WebMemo
Published by The Heritage Foundation

No. 2275
February 5, 2009

New Stimulus Tax Deductions Just Another Bailout for Detroit Automakers

Curtis S. Dubay

The Senate recently tacked on an amendment for two new income tax deductions as part of the stimulus bill in yet another attempt to help the ailing auto industry. Added by voice vote, these new deductions would apply to interest paid on loans for cars bought between November 12, 2008, and December 31, 2009, and sales taxes paid on cars purchased during the same period. The new deductions are "above the line," so all taxpayers can claim them even if they do not itemize their deductions.

The deductions are supposed to help consumers by lowering the cost of new cars, the auto companies by increasing demand, and state and local governments by increasing sales tax revenue. However, this bad tax policy amounts to nothing more than a subsidy for American car buyers and a backdoor bailout for automakers and state and local governments.

Backdoor Bailouts. The new deductions use the tax code to artificially and temporarily increase the demand for cars. The deductions are temporary, so after they expire on December 31, 2009, demand for cars will subside to normal levels. Some car buyers will move up their planned car purchases to take advantage of the tax savings, while others will decide to buy because these deductions drop the price at the expense of the American taxpayer. This backdoor attempt to help automakers increase current sales is a subsidy plain and simple. The tax code should not be used to help struggling industries. Doing so decreases government transparency and stifles legitimate debate about whether struggling (or even failing) companies deserve taxpayer-funded bailouts. Furthermore, the deductions are only for cars manufactured in the United States, so foreign manufacturers will likely complain about protectionism.

State and local governments would also get a backdoor bailout, since *any* increased car sales would increase sales and excise tax revenues. But these revenues will also be just a shell game, moving purchases from one year to the next as taxpayers hurry to respond to these tax subsidies. In the end, states will likely be worse off when car sales decline after the temporary deduction expires. And a temporary jolt of revenues will only encourage states to enlarge spending programs and postpone tough fiscal decisions.[1] Moreover, using the tax code to get more revenues to state and local governments is bad tax policy. As with the auto companies, the deductions direct more money to state and local governments without transparency or proper debate.

Bad Tax Policy. New deductions for interest on car loans and sales taxes paid on car purchases are also bad tax policy. The income tax base already has countless deductions for everything from student loan and home mortgage interest to state and local

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/wm2275.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

taxes to gambling losses. Adding deductions only puts more upward pressure on rates at a time when they should be reduced. Furthermore, these new deductions would encourage car buyers to finance their new cars instead of paying cash. Truly sound tax policy would not influence this kind of decision.

Though these new deductions would lower the income tax bills of people buying cars during the specified time period, they are no different than a spending program that directly subsidizes car buyers. The government could accomplish the same result if it simply cut checks to car buyers for the amount of their loan interest and sales taxes. The deductions are retroactive, too, so they reward those who already purchased cars and punish those who did not engage in this favored activity. This misleading branding of spending as a tax cut gives lawmakers a freer hand to institute, through the tax code, the same programs that would be unpopular if rightly called spending.[2] The failure of the auto bailout spending legislation in both the House and Senate last year proves that it is much easier to cloak spending in the robes of a tax cut, where it will likely receive a free pass, than to call it what it is: spending.

Tax Cuts for All. A better way to help consumers and all companies, including automakers, is a broad-based tax cut that lowers tax rates for all taxpayers.[3] This policy would give a broad boost to the economy and help auto companies[4] without funneling money to them in a secretive manner, further damaging an already broken tax code.

—Curtis S. Dubay is a Senior Analyst in Tax Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

1. Brian M. Riedl, "Stimulus Bill Should Not Bail Out Irresponsible States," Heritage Foundation *WebMemo* No. 2266, February 4, 2009, at *http://www.heritage.org/Research/Economy/wm2266.*
2. Curtis S. Dubay, "'Making Work Pay' Credit Will Not Stimulate the Economy," Heritage Foundation *WebMemo* No. 2240, January 26, 2009, at *http://www.heritage.org/Research/Taxes/wm2240.cfm.*
3. J. D. Foster and William W. Beach, "Economic Recovery: How Best to End the Recession," Heritage Foundation *WebMemo* No. 2191, January 26, 2009, at *http://www.heritage.org/Research/Economy/wm2191.cfm.*
4. William W. Beach, "Big Gains for the Automakers from Senator DeMint's 'American Option,'" Heritage Foundation *WebMemo* No. 2259, February 2, 2009, at *http://www.heritage.org/Research/Economy/wm2259.cfm.*

The Heritage Foundation
LEADERSHIP FOR AMERICA