CTJ Citizens for Tax Justice

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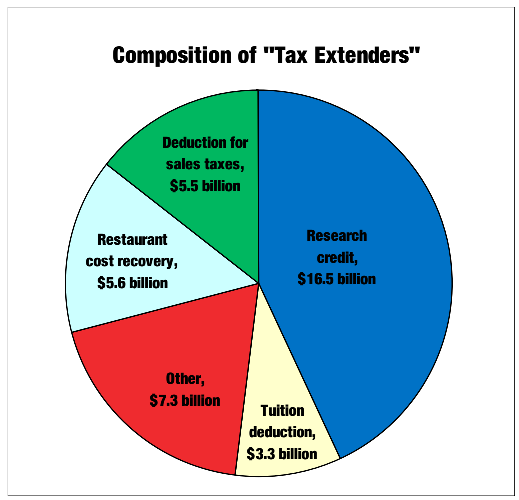
Time to End a Wasteful Congressional Tradition

Congress Can Reduce Tax Pork by Rejecting the "Tax Extenders"

Control over the House and Senate will change when the new Congress begins in January, but one thing remains the same: members of Congress of both parties still love to shower corporate interests with targeted tax breaks to encourage campaign donations. A package of extensions for a group of tax breaks, known on Capitol Hill as the "tax extenders," is attracting little notice among the general public but a fair amount of consternation among members of Congress. The package, with an estimated cost of over $38 billion, includes corporate tax breaks that are usually renewed every two years or so rather than enacted permanently — after all, corporate interests would have no incentive to make campaign contributions if they didn't have to return to the Hill every year to grovel.



Unfortunately, the consternation is not over the doubtful benefits of these politically motivated tax breaks but the best legislative strategies for passing them. The tax extenders were initially part of the larger tax break bill passed earlier this year, then removed from that bill and attached to a pension reform bill. They were then removed from the pension reform bill (which was subsequently enacted) and attached to the Republicans' ill-fated bill to gut the estate tax. Now, Congress is ready to make another attempt at passing them.

The bulk of the tax breaks in the extenders package expired almost a year ago, at the end of 2005. But Congress hopes to renew the tax loopholes retroactively, to the beginning of this year (and add an additional year onto that). They seem happy to spend tens of billions of dollars to give tax "incentives" for activities that already have been carried out.

So, as Republicans and Democrats eye each other warily in the lame duck session, they have finally decided to show the country, even before control of Congress changes in January, that they can be bipartisan — in extending these ill-conceived tax breaks.

The biggest tax break among the extenders, at a cost of $16.5 billion over two years, is the **research credit**. This tax credit for companies doing what is loosely defined as "research and experimentation," has a peculiar following among politicians who claim to support free markets. They argue that free markets do not work in this context, because they don't provide sufficient incentives for companies to do research. Sadly, they claim, companies that invest in research don't get to keep all the profits it produces. Instead, some of the benefits inevitably leak out to help other companies and people. This is both factually and theoretically wrong. Research is already among the most profitable kind of investments that companies undertake, and they can obtain patents and copyrights to protect the software, medicines or other products they create.

It may be perfectly true that a company's research may benefit others eventually, but that's equally true of many other things. For instance, if you build a nice looking home, passers-by will get much of the benefit. Should you get a government subsidy for your good taste? Should restaurant owners get a subsidy because people who eat end up being more productive than those who are starving? Saying that something ought to be subsidized by the government just because it might benefit someone besides the person who does it is an argument that can be expanded far beyond research, to a vast array of activities. Do the people who make such preposterous claims believe even slightly in free-market capitalism?

Getting back to restaurants, they actually do seem to feel entitled to government subsidies for their role in alleviating hunger. How else could we explain the $5.7 billion dollar tax subsidy in the extenders bill for "**qualified leasehold and restaurant improvements and new restaurant property**." It's a very slippery slope indeed.

The third largest tax break in the package is the **deduction for state and local sales taxes**, at a cost of $5.5 billion over two years. There are currently nine states that have no broad-based income taxes and rely more on sales taxes to fund public services. Politicians from these states argue that it's unfair for the federal government to allow a deduction for state income taxes, but not for sales taxes. But this misses the larger point. Sales taxes are inherently regressive and this deduction cannot remedy that since it is itself regressive. Lower-income people are likely to pay a much higher percentage of their incomes towards sales taxes than the wealthy. Lower-income people also are unlikely to itemize deductions and are thus less likely to enjoy this tax break. In fact, the higher your income, the more the deduction is worth, since it depends on your tax bracket.

Besides giving a few politicians bragging rights to their constituents, the sales tax deduction is mainly just another complication in federal taxes. In 2004, almost 12 million people took the trouble to itemize sales taxes, including about 2 million who otherwise would not have itemized at all instead of just using the simple standard deduction. The 6.8 million people earning less than $60,000 who took the deduction saved about $50 each in taxes. The 1.9 million people making more than $100,000 who took the deduction saved about $800 each, and that group of people got three-fifths of the total tax reductions. So the sales tax deduction is both complicated and regressive, not to mention an added burden on the vast majority who don't use it but have to pay for it. Yet too many of our politicians seem to think "other than those flaws, what's not to like?"

Next in size is a **deduction for college tuition and related expenses**, at a cost of $3.3 billion. The law already provides tax credits for college expenses, but these are phased out above about $100,000 in income. The expired deduction only benefits people who make more than that, up to $160,000 in earnings. Why should the 90 percent of taxpayers who make less than $100,000 be forced to subsidize the college expenses of those who make more?

These are followed by several smaller tax breaks targeted at various industries and interests for almost no logical reason. For example, a **$250 tax deduction is offered to K-12 teachers** for classroom expenses. That teachers are ever forced to pay out of their own pockets for classroom supplies is absurd but largely beside the point. Since the IRS cannot really audit to ensure that money was really spent on such supplies, this is essentially a $250 write-off for all teachers. Those in the 15 percent tax bracket will save $37.50 in taxes, while those who make enough to fall in the 25 percent bracket get a whopping $62.50. Why exactly would we add another complication to the tax code to provide teachers with this small benefit? And if we do think teachers are (slightly) deserving, what about firefighters or nurses or artists or anyone else with a socially useful occupation?

Which brings us to a broader point about these "extender" tax breaks. Rewarding someone or some company that engages in certain activities with a tax break is the same thing as giving them a direct subsidy. In both cases the recipients come out ahead and the rest of the taxpayers foot the bill. The only difference with a tax break is that members of Congress probably could not get away with spending directly on these items. For example, it seems unlikely that we would offer huge direct subsidies to big corporations that conduct research that they profit from and even less likely that we'd subsidize restaurants that redecorate, or give higher-income people rebates on their sales taxes. Offering direct subsidies for college tuition to those who need it would be popular, and in fact we do. But offering direct college subsidies to people in the top tenth of the income scale would seem very odd.

The bottom line is that members of Congress should stop thinking about tax subsidies differently than direct payments. If they did so, and refrained from using the tax code to fund gifts they wish to bestow on various interests, the results would be better tax policy and better budget policy. The party that just won the fall elections promised to give us both of these things. Scrapping the foolish and wasteful "tax extenders" bill would be a good first step toward honoring that promise.