Backgrounder

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Routine Tax Extenders Package Contains New Irresponsible Spending and Tax Hikes

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Abstract: *Congress cannot kick its spending habit. This time it is using the extension of long-overdue tax-reducing provisions to increase spending $174 billion and add $134 billion to the deficit. Even worse, Congress has crammed a job-destroying tax hike and other detrimental policies into an otherwise necessary bill. Congress should stop the spending madness and permanently extend sound tax policies.*

Talking Points

- The "tax extenders" are a group of 45 tax-reducing policies that expire each year unless Congress extends them. Under current PAYGO budget rules, their annual expiration provides Congress an excuse to raise other taxes each year.
- In addition to raising taxes to "pay for" the tax extenders, Congress has stuffed the extenders bill with $174 billion in new spending and other faulty policies.
- The irresponsible new spending will add $134 billion to the deficit over the next 10 years.
- The tax Congress chose to raise to offset the cost of the tax extenders is to reduce the foreign tax credit that United States businesses that operate overseas use to limit double taxation. Limiting the credit will drive more jobs to foreign countries.
- Congress should extend good tax policy permanently and not accompany it with harmful tax hikes and irresponsible spending.

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Congress is at it again, doing the only thing it seems to know how to do: spending more of the taxpayers' money. This time it is using a collection of popular "must-pass" tax provisions to hide huge new spending increases.

These provisions, better known as the "tax extenders," are a collection of about 45 long-established tax provisions—such as the R&D credit for businesses and the deductions for property taxes and tuition expenses for individuals—that expire each year unless Congress extends them. Congress has still not passed the tax extenders for 2010, leaving many taxpayers uncertain of whether they will be able to continue using tax reducers they have routinely factored into their long-term plans.

The pressure is on Congress to pass the tax extenders soon to provide businesses and individuals some stability for planning—at least for the remainder of the year. Not wanting to let an opportunity go to waste, Congress has larded the extenders bill (H.R. 4213) full of completely unrelated spending increases and tax hikes. According to the Congressional Budget Office

(CBO), the bill will increase spending by $174 billion[1] and increase taxes by more than $40 billion over 10 years. The result is an irresponsible increase of the cumulative deficit of $134 billion during the same period.

This latest exercise in congressional extravagance shows that Washington has still not received the message that the American people are tired of spending increases and tax hikes. Instead it continues to ignore warnings—from California to Greece, from Moody's to CBO—that continued runaway spending will lead to ruin. Better policy would have the tax provisions extended without adding unrelated or irresponsible spending increases to an otherwise necessary bill.

Higher Taxes

The CBO wrongly scores the yearly extension of the tax extenders as tax cuts.[2] As such, Congress has an excuse to raise other taxes because, under Pay-as-You-Go (PAYGO) budget rules currently in place, Congress must offset tax cuts with spending reductions or increases in other taxes. After just a few years of this unnecessary exercise, Congress is now out of relatively painless taxes to hike to "pay for" the extenders.

This is most evident with the distressing tax increase that Congress has chosen to pay for this year's extenders. H.R. 4213 would limit the foreign tax credits U.S. businesses can claim for income taxes paid to other countries. Congress is selling this change as a way to keep jobs in the U.S., but in reality it is an egregious tax hike that will drive more jobs overseas.[3]

If Congress passes H.R. 4213, the tax extenders will be retroactive for the 2010 tax year. In the near future Congress will have to go through this whole routine again to prevent steep tax increases for future tax years. The job-destroying reduction of the foreign tax credit shows that Congress is scraping the bottom of the barrel for tax hikes to offset the extenders. Even more injurious tax hikes could be on the way if Congress continues this annual tax hiking ritual.

More Spending

Beyond the tax extenders and the tax hikes to pay for them, Congress has added $174 billion in new spending that is not completely paid for. The spending largely involves extending the following four programs:

1. **Doctor Fix.** H.R. 4213 still does not provide a permanent solution to the problem of low Medicare reimbursement rates for doctors. Congressional leaders removed this costly fix from their health care overhaul and instead have kicked the can down the road one more time. H.R. 4213 prevents reductions in Medicare reimbursement for doctors for only 2012 and 2013 at a cost of $63 billion. Senate leaders should get serious about a permanent fix of the Medicare reimbursement for doctors[4] once and for all and find some way to offset spending rather than adding the additional costs to the deficit.
2. **Unemployment Insurance Extension.** Unemployment Insurance (UI) usually provides benefits for up to six months, with another three months available under the Extended Benefits program in high unemployment states. During this recession Congress has extended maximum UI benefits to almost two years (99 weeks) and

1. Douglas W. Elmendorf, Director, Congressional Budget Office, letter to the Honorable Sander M. Levin (D–MI), Chairman, Committee on Ways and Means, U.S. House of Representatives, May 21, 2010, at *http://www.cbo.gov/ftpdocs/115xx/doc11523/hr4213_LevinLtr.pdf* (May 24, 2010).
2. See J. D. Foster, "Obama to CBO Revenue Baseline: Nuts—and He's Right!" Heritage Foundation *WebMemo* No. 2019, August 11, 2008, at *http://www.heritage.org/Research/Reports/2008/08/Obama-to-CBO-Revenue-Baseline-Nuts-and-Hes-Right*.
3. See J. D. Foster and Curtis S. Dubay, "Obama International Tax Plan Would Weaken Global Competitiveness," Heritage Foundation *WebMemo* No. 2426, May 5, 2009, at *http://www.heritage.org/Research/Reports/2009/05/Obama-International-Tax-Plan-Would-Weaken-Global-Competitiveness.*
4. See John O'Shea, "Ending the Physician Payment Crisis: Another Reason for Major Medicare Reform," Heritage Foundation *WebMemo* No. 1931, May 20, 2008, at *http://www.heritage.org/Research/Reports/2008/05/Ending-the-Physician-Payment-Crisis-Another-Reason-for-Major-Medicare-Reform.*

made UI benefits slightly more generous. H.R. 4213 continues these extensions and expansion yet again through December 2010 at a cost of $47 billion. While extending UI to 99 weeks eases the financial pain of job loss as individuals look for scarce jobs in the recession, many workers with extended UI stay unemployed longer than those without UI. This measurably raises the unemployment rate. Congress can decide whether that is a worthwhile policy tradeoff. It is not, however, economic stimulus.

3. **Another Medicaid Bailout.** H.R. 4213 would continue to use federal taxpayer funds to bail out state Medicaid programs at a cost of $24 billion. Medicaid is crippling state budgets, but the solution is not to transfer the cost to the federal taxpayers. Instead, Congress should get serious about Medicaid reform and grant states the flexibility they need to fix the program.[5]
4. **COBRA or Nothing.** H.R. 4213 would give premium relief only to those unemployed workers who opt for COBRA coverage. It is well documented that COBRA coverage is one of the most expensive options available to those who lose their jobs.[6] Workers would be better served if they were able to decide whether to use this temporary assistance on COBRA or to use another, more affordable option, including policies available in the individual market. Nevertheless, H.R. 4213 would extend COBRA benefits through December 2010 at a cost of $7.8 billion.

These four spending provisions cost a total $142 billion over 10 years. To sneak these spending hikes through, Congress sidestepped its own PAYGO budget rules by designating most it as emergency spending. This is further proof that PAYGO budgeting rules do not inhibit congressional spending and have no impact on lowering the deficit. PAYGO is at best a convenient excuse for Congress to raise taxes.

Bad Policies

Costly spending increases and unnecessary tax hikes are not the only problems with H.R. 4213. The bill also sets other bad policy precedents, including:

More State Bailouts. Included in the $174 billion of new spending is over $31 billion in bailouts for the states. This includes Build America Bonds ($4 billion) and Recovery Zone Bonds ($2.4 billion) that subsidize state infrastructure expenditures, the $24 billion Medicaid bailout described above, and assorted other transfers to the states. In total, the state bailouts comprise 18 percent of the entire bill. That does not include an additional $23 billion that the Obama Administration wants added to the bill to stop state and local governments from laying off 300,000 teachers.[7]

State governments have spent above their means for years. Further bailouts from Washington will only delay the inevitable: States must cut back on spending to more sustainable levels. In the short term, more money from Washington only incentivizes states to continue spending well above what they can afford as Congress continues to cover for their profligacy.

It is time for Congress to stop facilitating the reckless spending of the states. Postponing the day of reckoning any longer is throwing good taxpayer money after bad and makes choices even harder for the states.

Premature Action on Oil Spill. The Oil Pollution Act of 1990 sets out the means by which the federal government leads oil spill cleanup efforts and pays for the costs. Generally, the responsible party—in the current case, BP—is on the hook for

5. See Dennis G. Smith, "State Medicaid Reform First—Before Payment Increases," Heritage Foundation *WebMemo* No. 2083, September 26, 2008, at *http://www.heritage.org/Research/Reports/2008/09/State-Medicaid-Reform-First-Before-Payment-Increases.*
6. See Nina Owcharenko, "Why COBRA Should Not Be the Only Option for Displaced Workers," Heritage Foundation *WebMemo*, April 23, 2002, at *http://www.heritage.org/Research/Reports/2002/04/Why-COBRA-Should-Not-Be-The-Only-Option-For-Displaced-Workers.*
7. Lori Montgomery and Shailagh Murray, "In Congress, Spending Measures Meet Bipartisan Resistance," *The Washington Post*, May 24, 2010, at *http://www.washingtonpost.com/wp-dyn/content/article/2010/05/23/AR2010052303486.html* (May 24, 2010).

all the cleanup costs, plus up to $75 million in compensation for damages. Beyond the $75 million, an oil spill liability trust fund created via a tax on oil provides an additional $1 billion per event. H.R. 4213 raises this amount to $5 billion and increases the tax from 8 cents per barrel to 32 cents to fund it. Raising the cap may be reasonable, though the tax increase is excessive and premature.

At this early stage, too few facts are in regarding the oil spill for legislative measures to make sense. And in any event, new laws would not affect ongoing cleanup activities, so there is no reason to rush. Once the facts are in, some changes to oil spill laws may be warranted—but now is not the time to increase taxes on energy. And certainly not in a tax extenders bill.

Defined Benefit Pension Funding Rules. A traditional or defined benefit (DB) pension plan pays retired workers a set benefit, usually a percentage of their pre-retirement income for every year that the worker was employed by the company. The financial health of private-sector DB pensions depends on regular contributions, investment earnings that reach at least a predicted level, and retirees living (and thus receiving benefits) as long as expected. Prior to 2006, when funding rules were tightened, employers were able to avoid cash contributions and could raise promised benefits even if the plan was seriously underfunded.

Because of the recession, certain employers may have to lay off additional workers in order to fully fund their pension plans. The pension relief sections of H.R. 4213 temporarily ease funding requirements for both single-employer and multi-employer pension plans to give them more time to rebuild losses from 2008 and after. At the same time, they still restrict plans from increasing benefits unless the increases are fully and separately funded. This combination is appropriate for the circumstances, but additional pressures for yet more funding relief should be resisted so that the days of irresponsible funding decisions and unpaid-for benefit increases cannot return.

Extension of Temporary Assistance for Needy Families. Included in the extenders package is a $2.5 billion extension of the Temporary Assistance for Needy Families (TANF) emergency fund. The Senate beat back an earlier attempt to include this provision in the FY 2011 budget; however, House leadership has managed to include it in the conference agreement. If passed, this would undo the historic welfare reform of 1996.

The TANF Emergency Fund, originally created as part of the stimulus package, was meant as a "temporary" measure. The President, and now Congress, are intent on extending it another year. This anti-reform fund would pay states for increasing their welfare caseloads, providing no incentive to help people into jobs.[8] Such action would completely reverse the successful 1996 reform that helped to move millions of families out of poverty and into self-sufficiency. President Obama has sought to curb this success in the name of "stimulus." His FY 2011 budget aims to extend this program for another year at a price of $2.5 billion.

Stick to Basics

Before H.R. 4213, the tax extenders were already a yearly occasion for Congress to raise taxes under the guise of faux fiscal discipline. Congress has now taken this one step further by using the tax extenders as vehicle to significantly increase spending and the deficit. It is time for Congress to make the tax extenders permanent so it cannot use their annual extension to increase the size of government.

Congress should make all the provisions in the tax extenders that are good policy permanent[9] and allow the ones that are not to expire. It should then cut other taxes to make sure the reforms are revenue-neutral. If it takes these steps, Congress will have one less way to raise taxes and sneak through

8. See Katherine Bradley and Robert Rector, "How President Obama's Budget Will Demolish Welfare Reform," Heritage Foundation *WebMemo* No. 2819, February 25, 2010, at *http://www.heritage.org/Research/Reports/2010/02/How-President-Obamas-Budget-Will-Demolish-Welfare-Reform.*

9. See Curtis S. Dubay, "Tax Hikes Unnecessary for Extension of Current Policy," Heritage Foundation *WebMemo* No. 2722, December 8, 2009, at *http://www.heritage.org/Research/Reports/2009/12/Tax-Hikes-Unnecessary-for-Extension-of-Current-Policy.*

this kind of irresponsible spending increase in the future.

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