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Tax Extenders: Don't Extend Bad Policy

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Every year or so, Congress reauthorizes a package of expiring tax provisions commonly known as tax extenders. While not the case every year, every expiring extender in this year's package grants an economic privilege tailored to some particular group or business interest.[1] Therefore, Congress should not renew any of these extenders and should instead allow them all to expire.

The recurring, temporary policy of tax extenders imposes unnecessarily high costs that are easily avoidable. Forty-seven distinct tax provisions expire in December 2016, 43 of which are positive tax expenditures, costing taxpayers $19 billion over 10 years.[2] Additionally, the yearly indecision around the extenders contributes to economic uncertainty, which distorts long-term financial planning and slows economic growth.[3] Temporary tax extenders also induce economically unproductive lobbying driven by special interests.

Last year, Congress chose to extend some expenditures indefinitely while extending others temporarily (each extender expires unless Congress chooses to renew it).[4] While not all tax extenders are created equal—some are corporate favoritism, pure and simple, whereas others have the potential to alleviate economic distortions in the income tax—the convention of temporary tax extenders should be ended. Meanwhile, all of the provisions in this year's package should be allowed to expire.[5]

TYPES AND EXAMPLES OF THE 2016 EXPIRING TAX EXTENDERS

This year there are 43 positive expiring tax expenditures in our analysis. About half of this year's extenders are

privileges in the form of tax credits. A tax credit allows an amount to be deducted directly from income taxes owed.[6] As a policy tool, tax credits are poorly designed incentives; they introduce unnecessary complexity and ambiguity to the tax code and most often poorly target the desired activity. An analysis by Mercatus economist Matthew D. Mitchell has shown that while tax credits can help the individual recipients, they usually have no impact on economic growth.[7]

Set to expire this year, the "second generation biofuel producer credit" provides a tax credit of just over a dollar per gallon for certain biofuel producers.[8] This credit demonstrates an archetypal problem of using tax credits as a privilege. The credit's benefits are highly concentrated, available to only a few producers. The benefit is so enticing and the credit's design is so complicated that three government agencies—the Environmental Protection Agency, the Internal Revenue Service, and the Department of Justice—have been unable to properly enforce the provision, as evidenced by several multi-million-dollar fraud cases involving this credit.[9] Even if policymakers decide that certain biofuels need a subsidy, it should be provided through the more transparent appropriations process rather than obscured and complicated in the tax code.

After tax credits, the most commonly used tax privileges are various forms of accelerated depreciation and related expensing. The tax code requires businesses to deduct the cost of new equipment and other capital purchases over a set number of years, a process known as tax depreciation. Depreciation is a feature of the income tax system that unnecessarily distorts tax rates and creates economic inefficiencies.[10]

Politicians are able to increase the after-tax profitability of an asset by shortening depreciation timelines and thus shifting tax payments into the future. Any deviation from the standard depreciation schedule is a relative tax subsidy for a specific industry or production method.

Specially tailored depreciation timelines or partial expensing for a privileged industry should be avoided. Congress should instead transition to a system of "full expensing"—allowing business to write off all expenditures in the year they are purchased. It would simplify the tax code, increase investment, and reduce the ability of politically favored industries to gain targeted tax benefits, while removing economic distortions and increasing economic growth.[11]

Included in this year's list of extenders is a 7-year recovery period for motorsports entertainment complexes, which allows recovery of motorsports racetrack construction and renovation costs to be realized over 7 years instead of the typical 15.[12] It is possible that NASCAR racetracks wear out in less than 15 years and that this special provision corrects their misclassification.[13] However, it is equally likely that NASCAR owners are the recipients of a tax privilege that is not available to other similarly situated businesses.

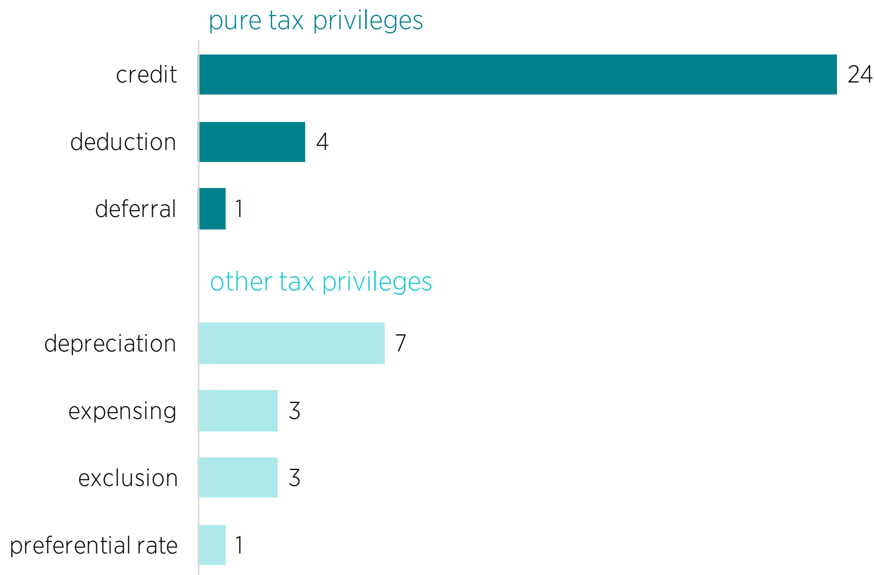
In addition to the NASCAR extender, this year's extenders include accelerated depreciation provisions for mining, green energy, racehorses, and film and TV production. A 2012 report by the Joint Committee on Taxation lists 55 similar statutory changes to depreciation periods.[14] Those provisions that use some form of partial or full expensing should be available to all businesses; if depreciation schedules are to be used, they need to be uniform and simple without special privileges.

EXTENDERS BY THE NUMBERS

It is important to distinguish between pure tax privileges, such as the biofuel producer credit, and extenders that, while still privileges, may be economically beneficial if expanded to all taxpayers, such as accelerated depreciation and expensing. A majority of tax extenders proposed for this year are unambiguously pure tax privileges. A smaller number of this year's extenders should be more carefully examined because they offer an opportunity to better understand some of the problems in our income tax system and the misleading way tax expenditures are measured.[15]

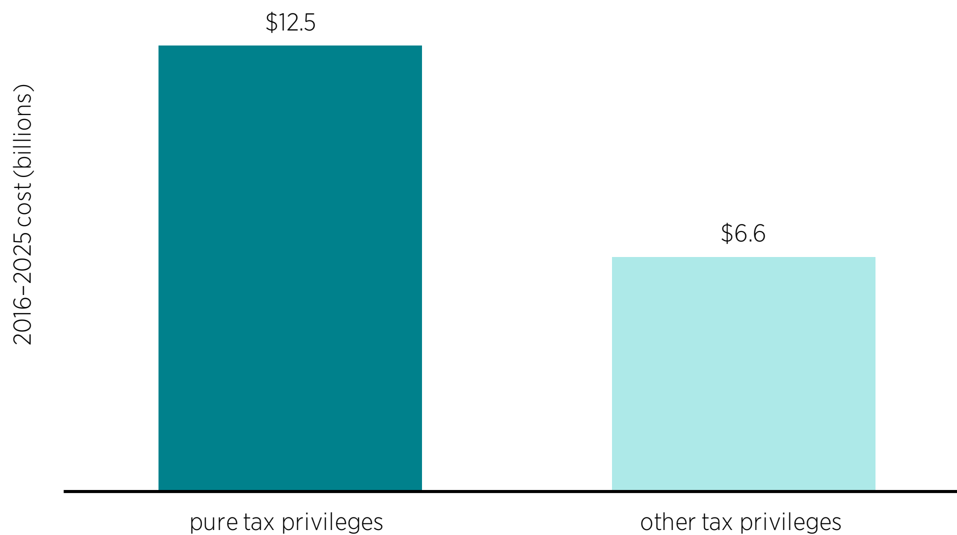
Figure 1 shows the number of tax extenders expiring this year, organized by the type of tax provision used to grant the privilege. By our count, the current list of extenders includes 29 pure tax privileges in the form of credits, deductions, and income deferrals.[16] Figure 2 shows that this first group's 10-year budget cost is $12.5 billion. The remaining 14 extenders in figure 1 are also tailored privileges that under their current design should be allowed to expire; these include narrowly tailored depreciation, expensing, tax exclusions, and preferential rates.[17] The estimated cost of these provisions is about $6.6 billion (figure 2). If applied to all taxpayers, this second group would correctly be thought of as patches to our income tax system and should thus not be counted as tax expenditures at all.[18] Even so, periodic temporary extensions are a poor way to craft tax policy.

FIGURE 1. 2016 TAX EXTENDERS BY COUNT AND TYPE



Source: Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2016–2025*, January 8, 2016.

FIGURE 2. 2016 TAX EXTENDERS BY DOLLAR AMOUNT AND CATEGORY



Notes: Cost estimates are for the 10-year budget window. Costs represent provisions that were generally in force from January 1, 2015, through December 31, 2016. Not all extenders have an estimated cost.

Sources: Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2016–2025*; Joint Committee on Taxation, *Estimated Budget Effects of Division Q of Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), the "Protecting Americans from Tax Hikes Act of 2015": Fiscal Years 2016–2025*, December 16, 2015.

They impose high costs on congressional time at the end of a session and create economic uncertainty, which distorts long-term financial business planning and slows economic growth.

CONCLUSION

Every year the message becomes clearer: Tax extenders should either all be made permanent or all be allowed to expire. This year, the choice is made simple by the extenders' blatant display of government privilege to special interests. Congress should not renew any of this year's extenders and instead should focus on more sustainable tax policy reforms:

- The savings from eliminating these privileges in the tax code should be used to lower top marginal rates across the board, which has been shown to facilitate growth.[19]

- Congress should institute more transparent accounting methods for tax expenditures by instructing the Joint Committee on Taxation and the Office of Management and Budget to use a more consistent consumption baseline.[20]

NOTES

1. Here we use "privilege" to describe government-granted benefits to an economic group. For a comprehensive examination of government-granted privilege, see Matthew Mitchell, *The Pathology of Privilege: The Economic Consequences of Government Favoritism* (Arlington, VA: Mercatus Center at George Mason University, 2014).

2. In order to analyze the different types of tax provisions, we have broken some of them into their component parts. Not included in our analysis are three negative tax expenditures (revenue raisers), the Airport and Airway Trust Fund excise taxes, and an increase in the cover-over limit for rum excise tax revenues to Puerto Rico and the US Virgin Islands. All of these extenders should also be allowed to expire. Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2016–2025*, January 8, 2016; Joint Committee on Taxation, *Estimated Budget Effects of Division Q of Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), the "Protecting Americans from Tax Hikes Act of 2015": Fiscal Years 2016–2025*, December 16, 2015.

3. Seth H. Giertz and Jacob Feldman, "The Costs of Tax Policy Uncertainty and the Need for Tax Reform," *Tax Notes*, February 25, 2013, 951–63.

4. Congress often allows some provisions to expire temporarily and then extends them retroactively. For example, the research and development tax credit was allowed to expire and retroactively extended 16 times before the extension was made permanent in 2015. Jason J. Fichtner and Adam N. Michel, "Can a Research and Development Tax Credit Be Properly Designed for Economic Efficiency?" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, July 2015), 14.

5. Extenders are most often temporary so that the official cost of the tax breaks appears small—a lower tax rate for one or two years appears less expensive than a permanently lower tax rate.

6. For example, a $10 tax credit reduces a firm's $100 tax liability to $90.

7. Matthew Mitchell, "Florida Man Seeks a Quarter of a Billion Dollars that Won't Help State," *Medium*, October 30, 2015; and Mitchell, *The Pathology of Privilege*. See also Michael Schuyler and William McBride, "The Economic Effects of the Rubio-Lee Tax Reform Plan" (Fiscal Fact No. 457, Tax Foundation, Washington, DC, March 2015); and Michael Schuyler and Stephen J. Entin, "Case Study #9: The Child Tax Credit" (Fiscal Fact No. 387, Tax Foundation, Washington, DC, August 2013).

8. 26 U.S.C. § 40(b)(6)(J) (2014); Paige Agostin, "$19.4 Billion in Corporate Welfare Congress Can Save Taxpayers This Year" (Report, Freedom Partners, Arlington, VA, August 2016).

9. Christopher Brown, "Biofuels Fraud Raises Questions about Oversight of Credits," Energy and Climate Report, *Bloomberg BNA*, October 4, 2016; Chris Prentice, "U.S. Biodiesel Executives Plead Guilty to over $60 Mln Fraud Scheme," *Reuters*, October 12, 2016.

10. Jason J. Fichtner and Adam N. Michel, "Options for Corporate Capital Cost Recovery: Tax Rates and Depreciation" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, January 2015).

11. Ibid.

12. 26 U.S.C. §§ 168(i)(15), 168(e)(3)(C)(ii) (2014).

13. Because every capital investment depreciates differently depending on use, location, and maintenance, all depreciation timelines are arbitrarily set and easily manipulated.

14. Joint Committee on Taxation, *Background and Present Law Relating to Cost Recovery and Domestic Production Activities* (scheduled for a public hearing before the Senate Committee on Finance, Washington, DC, March 6, 2012), 47–59.

15. For a more in-depth analysis, please see Veronique de Rugy and Adam N. Michel, "A Review of Selected Corporate Tax Privileges" (Mercatus Research, Mercatus Center at George Mason University, Arlington, VA, October 2016).

16. A tax deduction allows an amount to be subtracted from taxable income, reducing the income that will be taxed. Deferral allows payment of taxes owed to be postponed to a later time, which offers economic benefits. Unlike tax credits, deductions and deferrals are not always bad tax policy.

17. Exclusions and preferential rates can also provide pure tax subsidies, depending on their design.

18. For a more comprehensive discussion of these issues, see de Rugy and Michel, "A Review of Selected Corporate Tax Privileges."

19. Karel Mertens, "Marginal Tax Rates and Income: New Time Series Evidence" (NBER Working Paper No. 19171, National Bureau of Economic Research, Cambridge, MA, June 2013); Daniel J. Mitchell, "Lowering Marginal Tax Rates: The Key to Pro-Growth Tax Relief" (Backgrounder No. 1443, The Heritage Foundation, Washington, DC, May 22, 2001).

20. Ideally, the Congressional Budget and Impoundment Control Act of 1974 (Pub. L. No. 93-344, 88 Stat. 297 (1974)) should be amended to use a broad tax base that relies on final consumption. In fiscal years 2004–2009, the Office of Management and Budget set a precedent for such analysis. See Office of Management and Budget, *Analytical Perspectives: Budget of the United States Government, Fiscal Year 2009*, Appendix A.

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