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Tax Extenders Review Needs a Framework

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The House Ways and Means Committee is performing an important public service in laboriously working through the "tax extenders." Specifically, the Subcommittee on Select Revenue Measures under Chairman Pat Tiberi (R–OH) is compelling supporters to come forward and make the case why their provision merits extension.

The exercise is long overdue, but going forward the process requires a proper choice.[1] If the choice is simply whether to continue any or all of the 64 provisions listed by the Joint Committee on Taxation (JCT) as expiring in 2011 or 2012, then even the least defensible of provisions will find defenders, and the only real opposition will come from those who have an affinity for the principles of sound tax policy.[2] History suggests the outcome of such a contest at least nine times out of 10, which is why the list is so long today and its review so rare. Congress needs a more relevant, more critical choice.

A Bit of Background. The expression "tax extenders" refers to a set of tax provisions included in the tax law over the past few decades (yes, decades) but always on a temporary basis.[3] The granddaddy in both size and tenure is the Research and Experimentation (R&E) tax credit. Some of the odder elements include a 50 percent tax credit for maintaining railroad tracks, a tax incentive for investing in the District of Columbia (as though having the federal government resident in the District were not benefit enough), and an economic development credit for American Samoa.

In toto, the extenders involve some $55 billion in revenue as of 2010, the latest year for which there is an official scoring, with the R&E tax credit representing nearly 25 percent of that amount.[4] Other major tax extenders include the ethanol tax credit ($4.9 billion), the deduction for state and local sales taxes ($5.5 billion), and an international tax provision ($9.2 billion). On the other hand, 16 of these provisions involved less than $1 billion, the tiniest being a $1 million election to expense mine safety equipment. With so many relatively modest provisions under scrutiny, clearly this exercise is not a matter of grand deficit reduction but of trying to clean up the tax code.

One issue for policymakers to consider is that, irrespective of the amount of revenues involved, if any of these tax extenders were allowed to expire, then somebody would face a tax hike. This is equally true whether the tax provision is the development credit for American Samoa, the payroll tax relief, or the lower income tax rates from the Bush tax cuts. The provisions have been in law for some time, reducing some taxpayers' tax liability. Allowing a provision to expire is thus a tax hike on those taxpayers.

The official JCT tables do not describe the budgetary consequences of an expiring tax extender in terms of tax hikes, but that is only because the Congressional Budget Office continues to employ the indefensible practice of developing the revenue baseline according to current law and the spending baseline according to current policy.[5]

As this is Washington, no one should be surprised that a change in policy shown in the official scoring as a tax cut to the government is, from

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a taxpayer's perspective, preventing a tax hike. The only surprise is that, once exposed, the practice is allowed to continue. Policymakers ought not let themselves be confused by this malpractice: Allowing a tax provision to expire that causes some taxpayers' taxes to go up is a tax hike.

A Reasonable Process. Every tax extender has its defenders. Many also have detractors. Some even have good arguments in support, such as the R&E tax credit and the deduction for qualified tuition and expenses. Allowing any tax extender to expire means raising taxes. These are the facts, and together they offer a poor framework for policymakers to choose—kill off a bad tax provision and raise taxes for the sake of sound tax policy. Framing the choice this way may explain why, during a recent hearing on tax extenders in the committee, even some staunch free-market conservatives supported such tax policy atrocities as the wind energy production tax credit.

A better framework would be for the committee and Congress to settle on a sound, scaleable, alternative tax relief proposal that would move toward sound policy and strengthen the economy. The revenues gained from expiring tax extenders would be used to offset the costs of the new tax relief.

For example, Congress could include a provision to exclude a certain amount of interest income from tax. This would improve saving incentives and would overwhelmingly benefit low- and middle-income savers, especially retirees struggling with the consequences of historically low interest rates.

Define a Workable Framework. An interest income exclusion is just one example. No doubt the committee—indeed the entire Congress—could embrace other examples of sound policy that would also strengthen the economy, though it would have to resist the temptation to replace one bad idea with another. The point is that it is hard to clean up the tax code when the alternative is just raising taxes under the banner of sound tax policy. The Ways and Means Committee has made a good start on defining the issue; now it needs to define a workable framework for making choices.

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1. See Curtis S. Dubay, "Tax Extenders and the AMT Patch: Time to Pull the Plug on Congress's Annual Dance," Heritage Foundation *Backgrounder* No. 2654, February 16, 2012, http://www.heritage.org/research/reports/2012/02/tax-extenders-and-the-amt-patch-time-to-pull-the-plug-on-congresss-annual-dance.
2. See Joint Committee on Taxation, "Legislative Background of Selected Federal Tax Provisions Scheduled to Expire in 2011 or 2012," April 25, 2012, https://www.jct.gov/publications.html?func=startdown&id=4425 (accessed April 30, 2012).
3. Some long-standing tax extenders were allowed to expire at the end of 2011, but the possibility of their reinstatement is part of the policy discussion.
4. All figures herein are 10-year revenue estimates, though the provision being scored in 2010 was typically a one-year extension. For official scores, see Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,'" December 10, 2010, at https://www.jct.gov/publications.html?func=startdown&id=3715 (accessed April 30, 2012).
5. See J. D. Foster, "CBO Baseline: A Few Quirks Do Not Distract from a Dismal Picture," Heritage Foundation *WebMemo* No. 3479, February 1, 2012, http://www.heritage.org/research/reports/2012/02/cbo-baseline-budget-outlook-shows-dismal-state-of-us-finances.