Citizens for Tax Justice

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The Senate UI Bill: Must Everything Involve Tax Cuts?

Efforts by Congressional leaders to extend unemployment insurance (UI) benefits are entirely reasonable. Around 400,000 workers exhausted their unemployment benefits at the end of September and far more will exhaust them by the end of this year unless an extension is provided.[1] It is unfortunate, however, that the price of providing this necessary help will be tax breaks to corporations and to the housing industry.

The Senate may vote this week on H.R. 3548, the Worker, Homeownership, and Business Assistance Act of 2009, and send it back to the House of Representatives, which is likely to approve it immediately under an expedited procedure. The legislation would extend unemployment benefits in every state for up to 14 weeks. In the states where the rate of unemployment is over 8.5 percent, UI benefits would be extended an additional six weeks.

These provisions would not add to the budget deficit because they would be offset by an extension of the Federal Unemployment Tax Act (FUTA), which employers pay to administer and partially fund the UI program.

Sadly, Senators did not think this was worthy enough to do without larding the bill up a bit with tax cuts. One is a tax cut that will benefit people who buy a residence and who would have done so whether or not a tax cut was offered to them. The second will essentially give unprofitable companies cash with no strings attached.

The Homebuyer Tax Credit

Official 10-Year Cost Estimate: $10.8 Billion
Realistic 10-Year Cost Estimate: ?

The housing bill passed by Congress last year and signed by President Bush included a $7,500 tax credit for first-time homebuyers that would have to be paid back over a number of years, essentially amounting to an interest-free loan. The American Recovery and Reinvestment Act (ARRA) enacted early this year extended and expanded this provision into an $8,000 credit with no requirement for repayment, available for first-time homebuyers with incomes below $75,000 for singles and below $150,000 for married couples. To receive the credit, homes would have to be purchased before the end of November of this year.

This seemed like a bad idea from the very beginning. One problem with a tax incentive of this sort is that it goes to people who would have engaged in whatever activity Congress is trying to encourage (in this case, home purchases) even if the tax incentive was not available. But even if the homebuyer tax credit does prod some people to buy homes who otherwise would not, why is that something Congress wants to encourage? Isn't over-consumption of housing, and the hugely inflated housing prices that resulted, what caused the recession? That Congress would want to push housing prices

[1] National Employment Law Project, "Talking Points: Immediate Action Needed to Extend Unemployment Benefits," August 20, 2009. http://www.nelp.org/page/-/UI/August2009ExtensionTalkingPoints.pdf?nocdn=1

back up seems bizarre.

The homebuyer tax credit was estimated at the time of enactment to have a cost of $6.6 billion, but is actually on track to cost more than twice that, according to Ted Gayer at the Brookings Institution. He has written that:

> The tax credit is very poorly targeted. Approximately 1.9 million buyers are expected to receive the credit, but more than 85 percent of these would have bought a home without the credit. This suggests a price tag of about $15 billion – which is twice what Congress intended – for approximately 350,000 additional home sales. At $43,000 per new home sale, this is a very expensive subsidy.[2]

The Senate UI legislation includes a provision that would extend the homebuyer credit to those who enter a contract to purchase a house by the end of April 2010 and close within 60 days.

Even worse, the Senate would extend the credit to people who are currently not eligible for it. The income limits would be raised from $75,000 to $125,000 for singles and from $150,000 to $225,000 for married couples.

Most bizarrely of all, even current homeowners will be allowed a credit of $6,500 for the purchase of a new home if they've lived in their current home for at least the last five years. If the problem with the housing market is that supply exceeds the demand, it's not obvious how moving a family from one house into another house helps that problem at all.

Net Operating Loss Carryback

Official 10-Year Cost Estimate: $10.4 Billion
Realistic 10-Year Cost Estimate: $18 Billion

As a general rule, a company operating at a loss (for tax purposes) in a given year will not have to pay taxes for that year, because its deductions will wipe out its taxable income. Usually, if a company has excess deductions for net operating losses (NOLs) beyond its taxable income for the year, it can apply those excess deductions not only against earnings in later years, but also against income taxed in the previous two years. That allows it to get previously paid taxes refunded.

The American Recovery and Reinvestment Act (ARRA) enacted early this year includes a provision that allows a company to apply these excess deductions for losses in 2008 against income that was taxed in the previous 5 years (instead of just the previous 2 years). The ARRA restricted this break to businesses with less than $15 million in annual revenue, but Senate leaders and the Obama administration want to expand this break.

There is no reason to think this change would lead to greater investment or to the creation or retention of jobs. Allowing a company to use its current year losses to get a refund of taxes paid in the past does not lower the costs of doing business or make it easier to profit. It would simply hand cash to business-owners who are not profiting currently. Smart business people will expand their business only if they can profit by doing so, regardless of how much cash they have on hand. A business owner is likely to lay off workers if she cannot earn enough to cover expenses and enjoy a profit. Simply giving the business owner some cash with no strings attached will not change that.

Worse, this provision funnels tax cuts to the financial and construction industries, which many

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[2] Ted Gayer, "Should Congress Extend the First-Time Homebuyer Tax Credit?" September 29, 2009, Brookings Institution. http://www.brookings.edu/opinions/2009/0924_tax_credit_gayer.aspx

analysts believe played a significant part in inflating the housing bubble that turned into the current recession.

Sadly but predictably, the Senate wants to both extend and expand this tax break. It would be extended by allowing a five-year carryback of losses incurred in 2009 or 2008 (whereas ARRA only allowed this for losses in 2008). And this tax break would be expanded so that it's available for all companies, not just those with gross receipts under $15 million. Companies would be allowed to use the NOLs to offset up to half of their income from the fifth year and all of the income in the other four years.

The NOL provision will cost a lot more than the official estimates would have you believe. This was demonstrated in the previous versions of the NOL carryback before the final recovery bill was passed. The Senate NOL carryback provision had an official estimated cost of $17 billion over ten years, but CTJ calculated that it would really cost $24 billion over ten years.

The official score for the NOL provision in the present UI legislation is $10.4 billion but the real cost, including interest on deferred tax revenues exceeds $18 billion. Specifically, the Senate version is estimated to cost $33.2 billion in 2010, with paybacks thereafter, as deductions taken early are no longer available, reducing the 10-year cost to $10.4 billion. When you consider the interest lost to the government on those delayed tax payments, the provision's present-value cost (its lump-sum equivalent if paid in full right away) is over $18 billion.

Offsetting the Costs of The Tax Cuts: "Delaying" a Tax Cut that Does Not Exist

Lawmakers who question the value of these tax cuts might comfort themselves by saying that they at least avoid increasing the budget deficit since the cuts are offset with revenue-raising provisions. Their rationalization is unwarranted: the revenue offsets involve delaying a tax cut that has not even taken effect yet. Congress should not give itself credit for raising revenue in this manner unless it repeals the tax cut altogether.

The tax break in question, the "worldwide interest allocation" rules, were enacted in 2004 but were originally to take effect in 2009. They would allow multinational corporations to include interest expense of foreign subsidiaries in their worldwide interest allocations. This would decrease the amount of domestic interest expense allocated to foreign income, increasing the amount of foreign tax credit that can be claimed against U.S. tax.

Repeal of worldwide interest allocation was included in Congressman Rangel's 2007 tax reform bill. But Congress has not chosen to repeal this tax break. The housing bill enacted in the summer of 2008 delayed implementation of this tax break for two years, until 2011.

Now, the Senate bill would delay it for another nine years. It's clear that some members of Congress want to keep this tax break on the books so that they can "delay" it's implementation every few years, which will always be recognized as producing savings that can be spent on something else. It has been reported that Congress heard very little from lobbyists who opposed delaying the worldwide interest allocation rules, making it one of the few revenue sources that Congress can turn to over and over without offending corporate lobbyists.[3]

[3] Brett Ferguson and Heather M. Rothman, "Opponents of Delaying Worldwide Interest Allocation Rule Question Its Score as Offset," Daily Tax Report, September 8, 2008.