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CTJ Citizens for Tax Justice

Tax Provisions in Recent Jobs Legislation

Over the past several weeks, Democratic leaders in the House and Senate have pursued a strategy of enacting several small pieces of legislation to address joblessness. While lawmakers might find this strategy easier than passing one great big bill, it does make it a bit difficult for those of us who are trying to keep track of which tax provisions Congress has passed and which provisions are still being debated. We provide the following information to simplify this task.

Summary

On March 2, the President signed a short-term extension of unemployment insurance (UI) and COBRA health benefits for the unemployed (H.R. 4691) into law, after Senator Jim Bunning (R-KY) infamously held up the bill for days, wreaking havoc on state unemployment offices, construction projects, and working and out-of-work families.

On March 10, the Senate passed H.R. 4213, which includes a longer-term extension of UI and COBRA (through the end of 2010) as well as the “tax extenders,” which are one-year extensions of tax cuts (mostly for business) which Congress passes every year. The biggest revenue-raising provision used to offset the costs of this bill would close the “black liquor” loophole benefiting paper manufacturers. (This revenue-raiser is included in the health care reform bill before Congress now, meaning H.R. 4213 would probably have to be amended with new revenue-raisers before it could be enacted.) It’s unclear how the House will proceed with this bill. (The House passed its own version of the “tax extenders,” H.R. 4213, on December 9.)

On March 18, the President signed into law H.R. 2847, the “HIRE” Act (which was approved by the Senate the previous day and by the House on March 4). This bill creates a tax credit for companies that hire people who have been unemployed for at least 60 days. The “jobs tax credit” may not be very effective, but on the upside, one of the revenue-raising provisions cracks down on offshore tax evasion.

On March 24, the House passed H.R. 4849, the “Small Business and Infrastructure Jobs Tax Act,” which includes capital gains tax breaks for small business, an extension of the TANF emergency fund, and provisions relating to bonds for infrastructure. One of the revenue-raising provisions is a measure championed for several years by Congressman Lloyd Doggett (D-TX) and CTJ to prevent corporations from taking advantage of tax treaties to avoid taxes.

Many policy analysts have begun to rally around a bill that includes no tax changes. On March 10, Congressman George Miller (D-CA), chairman of the House Committee on Education & Labor, introduced the “Local Jobs for America Act,” H.R. 4812, which would spend $100 billion over two years to help state and local governments and non-profits hold off on personnel cuts and hire more teachers, police officers, daycare workers and other providers of important services.

H.R. 4691, Temporary Extension Act
Signed into law on March 2.

- Short-term extension of unemployment benefits, COBRA health benefits for the unemployed, and other measures.

This is the bill that was famously blocked for days by Senator Jim Bunning (R-KY). It does not change tax policy, but some Republican Senators had threatened to block it unless Democrats agreed to hold a vote on a measure to cut the estate tax for millionaires.

H.R. 4213, American Workers, State and Business Relief Act
Passed by Senate on March 10; must be passed by the House or reconciled with House-passed "tax extenders" bill.

- Extends UI and COBRA health benefits for unemployed through end of 2010.
- Includes the "tax extenders," which are one-year extensions of tax cuts (mostly for business) that Congress passes each year.
- Extends additional state Medicaid funding (originally part of Recovery Act) for six months.
- Other provisions relate to the Medicare "doc fix," pension plans, and satellite television.

Offsets

- Closes the "black liquor" loophole.

Ten-year revenue gain: $21.7 billion
(This provision is included in the new health care bill before Congress and would therefore need to be replaced with a different revenue-raising provision.)
Congress created a tax credit for the use of alternative fuels mixed with fossil fuels in 2005 and then expanded it in 2007. Companies that manufacture paper realized they could qualify for the credit by mixing some diesel with "black liquor," which is a sort of liquefied wood that is a by-product of their manufacturing process and which they've been using as fuel for decades. This loophole will likely be closed when the two chambers decide when and how. (The House included this loophole-closer in the health care reform bill it passed last year.)

- Clarifies the "economic substance" doctrine.

Ten-year revenue gain: $5.5 billion
(This provision is included in the new health care bill before Congress and would therefore need to be replaced with a different revenue-raising provision.)
The doctrine has been developed over the years by courts to disallow losses or deductions that have no economic substance apart from their tax benefits. Unfortunately, courts do not apply the doctrine uniformly. The bill would put the economic substance doctrine into the tax law, thereby disallowing losses, deductions, or credits arising from "tax avoidance transactions," for example, where the present value of the tax savings far exceeds the present value of the pre-tax profits.

- Requires information reporting for rental property expense payments.

Ten-year revenue gain: $2.5 billion

- Other offsets.

Ten-year revenue gain: $1.6 billion

H.R. 2847, Hiring Incentives to Restore Employment (HIRE) Act
Signed into law on March 18.

- Provides tax credits for hiring people who have been unemployed for at least 60 days.

Any business hiring a person in 2010 who has been unemployed for at least 60 days would not have to pay the employer half of Social Security taxes for as long as the person is employed, through the end of the year. This could save a business up to $6,621 per employee. The business would be allowed an additional credit of $1,000 for each of these employees that are retained for a full year. There are serious questions about whether or not tax credits for job creation accomplish very much, since they inevitably go to companies who would hire workers with or without such credits. At least this particular jobs tax credit is limited to a very specific population (the long-term unemployed) which restricts the overall cost of the credit.

- Extends higher limits for small business expensing under Section 179 (doubled from $125,000 to $250,000) for another year, through the end of 2010.
- Expands eligibility for Build America Bonds (which help state and local governments borrow to finance building projects).
- Extends Highway Trust Fund.

Offsets

- Foreign Account Tax Compliance.

Ten-year revenue gain: $8.7 billion

This measure to combat offshore tax evasion was initially proposed last year by the chairmen of the House and Senate tax-writing committees. It would subject transfers of income to foreign financial institutions to a withholding tax unless the institution provides information about their U.S. customers to the IRS. The IRS would be given several additional tools to more easily identify those illegally hiding their income in offshore tax havens.

- Delay Implementation of "Worldwide Interest Allocation" until 2021.

Ten-year revenue gain: $9.9 billion

The "worldwide interest allocation" rules were enacted in 2004 but were originally scheduled 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. Then the UI/homebuyer tax credit bill enacted in November delayed this tax break another seven years, to 2018. The HIRE Act would delay this tax break again, this time for an additional two years, to 2020.

H.R. 4849, Small Business and Infrastructure Jobs and Tax Act
Passed by the House on March 24; no action yet in the Senate.

- Allows 100% tax exclusion for capital gains from small business stock acquired after March 15, 2010 and before January 1, 2012.

The American Recovery and Reinvestment Act (the Recovery Act) increased the existing exclusion for small business capital gains from 50% to 75% for 2009 and 2010. This measure would go farther, but not as far as the Obama administration proposes (which would allow a 100% exclusion permanently). It's hard to imagine that this will boost small business investment and create jobs any time soon. Investors need to see that there is demand right now for whatever product or service is being sold. This tax break merely increases the after-tax gains of investors in the future *if* that demand materializes.

- Includes provisions related to infrastructure bonds.
- Changes in the low-income tax credit.
- Extends the Temporary Assistance for Needy Families (TANF) emergency fund (included in the Recovery Act) for another year.

Offsets

- Prevents treaty-shopping.

Ten-year revenue gain: $7.7 billion
U.S. subsidiaries of foreign corporations don't have to pay withholding taxes on passive income if they are based in a country that has a treaty with the U.S. allowing that country to have the sole taxing power. But corporations based (on paper at least) in a non-treaty country can shift profits from a U.S. subsidiary to another subsidiary in a treaty country and then shift them to the parent corporation in the non-treaty country, ensuring that they are never taxed. This provision (which was originally proposed by Rep. Lloyd Doggett of Texas) would simply apply the withholding tax that would apply if the payment was made directly to the parent company in the non-treaty country in that situation.

- Prevents a scheme used to avoid gift and estate taxes. (Requires minimum 10-year term for GRATs).

Ten-year revenue gain: $4.5 billion
A person owning an asset with a quickly rising value may want to find some way to "lock in" its current value for purposes of calculating estate and gift taxes before it rises any further. One way is to place the asset in a certain type of trust (a Grantor Retained Annuity Trust, or GRAT) that pays an annuity for a certain time and then leaves whatever assets remain to the trust's beneficiaries. The gift to the trust's beneficiaries is valued when the trust is set up, rather than when it's received by the beneficiaries. This benefit is particularly difficult to justify when the trust has a very short term (perhaps just a couple years) and wealthy people have used such short-term trusts to aggressively reduce or even eliminate any tax on gifts to their children. This proposal, which is included in President Obama's budget plans, would require a GRAT to have a minimum term of 10 years, increasing the chance that the grantor will die during the GRAT's term and the assets will be included in the grantor's estate.

- Requires information reporting for rental property expense payments.

Ten-year revenue gain: $2.5 billion
(This offset is included in the Senate-passed H.R. 4213.)

- Repeals "80/20 rules" that allow foreign taxpayers to avoid U.S. withholding taxes on their dividends paid from U.S. sources.

Ten-year revenue gain: $950 million

- Blocks "Reverse Morris Trust" transactions.

Ten-year revenue gain: $260 million
Corporations generally recognize capital gains when they sell a division of the company for more than they paid to acquire or establish it. But Verizon recently found a way around this by using a "Reverse Morris Trust" transaction, which involves selling a division to another company but keeping just over 50 percent of the ownership of the spinoff in the hands of the original parent company's shareholders (Verizon shareholders). The spun-off division is fully managed and controlled by the company it was sold to, but no capital gain is recognized because the transaction is not technically a sale of the division.

- Other offsets.

Ten-year revenue gain: $961 million

H.R. 4812, Local Jobs for America Act
Introduced March 10 by House Education & Labor Committee Chairman George Miller.

- Spends $75 billion to prevent layoffs or rehire laid off employees in state and local government and community organizations.
- Spends $23 billion to hire or retain public school employees.
- Spends $2 billion to hire or rehire police officers and provide on-the-job training positions.
- Legislation would be considered emergency spending and the costs therefore not offset.