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The Senate Can Use Tax Extenders as an Opportunity to Improve the Tax Code

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The tax extenders are a group of approximately 50 tax-reducing policies that expire regularly. Congress has traditionally extended them just as regularly as they expire. Late last year, Congress retroactively renewed them for 2014, which means they are currently expired.

The Senate Finance Committee marked up its version of this year's tax extender bill recently. In that mark up, the committee retroactively renewed all the tax extenders for 2015 and extended them through the end of 2016. There will only be a few minor deviations from the original mark released by Chairman Orin Hatch (R–UT).[1]

By extending all the policies in the package, the Senate Finance Committee missed an important opportunity to improve the tax code. But the opportunity remains for the Senate to improve the legislation.

Extension Is Not a Tax Cut

If Congress is to use the extenders constructively to advance sound policy through tax reform, it must first not fall into the trap of trying to offset their cost, a mistake that routinely plagues this issue and bogs Congress down from making meaningful improvements.

The problem arises because of the incorrect way the Congressional Budget Office (CBO) constructs its revenue baseline. CBO assumes that Congress intends to allow expiring tax-reducing provisions, such as the tax extenders, to expire permanently. This is contrary to the way it estimates its discretionary spending baseline, where it assumes that Congress intends for expiring spending programs such as the farm program, highway spending, and annual appropriations to continue permanently.

As a result, expiring tax-reducing provisions raise CBO's revenue estimates higher than they would be if CBO treated revenue the same way it treats discretionary spending. Because it wrongly assumes that expiring tax provisions raise revenue, it also wrongly considers Congress's restoring those policies to be a tax cut.

Under the budgeting rules Congress follows, it must offset policies that increase spending or lower taxes so as not to add to the deficit. It can do so by either lowering spending or raising taxes in other areas. Since CBO's faulty revenue baseline wrongly scores extending the tax extenders as a tax cut that adds to the deficit, some feel the need to offset their extension.

Congress should not have to accommodate CBO's error. Extending the tax extenders is not a tax cut. These policies have long been in place, some—such as the Research and Experimentation (R&E) Credit—for more than 30 years. If they expire, taxes will rise on those taxpayers who use them. Extending them prevents a tax increase, and there is no need for Congress to offset their cost.

If Congress insists on paying for their extension by raising other taxes, it will create an oxymoronic condition where it is raising some taxes to prevent raising others. And, of course, raising taxes is not sound policy.

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Go Through Policies Individually

Congress should also not fall into the trap of extending all the policies that make up the tax extenders en bloc. The various provisions in the package are of varying merit as they pertain to tax neutrality. Congress should go through each individual policy in the extenders package and evaluate them on their necessity for neutrality. It should retain those that pass the test and eliminate those that do not.[2]

Policies that particularly harm the neutrality of the tax code that Congress should unquestionably eliminate include:[3]

- Credits for producing biodiesel and renewable diesel;
- Credits for producing or selling alternative fuel and alternative fuel mixtures;
- The Alternative Fuel Vehicle Refueling Property Credit (for installing alternative-fuel mechanisms);
- Income tax credits and excise tax credits for producing or using ethanol;
- Renewable electricity production credit and the optional investment credit (better known as the wind tax credits);
- Credit for construction of homes designated by the government as energy efficient;
- Credit for producing appliances designated by the government as energy efficient;
- Credit for improving the energy efficiency of existing homes;
- New-markets tax credit;
- Empowerment-zone tax incentives;
- Enhanced mass-transit subsidies; and
- Low-income housing provisions.

There are policies in the package that arguably represent sound policy but are narrowly construed to apply only to certain industries. They pose a greater challenge.

One example is shorter depreciation schedules for capital purchased by restaurants and retail stores, motorsport racing track facilities, businesses on Indian properties, certain film and television productions, and a variety of other specific industries. For those industries that qualify, these policies move the tax code closer to expensing—i.e., allowing businesses to deduct immediately the cost of their capital expenses, which is the proper policy. But not all businesses can benefit from these incremental improvements. It would be better policy if all businesses could use them.

The increased payments to the Puerto Rican and U.S. Virgin Islands treasuries from excise taxes collected on rum imported into the 50 states and the District of Columbia from those islands pertains to the governance of U.S. territories and is best dealt with outside tax legislation.

Make Pro-Growth Changes

Congress should treat the elimination of unsound policies in the tax extenders as a small-scale tax reform and institute pro-growth changes in the tax code that reduce taxes by the amount of revenue that eliminating unsound policies would raise.

All areas of the code need improving, which is why fundamental tax reform is needed. A few places Congress could look to make incremental improvements that would strengthen the economy include:

1. Joint Committee on Taxation, "Estimated Revenue Effect of the Chairman's Mark of a Bill to Extend Certain Expiring Provisions Scheduled for Markup by the Committee on Finance on July 21, 2015," July 17, 2015, https://www.jct.gov/publications.html?func=download&id=4801&chk=4801&no_html=1 (accessed July 17, 2015).
2. Curtis S. Dubay, "Tax Extenders an Opportunity to Improve the Tax Code," Heritage Foundation *Issue Brief* No. 4187, March 31, 2014, http://www.heritage.org/research/reports/2014/03/tax-extenders-an-opportunity-to-improve-the-tax-code.
3. For an explanation of why these policies violate neutrality, 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.

- Expanding section 179 expensing so small businesses can expense all of their capital expenditures,
- Exempting taxpayers from paying interest on all or a portion of their savings, and
- Making it easier for all families to save more for whatever reason they deem necessary.

It would be best if the the two Houses of Congress chose which policy improvements they intend to make with the revenue raised from eliminating certain extenders first. That way, they could weigh the foregone benefit of that improvement against keeping unjustified tax extenders.[4]

Still Time to Follow Correct Process

Even though the extenders are currently expired, there is still time for the Senate to make the free-market supporting, pro-growth changes to the extenders legislation recommended above.

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4. J. D. Foster, "Tax Extenders Review Needs a Framework," Heritage Foundation *Issue Brief* No. 3586, May 1, 2012, http://www.heritage.org/research/reports/2012/05/tax-extenders-review-needs-a-framework.