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How "Legislating to the Score" Makes Tax Policy Worse

Introduction

The issue of "tax extenders"—narrow tax breaks that are frequently renewed on a temporary basis in order to receive a deceptively smaller budget score—looms once more in Congress. Even after passage of tax reform that lowered rates across the board, lawmakers in the House and Senate are considering another round of tax extenders, featuring the revival of several measures that expired in 2017.

As with many things in Washington, the bizarre exercise of regularly renewing temporary provisions exists in no small part due to the scoring conventions of the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO). Extenders are often considered on a short-term basis because they would receive a more favorable budgetary score than a longer-term or permanent extension. However, continually extending short-term tax breaks, and enacting retroactive changes, is a shoddy method of administering tax policy that imposes extra complexities into the tax code and distorts long-term budget projections.

Key Facts:

- **"Tax extenders" refer to narrowly-targeted, temporary tax breaks that are regularly renewed, due in large part to budgetary scoring conventions.**
- **Administering tax policy through short-term, often retroactive, extenders creates problems in transparency and distorts the revenue baseline.**
- **The extenders should be considered as part of the annual budget process rather than on an ad hoc basis, and rigorous use dynamic scoring is critical for evaluating the tax code.**

Tax Extenders Explained

Tax extenders generally refer to short-term, targeted tax breaks that are regularly extended before they expire, or in some cases, are retroactively revived after they have expired. The number of extenders has declined in recent years. The Protecting Americans from Tax Hikes Act of 2015 made permanent several previously temporary tax provisions, including a tax credit for research and experimentation that was originally established as a temporary measure in 1981, and the deduction for state and local sales taxes that had been repealed in 1986 was then revived in 2004. Extenders were most recently continued in the Bipartisan Budget Act of 2018, which retroactively re-upped 28 provisions that had expired in 2016.

After the passage of the Tax Cuts and Jobs Act of 2017 (TCJA), which eliminated several tax breaks in exchange for lower overall individual and corporate income tax rates, the future of tax extenders was in question, but their popularity with legislators has led to another possible revival.

Tax Extender Proposals in Congress

The current tax extender package, as summarized by Adam Michel of the Heritage Foundation, represents specific tax breaks not popular enough to have been included in large-scale tax reform, and are instead biding their time before being attached as riders to much larger "must pass" legislation later in the year.

In the House, these extenders have been packaged in H.R. 3301, the Taxpayer Certainty and Disaster Tax Relief Act of 2019. Although the bill touts "certainty," this proposal would add an additional year—and in some cases two—to extenders, adding further uncertainty to an already rocky baseline. The extenders include three provisions on the individual income side of the tax code, eight business income tax breaks, and 14 energy tax provisions. The bill also includes temporary disaster tax relief and an extension of six tax breaks set to expire at the end of 2019, including an employer credit for paid family and medical leave, a new markets tax credit, a "look-through" treatment for controlled foreign corporations, and a TCJA excise reduction for brewers, distillers, and winemakers. The bill includes two revenue increases: an extension of an excise tax on coal to finance the Black Lung Disability Trust Fund, and a rollback of estate tax reform enacted in the TCJA that would boost death taxes by $37.6 billion over the next decade.

In the Senate, the Chairman Chuck Grassley (R-IA) and Ranking Member Ron Wyden (D-OR) of the Finance Committee have introduced S.617, the Tax Extender and Disaster Relief Act of 2019. The bill is very similar to the House's version but excludes the increase in the estate tax and the extension of the provisions set to expire at the end of 2019. It also includes two additional extenders: a 3-year depreciation for young race horses (two years old or younger) and an election to expense mine safety equipment.

The Scoring Problem

One of the main reasons these extenders regularly reappear as short-term breaks is because of the scoring concerns. A temporary tax provision will have much less of a revenue impact than a permanent one. Under pay-as-you-go budgeting rules, reductions in revenue need to be offset with either revenue increases or spending reductions elsewhere in the budget.

The Joint Committee on Taxation (JCT) estimated that the House's extenders from 2017 would result in tax relief totaling $20.4 billion over the first two years and $25.4 billion over the next ten years. JCT had earlier estimated that making all 2017 provisions permanent would reduce revenues by $91.4

billion over a decade.[1] As this latest legislative extender endeavor shows, this larger number is closer to the real budgetary impact these extensions would have as they are regularly re-upped over short-term intervals.

Additionally, the Congressional Budget Office (CBO) is statutorily required to construct its revenue baseline based on current law. So even though some of these provisions have been revisited and revived for at least a decade, they are officially scored for only the short duration for which they are extended in statute. Thus CBO's revenue projections are higher than would be expected considering the actual policies that Congress tends to implement.

The Defects of Implementing Short-term Tax Policies

The idea of targeted, narrow tax breaks for businesses in certain situations is not without merit. Sometimes it is good policy to implement temporary tax policy (for example to address an economic turndown or as part of disaster relief). In theory, making a tax break temporary allows for a built-in review process for Congress to evaluate its effectiveness. Unfortunately, this does not always happen, as extenders are regularly re-upped as a package without individualized examination. Dr. Rosanne Altshuler, Professor and Chair of the Department of Economics at Rutgers University, emphasized this lack of oversight in testimony before the Senate Finance Committee in 2012:

> [A]n expiration date can be seen as a mechanism to force policymakers to consider the costs and benefits of the special tax treatment and possible changes to increase the effectiveness of the policy. This reasoning is compelling in theory, but has been an absolute failure in practice as no real systematic review ever occurs. Instead of subjecting each provision to careful analysis of whether its benefits outweigh its costs, the extenders are traditionally considered and passed in their entirety as a package of unrelated temporary tax benefits.

This year's tax extender package is proving to be a notable exception from Dr. Altshuler's observation. While there have been hearings of varying degrees of detail regarding tax extenders, along with reports by the JCT and the Congressional Research Service, this year marks the first time in recent memory that a congressional committee has conducted a deep dive into the issue. Senate Finance Chair Grassley recently assembled three task forces to examine the current crop of extenders. Despite members' disagreement regarding the necessity of particular provisions, the bipartisan Cost Recovery Temporary Tax Policy Task Force concluded:

> The Tax Force believes temporary tax policy is inefficient. In some cases, the short-term nature of these provisions depresses investment over the uncertainty concerns of investors....it also hides the true budgetary impact of infinite, short-term extensions of these policies.

It is also worth noting that three other task force reports examining employment and development, health, and disaster relief tax breaks are forthcoming.

Impact on Tax Planning

Advocates for another round of tax extenders are requesting retroactive tax breaks despite having already made business decisions in an environment without their requested tax breaks. Businesses who stand to benefit from extender tax breaks have been making financial decisions for well over a year, expecting that the policies would be continued. This is an opaque process of making policy and fails to provide the tax certainty necessary for sound business planning.

[1] This figure excludes the "Beginning-of-construction date for non-wind renewable power facilities eligible to claim the electricity production credit or investment credit in lieu of the production credit" due to its lack of inclusion in either S. 616 or H.R. 3301.

Lack of Comprehensive Review

The structure of tax extender provisions is haphazard policy making, as noted by groups across the ideological spectrum. Through extenders, Congress is providing narrowly-targeted tax breaks on an informal ad hoc basis rather than via a formal and robust budget process considering tax policy as a whole. Many have raised concerns that the provisions only benefit a narrow part of the economy or are propping up otherwise unprofitable industries.

A Better Path for Tax Policy

Lawmakers should strive to make the tax code simpler and fairer. The tax extender process imposes unnecessary complexities in to the system, impacting private sector planning and also federal administration and budgeting. The tax extenders should be considered as part of the regular annual budget process. Pro-growth extenders could be made permanent while other narrow carve-outs could be converted to achieve lower tax rates for all taxpayers.

Rigorous use of dynamic scoring would be critical to the success a reformed process on extenders. Through dynamic scoring, analysts to assess the macroeconomic impact of proposals using market-based metrics rather than presuming static response to changes in policy. In one example, JCT's dynamic score of a previous extender found that its revenue loss was 11 percent lower than under a static analysis.

Unfortunately, House Democrats scrapped a dynamic scoring requirement in its rules package for the current Congress. The previous Repbulican majority had instituted dynamic scoring in its biennial rules for the Chamber. In the absence of dynamic scoring, budgetary cost estimates will not take into account the reality that consumers and the market react to changes in tax policy, be they incentives to do something through tax cuts or disincentives through tax hikes.

Through comprehensive review, lawmakers could also evaluate whether specific, narrow breaks are duplicative of other provisions, especially in the wake of the TCJA. The current crop of extenders includes several expensing reimbursements and place-based initiatives that potentially overlap with provisions in the TCJA. Many of these expensing reimbursement extenders (racehorses, racetracks, mine safety equipment, and second generation biofuel production) are already covered by TCJA investment tax cuts, allowing these small interests to double-dip. Locational extensions (such as an American Samoa tax credit, Indian reservation investment, and empowerment zones) could all be covered by the TCJA's "Opportunity Zone" provision.

Conclusion

Retroactive lawmaking is bad policy, adding unnecessary complexities to tax planning and federal budgeting in service of a "prettier" budget score. If there are "extenders" that are pro-growth, lawmakers could consider making them permanent. Otherwise, lawmakers should follow the model of TCJA and eliminate redundant tax breaks in order to achieve lower tax rates across the board.

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