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POLICY POINTS

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# "TAX EXTENDERS" BILL THE LATEST TEST OF CONGRESS'S COMMITMENT TO FISCAL DISCIPLINE

"Tax extenders" legislation now before the Senate has become the latest battleground in the intensifying debate over whether Congress should abide by its "pay-as-you-go" (PAYGO) rules and pay for new tax and budget measures so they don't expand the deficit. Opposition to abiding by PAYGO is also impeding congressional action to extend Alternative Minimum Tax relief and to avert a scheduled cut in Medicare payments to doctors, and it will be central to the coming debate over extending the 2001 and 2003 tax cuts.

Unfortunately, key congressional Republicans are now arguing that any extension of existing tax provisions should be deficit financed, *on principle.* This claim will make it much tougher for Congress to live up to its pledge of fiscal discipline and could ultimately lead to multi-trillion dollar increases in the national debt.

**Congress should pay for the tax extenders, as its budget rules require.**

- On May 21, the House adopted legislation extending for one year various tax cuts that expired at the end of 2007, including the Research and Development Tax Credit, the state and local sales tax deduction, and the tuition deduction. The legislation does not add to deficits because it fully offsets the cost of these provisions (as well as other tax cuts it contains[1]) with revenue-raising measures.

  According to news accounts, the Senate will soon take up and attempt to pass the House bill or a similar measure. However, Senate Republican leaders and the White House are urging the Senate to instead extend the expiring tax provisions *without* offsets.

- Congress's PAYGO rules, which require it to offset the cost of new tax cuts, extensions of existing tax cuts, or expansions of entitlement programs, reflect the simple reality that all tax cuts and program increases must eventually be paid for. As the Administration's own Treasury Department has found, tax cuts do not pay for themselves; nor can they be financed with higher deficits forever. Given that the nation already faces massive fiscal challenges in coming decades, it is irresponsible to foist the cost of new budget and tax legislation on to future taxpayers.

- If enacted without offsets, the tax cuts in the House-passed extenders bill would add $54 billion to deficits and debt. Moreover, failure to pay for this year's extenders bill could set a precedent for further unpaid-for extensions of these provisions, which could add as much as $500 billion to deficits and debt over the next decade.

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[1] For example, the House-passed bill includes an important improvement in the refundable Child Tax Credit; see Aviva Aron-Dine, "Improving the Refundable Child Tax Credit," Center on Budget and Policy Priorities, revised May 19, 2008, http://www.cbpp.org/10-24-07tax.htm.

**Arguments against applying PAYGO to the extenders bill do not withstand scrutiny.**

- Congressional Republican leaders and the Administration argue that all extensions of expiring tax provisions should be exempt from PAYGO rules. They also argue that no expiring tax cuts should be allowed to expire. *Adopting these two principles would add more than $4 trillion to deficits over just the next ten years.*

- Adopting the principle that extensions of expiring tax provisions need not be paid for would also encourage policymakers to create even more new "extenders." Supporters of new tax cuts would know that, if they could just enact these tax cuts for as short a period as one year, the tax cuts could then be made permanent without any offsets. This could lead to an even greater explosion in temporary tax provisions than has already occurred and to even larger increases in deficits and debt.

- Last fall, Senate Minority Leader Mitch McConnell declared that to offset the cost of extending expiring tax provisions would be "offensive" to Senate Republicans. This position — that extensions of tax provisions should be deficit financed *as a matter of principle* — is difficult to comprehend. It implies, for example, that even if Senate Republicans *support* a particular revenue-raising measure, they will *oppose* using it to pay for extending a tax provision.

**The offsets in the House-passed bill are reasonable policy.**

- One offset would close a loophole that allows wealthy hedge fund managers and certain other individuals to avoid paying tax on deferred compensation they shelter in offshore tax havens. In the past, senators of both parties have recognized that the deferred compensation rules are being abused and have voted to impose limits on deferred compensation. The House bill takes a different approach: it simply requires individuals to pay U.S. income tax on deferred compensation paid by tax-haven based corporations.

- The other offset in the bill would effectively roll back a tax cut for multinational corporations that was enacted in 2004 but has not yet taken effect. The 2004 provision (known as "worldwide interest allocation") allows firms to use a more favorable formula for apportioning certain tax deductions between U.S. and foreign income.

  The tax code already treats firms operating abroad very generously. In fact, the current tax system appears, on average, to *subsidize* U.S. firms operating abroad: the Joint Committee on Taxation has estimated that fully exempting the foreign earnings of U.S. firms from tax would actually *raise* revenue. This is in large part because current law effectively allows multinational firms to defer tax on their foreign earnings indefinitely while still claiming immediate tax deductions for foreign business expenses they incur in generating these earnings; they are able to apply these deductions to reduce tax on their *U.S.* earnings. The 2004 provision would make the tax treatment of multinational corporations even more generous, without addressing any of the opportunities for tax avoidance the current tax rules create.

- Much of the business community itself appears to believe that the offsets in the House bill would have little impact on business activity and are reasonable as part of the overall legislation. In fact, some in the business community have expressed resentment of Senate policymakers who oppose the House-passed offsets and plan to block extension of "extenders" legislation that includes these or other offsets. As one lobbyist told *Congress Daily*, "A number of companies are expressing a certain resentment that they're going to [lose tax benefits like the Research and Development Tax Credit] in the name of protecting hedge funds." Such comments from business lobbyists suggest that much of the opposition to the House offsets stems from the Republican leadership's commitment never to pay for any tax-cut extensions, rather than from concerns about the particular measures in the House bill.

**In the future, Congress should subject the extenders to greater scrutiny.**

- The tax extenders have become more expensive each year as Congress enacts new "temporary" tax cuts with no intention of letting them expire. The overwhelming majority of the expiring provision in this year's extenders bill were enacted since 2001.

- At last fall's markup of a similar extenders bill, Ways and Means Committee Chair Charles Rangel called for a comprehensive reevaluation of the tax extenders to see which were achieving their goals and should be made permanent and which should be allowed to expire. Such a review would be highly desirable. In the meantime, given that the President and lawmakers of both parties support continuing the now-expired tax extenders through 2008, it is important that Congress offset the cost.