at the end of the year, 21 are subsidies, 14 duplicate existing provisions, and the remaining two should be debated independently on their merits. There are also six provisions expiring next year, at the end of 2021. (See Appendix Table 1.)

The majority of tax extenders are narrowly tailored credits for energy and environmental projects, education, health care, and other favored industries.[5] These subsidies are often subject to fraud, do little to incentivize the behaviors they are intended to promote, and represent government efforts to pick winners in markets that are best governed by the forces of competition. Each of these should be allowed to expire.

A group of nine place-based subsidies for Empowerment Zones and other special jurisdictions duplicate Opportunity Zones, which were intended to consolidate and streamline existing programs.[6] These incentives most often enrich a select few individuals and businesses without advancing the policy goal of improvements to employment or wages.[7]

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.[8] There are seven tax extenders that allow this beneficial treatment only for certain interests, such as racehorses and biofuel property. The Tax Cuts and Jobs Act of 2017 offered expensing for short-lived assets, but this allowance begins to phase out after 2022.[9] Narrow depreciation allowances should not be extended. Instead, Congress should make full expensing permanent and expand the treatment to longer-lived structures. This would boost output by incentivizing long-term investments, which are crucial to economic recovery and make the narrow tax provisions that accelerate depreciation schedules for certain investments unnecessary.[10]

Coronavirus Should Not Add to Perennial Extenders

The Families First Coronavirus Response Act and the Coronavirus Aid, Relief, and Economic Security (CARES) Act also included 12 additional expiring tax provisions that may put additional pressure on the extenders process.[11] These provisions include smaller items, such as an excise tax exemption for alcohol used in hand sanitizer production, as well as more expensive provisions, such as a credit for paid family and sick leave and the suspension of aviation excise taxes.[12] President Donald Trump's executive order deferring payroll taxes also expires at the end of the year.[13]

Despite the attractiveness of potentially extending these tax breaks and subsidies to protect those disproportionately affected by the pandemic, lawmakers cannot afford to turn these temporary relief provisions into perennial tax extenders. Turning emergency relief policies into quasi-permanent features of the tax code will muddy economic-recovery policy and unnecessarily add to the budget deficit.

If Congress pursues additional coronavirus relief, it must be absolutely necessary, it should be targeted only to those most in need, and must be time limited so that it does not become another perennial tax extender. None of the expiring provisions meet this threshold as they are currently written. Congress should carefully consider pandemic relief independently of the tax extenders.

Some Provisions Require Additional Consideration

A few expiring provisions 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.

Motivating some of the urgency for a tax-extender package this year is the fast-approaching expiration of excise-tax credits for small producers of beer, wine, and spirits. As a stand-alone policy, lower effective excise tax rates is a worthy goal, although it would be better to simply lower the tax rate for all producers.[14] A proposal to make the craft alcoholic beverages credits permanent garnered 326 co-sponsors in the House and 73 co-sponsors in the Senate, more than enough to pass the stand-alone policy.[15] However, Congress never acted on this legislation, and the provision was extended temporarily at the end of 2019, wrapped up in the larger package of less justifiable extenders.

Several other business provisions should be considered as part of larger reforms. Look-through treatment for controlled foreign corporations, 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 package that addresses other glitches, future tax rate increases, and unintended consequences in the new international tax system.[16] Similarly, expanded access to net operating losses should be made permanent, and limits on interest-expense deductions should remain as they were at the beginning of 2020.[17]

A Path Forward

As the economy begins to recover from the COVID-19 containment measures, Congress should resist the temptation to eschew stable pro-growth policy in favor of temporary and poorly designed tax provisions. Narrow, temporary tax preferences introduce unnecessary complexity and ambiguity to the tax code and do a poor job of targeting the desired activity. The myriad special interest tax provisions up for renewal this year and next are each uniquely flawed, and as a whole, represent a failure of fiscal policy. Refusing to continue the policy of tax extenders would be an admirable first step in creating a functioning and effective long-term tax code.

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APPENDIX TABLE 1

Tax Extenders Under Consideration in 2020 and 2021 (Page 1 of 4)

Provision	Description	Expiration Year
Energy and the Environment		
Credit for certain non-business energy property (sec. 25C(g))	10% credit up to $500 for residential energy purchases (furnaces, boilers, biomass stoves, heat pumps, water heaters, central air conditioners, circulating fans).	2020
Credit for qualified fuel cell motor vehicles (sec. 30B(k)(1))	Credit of $4,000–$40,000, depending on weight for a fuel cell vehicle.	2020
Credit for alternative fuel vehicle refueling property (sec. 30C(g))	30% credit for property that dispenses alternative fuels, including ethanol, biodiesel, natural gas, hydrogen, and electricity. Up to $1,000 for individuals, $30,000 for businesses.	2020
Credit for two-wheeled plug-in electric vehicles (sec. 30D(g)(3)(E)(ii))	10% credit up to $2,500 for purchases of plug-in electric-drive vehicles with only two wheels.	2020
Second-generation biofuel producer credit (sec. 40(b)(6)(J))	Up to $1.01 per gallon of second-generation biofuel, such as algae or wood-based fuels.	2020
Beginning-of-construction date for renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit (secs. 45(d) and 48(a)(5))	Deadline for renewable power facilities to begin construction eligible for energy production credit.	2020
Credit for production of Indian coal (sec. 45(e)(10)(A))	A $2 per-ton credit, adjusted for inflation, for coal produced on Indian reservations.	2020
Credit for construction of new energy efficient homes (sec. 45L(g))	Credit of $1,000 or $2,000 for each certified energy efficient new home.	2020
Mine rescue team training credit (sec. 45N(e))	20% credit up to $10,000 for mine-rescue-team employee-training programs.	2020
Special rule for sales or dispositions by a qualified electric utility to implement Federal Energy Regulatory Commission (FERC) or state electric restructuring policy (sec. 451(k)(3))	Option for qualified electric utilities to recognize gains over eight years if the gains are used to purchase exempt utility property.	2020
Black Lung Disability Trust Fund: increase in amount of excise tax on coal (sec. 4121(e)(2))	Excise tax of $1.10 per ton of underground-mined coal or $0.55 per ton of surface-mined coal, limited to 4.4% of the sales price.	2020
Oil Spill Liability Trust Fund financing rate (sec. 4611(f)(2))	Tax of $0.09 per barrel of crude oil or petroleum products consumed in or exported from the U.S.	2020
Tax credits for alternative fuel and alternative fuel mixtures (secs. 6426(d)(5) and 6427(e)(6)(C)); (sec. 6426(e)(3)	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.	2020
Credit for residential energy property (sec. 25D(h))	10% credit up to $500 for residential energy purchases (furnaces, boilers, biomass stoves, heat pumps, water heaters, central air conditioners, circulating fans).	2021
Beginning-of-construction date for increased credit for business solar energy property (sec. 48(a)(2)(A)(i)(II))	Phases down increased investment tax credit for solar.	2021
Beginning-of-construction date for qualified property (sec. 48(a)(3)(A)(ii), (a)(3)(A)(vii), (c)(1)(D), (c)(2)(D), (c)(3)(A)(iv), and (c)(4)(C))	Phases out investment tax credit for credit for fiber optic solar lighting systems, geothermal heat pumps, qualified fuel cell and stationary microturbine power plants, combined heat and power, and small wind properties.	2021

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Provision	Description	Expiration Year
HEALTH, FAMILY, AND EDUCATION		
Credit for health insurance costs of eligible individuals (sec. 35(b)(1)(B))	Refundable tax credit equal to 72.5% of premiums for individuals in certain trade adjustment and PBGC programs.	2020
Employer credit for paid family and medical leave (sec. 45S(i))	Credit for employers who provide paid family and medical leave to their employees.	2020
Medical expense deduction: adjusted gross income (AGI) floor 7.5% (sec. 213(f))	Itemized deduction for unreimbursed medical expenses paid if the expenses exceed 7.5% of AGI.	2020
Deduction for qualified tuition and related expenses (sec. 222(e))	Above-the-line deduction for qualified tuition and related expenses for higher education, limited by AGI.	2020
INDUSTRY		
Work opportunity credit (sec. 51(c)(4))	Credit to employers hiring individuals who are members of one of 10 special groups, from veterans to ex-felons.	2020
Exclusion from gross income of discharge of indebtedness on principal residence (sec. 108(a)(1)(E))	Excludes up to $2 million of debt forgiveness on qualified principal residences from taxable income.	2020
Benefits provided to volunteer firefighters and emergency medical responders (sec. 139B(d))	Exclusion of state and local tax benefits and qualified payments for volunteer firefighters and emergency medical responders from taxable income.	2020
Treatment of premiums for certain qualified mortgage insurance as qualified residence interest (sec. 163(h)(3)(E)(iv))	Qualified mortgage insurance premiums are deductible.	2020
PLACE-BASED INCENTIVES		
Indian employment credit (sec. 45A(f))	20% credit up to $20,000 for qualified wages and employee health insurance costs.	2020
New markets tax credit (sec. 45D(f)(1))	Tax credits for investments in “severely distressed” census tracts.	2020
Five Empowerment Zones incentives (sec. 1391(d)(1)(A)(i) and (h)(2)); (secs. 1394 and 1391(d)(1)(A)(i)); (secs. 1396 and 1391(d)(1)(A)(i)); (secs. 1397A and 1391(d)(1)(A)(i)); (secs. 1397B and 1391(d)(1)(A)(i))	Tax incentives for investments in 40 designated low-income census tracts.	2020
American Samoa economic development credit (sec. 119 of Public Law No. 109-432, as amended)	Credits for taxes on business income attributable to American Samoa.	2020
Temporary increase in limit on “cover over” of rum excise tax revenues (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sec. 7652(f))	Excise tax revenue from imported rum is transferred to the treasuries of Puerto Rico and the U.S. Virgin Islands.	2021

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DEPRECIATION		
Three-year recovery period for race horses two years old or younger (sec. 168(e)(3)(A))	Three-year write-off period for racehorses two years old or younger, down from seven years.	2020
Seven-year recovery period for motorsports entertainment complexes (sec. 168(e)(3)(C)(ii) and (i)(15)(D))	Seven-year write-off period for motorsport entertainment complexes, down from 39 years.	2020
Accelerated depreciation for business property on an Indian reservation (sec. 168(j)(9))	Accelerated depreciation for certain property within an Indian reservation.	2020
Special depreciation allowance for second-generation biofuel plant property (sec. 168(l)(2)(D))	50% first-year bonus expensing for in-service second-generation biofuel plants.	2020
Energy efficient commercial buildings deduction (sec. 179D(h))	Deduction of up to $1.80 per building square foot for qualifying energy efficient improvements.	2020
Special expensing rules for certain film, television, and live theatrical productions (sec. 181(g))	Full expensing (up to $20 million) for qualified film, television, or live theatrical production costs.	2020
Five-year recovery period for certain energy property (secs. 168(e)(3)(B)(vi)(I) and 48(a)(3)(A))	Accelerated depreciation for certain solar energy property.	2021
OTHER		
Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules (sec. 954(c)(6)(C))	Exclusion of dividends, interests, and rents from foreign personal holding company income for qualified businesses.	2020
Provisions modifying the rates of taxation of beer, wine, and distilled spirits, and certain other rules (secs. 263A(f)(4), 5001, 5041, 5051, 5212, and 5414)	Reduces excise tax burdens for certain alcoholic beverages, including beer, wine, and distilled spirits, based on production amounts.	2020
Computation of adjusted taxable income without regard to any deduction allowable for depreciation, amortization, or depletion for purposes of the limitation on business interest (sec. 163(j)(8)(A)(v))	Business interest deduction limit is narrowed.	2021
TEMPORARY CORONAVIRUS RESPONSE PROVISIONS		
HEALTH, FAMILY, AND EDUCATION		
Student loans repayment employer deduction	Qualified education loan repayment employer assistance deductibility up to $5,250.	2020
Charitable Contribution Non-itemizers expansion	Allows taxpayers who don't itemize deductions to claim the charitable deduction for up to $300 in contributions.	2020
Charitable Contribution Limitation expansion	Suspends limitation of 50% of AGI for charitable contribution deduction.	2020
Temporary exemption from excise tax for alcohol used to produce hand sanitizer	Suspends the alcohol excise tax for alcohol used for hand sanitizer production.	2020

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Provision	Description	Expiration Year
INDUSTRY		
Employee Retention Credit	$5,000 maximum per-employee credit on 50% of qualified wages.	2020
Aviation Excise Tax holiday period	Complete suspension of the aviation excise taxes.	2020
Business Interest Deduction limit expansion	Increased limit from 30% to 50% of income for business interest expenses deduction.	2020
Payroll Tax Deferral	Can defer employer payroll taxes until January 1, 2021.	2020
Paid Family/Sick Leave Credit	Employer credit for providing mandated paid family and sick leave.	2020
OTHER		
Net operating loss carryover expansion	Suspends limitation of 80% of taxable income from December 31, 2017, to January 1, 2021.	2020
Modification of limitation on excess business losses for taxpayers other than corporations	Suspends limitation of $250,000 in allowable losses for noncorporate taxpayers. Effective for 2018, 2019, and 2020 returns.	2020
Adjustment to Qualified Medical Expense Deduction	Allowed to use deductible funds from health savings accounts (HSAs) and other health saving plans on over-the-counter medications, as well as telehealth.	2020

SOURCES: Joint Committee on Taxation, reports JCX-1-20, JCX-23-20, and JCX-12R-20.

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Endnotes

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