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Stop Extending Bad Policy—Let the Tax Extenders Die

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Every few years Congress engages in a ritual extension of expiring tax provisions. On the same day the House passed its landmark tax reform bill, the Senate Finance Committee introduced the Tax Extenders Act of 2017 (S. 2256).[1] The bill extends targeted temporary tax provisions—most of which expired in 2016—for a variety of business operations, individual expenses, and industries.

Almost every extender in this year's package grants an economic privilege tailored to some particular group or business interest. By picking winners and losers, these corrupt policies distort efficient market outcomes. They thereby hamper economic growth and reduce opportunity for individuals and businesses whom Congress did not shower with special favors. Congress should allow all 35 tax extenders to expire.

This year, Congress is likely to include the proposed package of extenders along with some other must-pass bill, obscuring the numerous special interest subsidies in a broader legislative package. Reports indicate that Congress may attach the tax extenders to a looming budget deal, using the threat of a government shutdown to distract from the tax package. Such deals almost always waive spending constraints, such as the 2010 Pay-As-You-Go Act, allowing Congress to provide deficit-financed handouts through the tax code.

This paper, in its entirety, can be found at
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Narrowly tailored tax benefits are poor tax policy and destructive economic policy. The most prevalent tax extenders, for example, privilege government-favored energy policy over potentially more efficient market alternatives. They are even worse when such subsides masquerade as temporary policy, and then remain as an ongoing permanent feature of the tax code.

Temporary Tax Policy Is Bad Tax Policy

Temporary tax extenders have been the poster-child for America's dysfunctional tax code. They signal the dire need for comprehensive tax reform. However, as part of the most wide-ranging tax rewrite since 1986, Congress was unwilling to eliminate many narrowly tailored tax subsidies and unwilling at the same time to extend them permanently.

The last time Congress passed an extenders package, at the end of 2015, Republicans claimed that confusion over temporary tax policy "ends with this bill."[2] For a short few days, the omission of the extenders from the Tax Cuts and Jobs Act seemed to fulfill this promise and was a bright spot in the battle to eliminate narrowly tailored incentives in the tax code. Finally, they would be allowed to expire. Unfortunately, if the Tax Extenders Act moves forward, temporary tax extenders will remain a recurring feature of the U.S. tax code.

Periodic temporary extensions are a poor way to construct tax policy, budget policy and economic policy. Temporary re-authorizations mask the true cost of what are effectively permanent policy features. They provide an opening for politicians to request patronage from special interests on a semiannual basis, and create economic uncertainty, which distorts long-term financial business planning and can slow economic growth because businesses need policy certainly to make long-term investments.[3]

Tax Credits

More than half of this year's tax extenders package endows privileges in the form of tax credits.[4] Tax credits are a popular way for Washington to subsidize politically favored activities without actually appropriating any funds. The most numerous of these incentives are intended to encourage energy production and energy conservation.

As a policy tool, tax credits are poorly designed incentives; they introduce unnecessary complexity and ambiguity to the tax code and often poorly target the desired activity.[5] The government's use of the tax code to pick winners and losers has harmful economic effects on American families and businesses, by limiting their access to market-determined products and a less dynamic economy.

In the Tax Extenders Act, the Senate would extend 20 temporary tax credits, all of which expired at the end of 2016. In each case, these policies would be retroactively extended to include past investments made in 2017. As a matter of economics, a retroactive tax subsidy provides no incentive to invest in targeted technologies or locations. Instead, retroactive tax incentives accrue as a onetime windfall to investors. To the extent that the extenders bill is retroactive, it is a pure transfer to moneyed political interests, without the intended effect of incentivizing favored industries or products.

The bill could rightly be considered an energy-subsidy bill as two-thirds of the provisions are energy-related. Among the retroactively extended investment tax credits are those for hybrid solar lighting systems, fuel cells, geothermal heat pumps, combined heat and power systems, and small wind power.

Even when the credits apply to future investments, Congress does no service to these energy technologies and companies by subsidizing them. Tax credits for a specific resource or technology manipulates private-sector investment based on political agendas rather than market realities, distorts markets, and creates competition for subsidies rather than competitive companies.[6]

Accelerated Depreciation and Expensing

Unlike targeted tax credits, some pro-growth tax policies do reward economic growth in a neutral way. Expensing and accelerated depreciation, properly conceived, allow a more neutral treatment of capital expenditures. Unfortunately, the tax extenders only allow these beneficial provisions for narrow interests, such as race horses, NASCAR complexes, and biofuel.

Under the 2017 Tax Cuts and Jobs Act, new short-lived capital investments can be fully expensed for the next five years, when the temporary provision begins to phase out. Expensing allows companies to deduct the cost of investments at the time they occur rather than deducting that cost over many years based on cumbersome depreciation schedules. For those purchases that can be expensed, the provision removes a current tax bias against investment.

Full expensing should be permanent and afforded to all business purchases, not just used to favor new equipment or certain other parochial interests. Congress should resist the temptation to extend any narrowly tailored expensing or accelerated depreciation provision without first expanding its availability to all purchases without an expiration date.

Work Still Ahead

It would be a shame if Congress upended the success of the just passed Tax Cuts and Jobs Act by reanimating dozens of expired tax preferences. By not extending bad policy, the tax code can be improved through attrition.

1. S. 2256, The Tax Extender Act of 2017, https://www.congress.gov/115/bills/s2256/BILLS-115s2256is.pdf (accessed January 16, 2018).
2. Kevin Brady, Naomi Jagoda, and Cristina Marcos, "House Approves $622B Tax Plan," *The Hill*, December 17, 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, pp. 951–963, https://digitalcommons.unl.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1088&context=econfacpub (accessed January 16, 2018).
4. A tax credit allows the credited amount to be deducted directly from owed income taxes.
5. Veronique de Rugy and Adam N. Michel, "Tax Extenders: Don't Extend Bad Policy," *Mercatus on Policy*, November 2016, https://www.mercatus.org/system/files/mercatus-de_rugy-michel-tax-extenders-v1.pdf (accessed January 16, 2018).
6. Katie Tubb and Nicolas D. Loris, "Tax Extenders Would Make Energy Companies Dependent, Not Dominant," Heritage Foundation *Backgrounder* No. 3279, forthcoming.

TABLE 1

2017 Tax Extenders (Page 1 of 3)

ESTIMATED 10–YEAR COST OF 2–YEAR EXTENSION

Tax Credits and Other Provisions	Description	Cost (millions)
WIND, SOLAR, GEOTHERMAL, AND OTHER RENEWABLES		
Residential energy property (§25D(h))	30 percent of the costs including installation for small wind, geothermal, and fuel cell products (up to $500 per kilowatt for fuel cell products); credit reduced to 26 percent on December 31, 2019, and reduced to 22 percent on December 31, 2020	$1,100
Beginning-of-construction date for non-wind renewable power facilities eligible to claim the electricity production credit (§45(d))	Production tax credit per kWh for the first 10 years of service for open- and closed-loop biomass, geothermal, landfill gas, municipal solid waste, certain hydropower, marine, and hydrokinetic power facilities	1,356
Investment credit in lieu of the production credit and (§48(a))	30 percent investment tax credit including fiber-optic solar, small wind, and fuel cell property and 10 percent investment tax credit for microturbines and biomass combined heat and power; 30 percent investment tax credit reduced to 26 percent on December 31, 2019, and reduced to 22 percent on December 31, 2022	
ENERGY EFFICIENCY		
Certain nonbusiness energy property (§25C(g))	10 percent of residential energy efficiency purchases up to $500 total (such as solar-powered water heaters, and energy-efficient windows, doors, roofs, and HVAC)	$1,331
Construction of new energy-efficient homes (§45L(g))	Up to $2,000 for builders of homes meeting energy efficiency and savings requirements or that meet ENERGY STAR requirements	760
Energy-efficient commercial buildings deduction (§179D(h))	Tax deduction up to $1.80 per square foot for energy-efficient property (lighting systems, building envelope, HVAC, ventilation, or hot water systems) in a commercial building to reduce energy consumption	324
BIOFUELS AND ALTERNATIVE FUELS		
Qualified fuel cell motor vehicles (§30B(k)(1))	$4,000–$40,000, depending on weight, for a fuel cell vehicle	$6
Alternative vehicle refueling property (§30C(g))	30 percent credit for refueling equipment for hydrogen, electricity, biodiesel, and other alternative fuels, up to $1,000 for individuals or $30,000 for businesses	112
Two-wheeled plug-in electric vehicles (§30D(g)(3)(E)(ii))	10 percent of the cost up to $7,500 for battery-powered road vehicles like electric motorcycles	4
Second-generation biofuel producer credit (§40(b)(6)(J))	Up to $1.01 per gallon of second-generation biofuel (such as algae or wood-based fuels)	45
Biodiesel, renewable diesel, and alternative fuel tax credits and excise taxes (§40A, §6426(c)(6), §6427(e)(6), §6426(d), §6427(e)(6)(B))	Excise tax or tax credit of $1 per gallon of biodiesel, biodiesel mixtures, and renewable diesel, $0.50 per gallon of alternative fuel (such as compressed natural gas and liquid petroleum gas) excise tax credit	3,481

TABLE 1

2017 Tax Extenders (Page 2 of 3)

ESTIMATED 10–YEAR COST OF 2–YEAR EXTENSION

Tax Credits and Other Provisions	Description	Cost (millions)
BIOFUELS AND ALTERNATIVE FUELS (cont.)		
Special allowance for second-generation biofuel plant property (§168(l)(2)(D))	5-year depreciation schedule plus an additional 50 percent deduction in the first year of in-service second-generation biofuel plants	—
CONVENTIONAL ENERGY		
Mine rescue team training credit (§45N)	20 percent or up to $10,000 for mine rescue employee training	$4
Election to expense advanced mine safety equipment (§179E(g))	50 percent deduction of the cost of advanced mine safety equipment in the year put in service, such as emergency communication technology or comprehensive air-quality monitoring systems	—
Special rule for sales or dispositions to implement Federal Energy Regulatory Commission or state electric restructuring policy (§451(i))	Option for electric utilities to recognize gains over 8 years from transmission sales which are used to invest in the producing, transmitting, distributing, or selling of electricity or natural gas	—
Production credit for Indian coal facilities (§45(c)(10)(A))	Production tax credit per ton of coal produced and sold for Indian coal production facilities	75
Oil spill liability trust fund (§4611(f)(2))	Tax on crude oil and petroleum products of 9–9.7 cents per barrel	n/a
Production credit for advanced nuclear power facilities (§45J(b))	Production tax credit of 1.8 cents per kWh for the first 6,000 megawatts of new nuclear capacity placed in service, available for the first 8 years of operation; the credit is transferrable to public entities	400
Carbon dioxide sequestration credit (45Q)	$35 per metric ton tax credit for carbon capture used for enhanced oil recovery and $50 per metric ton tax credit for carbon capture geologic storage	n/a
NON-ENERGY BUSINESS PROVISIONS		
Indian employment tax credit (§45A)	20 percent credit to employers for up to $20,000 qualified wages and health insurance costs	$100
Railroad track maintenance credit (§45G)	50 percent credit for qualified railroad track maintenance by regional and short line railroads	400
Qualified zone academy bonds (§54E)	Certain qualified schools can borrow at low interest rates to establish special programs in partnership with the private sector	200
Classification of certain race horses as 3-Year property (§168(e)(3)(A)(i))	3-year write-off period for race horses, down from 7 years	—
7-Year recovery period for motorsports entertainment complexes (§168(i)(15))	7-year write-off period for motorsports entertainment complexes, down from up to 39 years	100

TABLE 1

2017 Tax Extenders (Page 3 of 3)

ESTIMATED 10–YEAR COST OF 2–YEAR EXTENSION

Tax Credits and Other Provisions	Description	Cost (millions)
NON-ENERGY BUSINESS PROVISIONS (cont.)		
Accelerated depreciation for business property on an Indian Reservation (§168(j)(9))	Special shorter depreciation schedules for qualifying business property on an Indian reservation	200
Special expensing rules for certain productions (§181)	Full expensing for qualifying film, television and live theatrical production costs in 2017, permanently extended in TCJA	—
Deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (§199(d)(8))	Up to 9 percent deduction of qualifying income from certain manufacturing and other domestic production in Puerto Rico	200
Empowerment zone tax incentives (§1391)	Businesses and individuals in economically depressed census tracts, eligible for a 20 percent wage credit, additional expensing, tax-exempt bond financing, and capital gains deferral	200
Extension of temporary increase in limit on cover of rum of excise raxes to Puerto Rico and the Virgin Islands (§7652(f))	$2.75 increase in the proof-gallon federal tax payment to Puerto Rico and the Virgin Islands based on locally or foreign produced rum	300
American Samoa economic development credit	Credit for taxes on business income attributable to American Samoa	—
INDIVIDUAL PROVISIONS		
Exclusion from gross income of discharge of qualified principal residence indebtedness (§108)	Excludes up to $2 million (married) of debt forgiveness on qualified principal residences from taxable income	$25,400
Mortgage insurance premiums treated as qualified residence interest (§163(h)(3)(E))	Qualified mortgage insurance premiums paid for a residence that qualifies for the mortgage interest deduction are also deductible	2,300
Above-the-line deduction for qualified tuition and related expenses (§222)	Deduction for the cost of college tuition and other education-related fees and expenses.	600

NOTES: For costs labeled "n/a," Joint Committee on Taxation provided no data. For costs labeled "—" costs are negligible or zero. Cost for the non-wind renewable power facilities credit does not account for the phase-out proposed in the Tax Extenders Act of 2017, which was not available.

SOURCES:
- Joint Committee on Taxation, "Estimated Revenue 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,'" JCX-143-15, December 16, 2015, https://www.jct.gov/publications.html?func=startdown&id=4860 (accessed October 18, 2016).
- Joint Committee on Taxation, "Technical Explanation, Estimated Revenue Effects, Distribution Analysis, and Macroeconomic Analysis of the Tax Reform Act of 2014: A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code," JCS-1-14, November 18, 2014, https://www.jct.gov/publications.html?func=startdown&id=4674 (accessed October 18, 2016).
- Joint Committee on Taxation, "Estimated Revenue Effects of H.R. 1, the 'Tax Cuts and Jobs Act,' Scheduled for Markup by the Committee on Ways and Means on November 6, 2017," JCX-46-17, November 2, 2017, https://www.jct.gov/publications.html?func=startdown&id=5026 (accessed January 9, 2017).

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A minority of the tax extenders that have economic benefits should be debated on their merits in future tax legislation, rather than bundled with pure subsides. In addition to expensing, there is a provision that provides capital gain protections for timber investments. This is a good policy which protects long-term investments from double taxation, is pro-growth, and works to remedy a fundamental flaw in the income tax system. Future legislation should address the treatment of timber and expensing permanently, without attaching subsidies for other industries.

The Tax Cuts and Jobs Act created a bevy of new expiring tax cuts which will also need to be extended to keep taxes from going up on millions of Americans. However, without spending restraint, Congress will find it difficult to permanently extend good tax policy. In the face of rising deficits and an unwillingness to address increasing spending, legislators have historically sought new sources of revenue or allowed tax cuts to expire.[7] Portions of President Ronald Reagan's tax cuts in 1981 and President George W. Bush's cuts in the early 2000s were ultimately reversed. Thus, spending reforms are a critical component of sustainable tax reform amid high government deficits and debt.

The tax extender's subsidies for railroads, electric vehicles, energy-efficient homes, and rum producers, just to name a few, should be allowed to expire forever. If Congress and the President are serious about removing the federal government from the business of picking winners and losers in the private market, there are many other permanent tax subsidies that also need to be repealed.[8] Future tax legislation should extricate the tax code from subsidizing privileged interests of all types.

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7. Christina D. Romer and David H. Romer, "Do Tax Cuts Starve the Beast? The Effects of Tax Changes on Government Spending," *Brookings Papers on Economic Activity* (Spring 2009), http://eml.berkeley.edu//~dromer/papers/Romer_BPEA_Reprint.pdf (accessed May 15, 2017).
8. Adam N. Michel, "Senate Should Follow House's Lead in Nixing Special-Interest Loopholes," The Daily Signal, http://dailysignal.com/2017/12/11/senate-follow-houses-lead-nixing-special-interest-loopholes/.