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CBPP STATEMENT

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Greenstein: Assessing the Tax Provisions of the Bipartisan Budget and Tax Deals

The tax parts of the new bipartisan deals include provisions that mark a major achievement in reducing poverty and helping poor and modest-income working families, but also disturbing provisions that could cause budget deficits and health care costs to rise substantially over time. Assessing the tax provisions as a whole depends on the standard one uses: whether one compares them to exemplary tax policy or to what policymakers likely would do in the absence of these deals.

Moreover, a more definitive judgment lies in the future, because much depends on whether the provisions delaying the excise tax on high-cost health insurance plans and suspending the health insurance and medical device taxes prove a death knell for those measures or whether they ultimately take effect, with reforms in the excise tax.

Tax Credits for Working Families

The deal makes permanent three significant improvements in the Earned Income Tax Credit (EITC) and the low-income component of the Child Tax Credit (CTC), along with the American Opportunity Tax Credit (AOTC) — all of which were originally enacted as part of the 2009 Recovery Act. Under current law, these EITC and CTC improvements as well as the AOTC, which helps low- and middle-income families defray college costs, are set to expire at the end of 2017.

Making the EITC and CTC improvements permanent would rank among the biggest anti-poverty achievements, outside of health reform, in years. These improvements lift about 16 million people, including about 8 million children, out of poverty or closer to the poverty line each year. With these improvements, the EITC and CTC keep more children out of poverty than any other federal program, which would no longer be true if the improvements expired. Making permanent the American Opportunity Tax Credit also would also help many low- and middle-income families, though we lack data on its poverty impacts.

The EITC and CTC improvements also help many families modestly above the poverty line that struggle to make ends meet. Overall, these provisions supplement the wages of working families that contain about 50 million people, including about 25 million children.

For example, a single mother with two children who works full time at the federal minimum wage of $7.25 an hour and makes $14,500 a year would lose her entire $1,725 Child Tax Credit if these improvements lapsed.

Growing evidence indicates that not only do the EITC and CTC encourage and reward work, but the income that low-income working families receive from these credits is also linked to improvements in maternal and infant health, better school performance among children, higher college enrollment, and increased work effort and earnings when the children reach adulthood.

Tax Extenders

The deal makes permanent several of the most popular "tax extenders," including the research and experimentation (R&E) tax credit, a provision (known as section 179) that allows small businesses to deduct a certain amount of investment immediately, a deduction for certain state and local sales taxes, and tax breaks for charitable giving. The deal extends most of the other extenders for two years, with a few small or modest breaks continued for five years. It also continues for five years the bonus depreciation tax break — a major corporate tax break that has been in effect since 2008 — while scaling it down so that by the fifth year, the tax reduction that this measure provides would be three-fifths its current size.

On the one hand, policymakers should not continue these tax breaks without paying for them, and they shouldn't continue bonus depreciation — launched as a stimulus measure during the economic downturn — at all, given that the economy is well into recovery. On the other hand, without the deal, policymakers almost certainly would continue nearly all of the extenders for another two years, without scaling them back. And at the end of the two-year period, they very likely would extend them again, as they consistently have in the past.

Consider the history. The R&E tax credit has been around for over three decades and is strongly supported by Republicans and Democrats alike. The pattern with these extenders is clear: every year or two, no matter the balance of party power, policymakers enact a package of tax extenders without paying for them by huge bipartisan majorities.

In this respect, the official "score" for (that is, cost of) the tax-extender provisions is a little deceptive: the R&E credit and other extenders that the deal makes permanent will ultimately cost the same amount whether policymakers make them permanent now or continue to extend them every year or two.

In this vein, I can find one modest benefit and one glimmer of hope in this part of the package. On the modest benefit, absent the deal, policymakers would likely extend bonus depreciation for two years without scaling it back at all. That would increase the risk that this large tax break would become embedded as one of the ongoing extenders and be extended every few years. At least this package scales bonus depreciation back.

On the glimmer of hope, perhaps after making the most popular extenders permanent, thus removing them from future extender packages, policymakers may not find it so easy politically in the future to keep extending all of the other tax breaks without paying for them, thinning them out, or scaling them back.

Health Tax Provisions

The health tax provisions, by contrast, do not continue tax breaks that are already in law, and they threaten to punch a large new hole in federal revenues and to undo one of the most important measures on the books to slow the rate of growth of health care costs.

The deal delays for two years the excise tax on high-cost health insurance plans (the "Cadillac tax") that would otherwise take effect in 2018, suspends for two years the medical device tax (which is already in effect), and suspends for one year the tax on health insurance companies (also already in effect). We won't know how large and deleterious the effects of these provisions will be until we see what happens to these taxes at the end of these delay and suspension periods.

If policymakers treat the delays or suspensions of these taxes themselves as a new kind of "extender," repeatedly renewing the delays and suspensions and never letting the taxes take effect, the adverse long-term consequences would be big. The federal government would have substantially less revenue: these taxes are projected to raise $257 billion over the next ten years and a much larger amount — close to $750 billion — in the decade after that. (The $257 billion reflects the Joint Committee on Taxation's estimate for the next ten years. Based on JCT's estimated revenue losses in the tenth year, 2025, and its estimate of the year-to-year change in the revenue losses, the loss in the second decade would be roughly $750 billion.)

In addition, economists widely believe the excise tax on high-cost insurance plans would play a significant role in slowing the rate of growth of health care costs throughout the U.S. health care system. Higher health-care cost growth ultimately has adverse effects on federal and state budgets, on consumers, and on the economy.

Accordingly, the long-term impacts of the tax provisions will depend significantly on what happens to these health taxes after their delay and suspension periods. If policymakers make needed adjustments in the Cadillac tax to address various concerns with it (the deal takes a small first step in that direction by making the excise tax on high-cost plans deductible for firms) — or if they replace the tax with another measure to achieve cost-containment goals such as a well-designed cap on the tax exclusion for employer-based health coverage — and they reinstate the other two health taxes, the damage (in terms of rising deficits and health care cost growth) will be contained. On the other hand, if the health tax measures die, the long-term damage will likely be substantial.

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