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Citizens for Tax Justice

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Bush Administration Demands that Congress Increase the Deficit with Tax Breaks for Business

The White House has indicated that the President would likely veto a bill, recently passed by the U.S. House of Representatives, that would cut taxes by $54 billion because it includes revenue-raising provisions to offset the costs.

The bill (H.R. 6049) was approved by the House on Wednesday and includes extensions of several temporary tax cuts targeting various interests (commonly referred to as "extenders") as well as renewable energy tax incentives and a few new tax cuts. Similar bills passed during the Bush years resulted in increases in the federal budget deficit because they did not include revenue-raising provisions.

The one-year "extenders" included in this bill cost a total of $27 billion and include extensions of several tax breaks targeting businesses and generally well-off individuals. The renewable energy tax incentives in this bill cost a total of $17 billion and the largest is the 3-year extension of the "section 45 tax credit" for the production of energy from renewable resources.

The new tax cuts in the bill, which cost an additional $10 billion, include a change in the AMT related to the treatment of stock options, a deduction for property taxes for non-itemizers, and an expansion in eligibility for the Child Tax Credit for low-income families.

White House Demands Increase in Budget Deficit

The Office of Management and Budget (OMB) issued a statement saying that it would advise the President to veto the extenders bill if approved by Congress in its current form. The main reason is that the legislation includes revenue-raising provisions to prevent it from increasing the federal budget deficit.

The Administration argues that since this bill primarily extends tax breaks that were available last year, it only constitutes a continuation of existing tax policy and not new tax cuts that would need to be paid for. The OMB statement says, "Overall, the Administration does not believe that efforts to avoid tax increases on Americans need to be coupled with provisions to increase revenue."

But this argument ignores the legislative language enacted into law by the President and his allies when they controlled Congress. These tax breaks were intentionally made temporary (in most cases in legislation signed by President Bush) because of cost constraints. As a result, Congress never budgeted for the costs that they would entail in future years if they were made permanent (or put another way, the revenue "baseline" used by the Congressional Budget Office assumes that these tax breaks will expire).

So the extenders bill does cut taxes, compared to current law and the baseline used by Congress. And under the budget rules that lawmakers adopted in early 2007, any new tax cuts must be paid for.

President's Logic Would Remove Any Constraint on Driving Up the Federal Budget Deficit

Why should arcane budget rules matter at all? Why should new tax cuts be paid for? For one thing, the federal government is currently not collecting nearly enough revenue to pay its bills. Instead, the government is running very large deficits, half of which are due to the Bush tax cuts. (Most of the rest of the deficits stem from the Iraq war.) Any new tax cuts that are not paid for will increase the budget deficit and the national debt. That national debt, of course, is a burden that Americans will have to pay for in the form of cuts in public services or increased taxes in the future.

President Bush and his allies in Congress have consistently tried to ignore this problem. Under their logic, any tax cut whatsoever can be enacted, extended or made permanent without Congress or the public ever facing up to the true cost.

Imagine that the President proposes a tax cut that will cost $14 billion over ten years, and some members of Congress think that cost is too high. The President could then propose the that same tax cut be enacted for just one year, at a cost of only $1 billion, which seems more reasonable. If the tax break is enacted, then in the following year, the President could insist that this tax break must be made permanent because letting it expire would amount to a "tax increase"! And since making the tax break permanent would merely avoid a tax increase, not create a new tax cut, there would be no reason, the President would argue, to raise any revenue to offset the cost.

This is one of the many illogical ways that President Bush and his friends in Congress have argued for deficit-financed tax cuts over the past seven and a half years.

What the President Does Support: Unjustified Tax Giveaways for Business and the Wealthy

Equally alarming is the fact that the White House actually supports all of the most poorly targeted and unjustified tax breaks in the extenders bill, even while opposing any effort to pay for them.

The Administration supports extending the research and experimentation credit (R&E credit) which the President has proposed making permanent. Extending it for one year will cost $8.8 billion. Supporters of the R&E credit tend to be the same people who claim to believe fervently in free markets and business-oriented solutions to problems. But the entire premise of the credit is that business won't invent anything new unless they're subsidized by the federal government.

One argument made for the R&E credit is that 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. It may be perfectly true that a company's research benefits others in some way, but that's equally true of many other business ventures that supply goods and services to people, and we do not subsidize all of these.

The Administration also supports extending a tax break for offshore financial services that would cost about $4 billion if extended for a year. This tax break, often oxymoronically called the "subpart F active financing exception" by tax experts, would allow indefinite "deferral" of taxes on certain kinds of passive investment income.

In most cases, companies are allowed to defer U.S. taxes on profits earned by their offshore subsidiaries. But deferral is generally not allowed for income from financial activities, because such income is too easy to shift offshore. In 1997, however, an exception was made for activities styled as "active" financing, including certain insurance and banking income and income from manufacturers' financing of sales of their products (such as cars). This exception has been extended several times, and is currently scheduled to expire at the end of this year.

This loophole creates an enormous tax shelter for the companies who have lobbied it into law. It ought to be allowed to expire.

Revenue-Raising Provisions

The revenue-raising provisions in the House extenders bill are borrowed from a bill that the House approved last year. One would delay a 2004-enacted law that has not even gone into effect yet. The soon-to-take-effect law is designed to make it easier for multinational corporations to take U.S. tax deductions for interest payments that are really expenses of earning foreign profits and therefore should not be deductible. Under the House bill, implementation of this tax break (the new "worldwide interest allocation" rules) would be delayed until 2019, raising about $30 billion over ten years.

The second revenue-raising provision would crack down on the use of offshore schemes that private equity fund managers use to avoid taxes on deferred compensation, raising about $24 billion over ten years.

The tax code allows employees to defer paying taxes on money that they or their employers put into "qualified" retirement savings plans, such as 401(k)'s, until they take money out during retirement. But contributions to such "qualified" plans are limited, to no more than $30,000 a year depending on the type of plan. That's the sort of plan most Americans can get — if they're lucky.

Highly-paid corporate executives, however, often get to go a giant step farther. They can set up "non-qualified" deferred compensation plans, which are not taxable to the executives until they take the money out, but which are not deductible by companies until then either. Currently, there is no limit on how much money executives can defer taxes on through these plans. But the corporations who pay them also have to defer the deduction they take for whatever they pay into the deferred compensation plan, so in theory there is only a small loss to the Treasury (and to the rest of the taxpayers).

But private equity fund managers have managed to create an approach to deferred compensation that goes even farther, and does impose a substantial cost on the rest of the taxpayers. Private equity fund managers often have an "unqualified" plan into which is paid an unlimited amount of deferred compensation. But they arrange the payments to be technically made by an offshore corporation in a tax haven country that has no corporate tax, or a very low one, so the loss of the deduction is not an issue. Of course, this is done with paper transactions. No one is actually working in the tax haven country, so this is really just a scheme to increase the amount of deferred compensation that can be paid to these already highly-compensated fund managers without being taxed right away.

These two provisions of the extenders bill — delaying worldwide interest allocation and cracking down on offshore deferred compensation for fund managers — are both good policy based on fairness grounds alone. The need to raise revenue to prevent an increase in the budget deficit makes them even more important.

The Extenders Bill Includes at Least One Good Provision — One Worth Paying For

At least one of the tax cuts in the extenders bill approved by the House is a good idea. It would expand eligibility for the Child Tax Credit for one year, at a cost of $3.1 billion.

First enacted during the Clinton administration, the Child Tax Credit was significantly expanded as part of the Bush tax cuts. It is now worth up to $1,000 for each child under age 17. But many low-income families do not benefit at all from the child credit, and many others get only partial credits. That's because the credit is unavailable to families with earnings below $12,050 (indexed for inflation), and the credit is limited to 15 percent of earnings above that amount. In other words, a working family making less than $12,050 this year is too *poor* to get any child credit.

The House extenders bill would lower the child credit's earnings threshold from the current $12,050 to $8,500 and would no longer increase the threshold for inflation. The Center on Budget and Policy Priorities points out that 13 million children would be helped by this provision.

The President should champion provisions like this, which actually do make the tax code more progressive, as well as the responsible and fair revenue offsets that would raise enough money to pay for this and other tax breaks in the bill.