Tax Extenders Explained

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National Priorities Project answers important questions related to the temporary tax breaks known as the "tax extenders."

What are tax extenders?

The term "tax extenders" refers to a set of 50+ temporary corporate and individual tax breaks designed to stimulate a weak economy, spur business investment, or assist individuals with the effects of an economic downturn, among other goals.

The vast majority of the tax extenders benefit businesses, and often large corporations, though they also include things like a tax break for homeowners who owe more on their loans than their homes are worth. These tax breaks were originally meant to be temporary, but are often extended by Congress for one or two years at a time, thus earning the name "tax extenders." While individual tax breaks vary in purpose and amount, the temporary nature of the tax extenders means that Congress often considers them together as part of the same legislation. A full list of temporary tax provisions is available here.

Why are we talking about tax extenders now?

The tax extenders includes a group of more than 50 tax breaks that expired at the end of 2014, meaning they are not currently in effect for the 2015 tax year. Lawmakers are currently working out whether they will extend the tax extenders package for tax years 2015 (which would be retroactive) and 2016, or even whether they will make some or all of them permanent.

If lawmakers want to retroactively extend the package for 2015, they face pressure to do so quickly. The longer Congress waits to extend the package, the more likely it will be that the Internal Revenue Service (IRS) will experience problems and delays in processing refunds come tax day.

Why are the tax extenders temporary?

When it passes a new tax break, Congress can choose to make it temporary or permanent. While the majority of tax breaks are permanent, meaning they are on the books until Congress changes them, the current debate is about a group of more than 50 tax breaks that were instituted on a temporary basis, often for one or two years at a time.

Tax breaks may be implemented on a temporary and not permanent basis because Congress is not sure how certain tax breaks will impact the economy or change behavior. Making tax breaks temporary allows lawmakers an opportunity to determine a tax break's effectiveness before deciding to make it permanent. Some tax breaks may be effective for a short period of time, but become less effective as time goes on. And some tax breaks are enacted on a temporary basis to provide additional economic stimulus in the face of an economic downturn.

While there are good reasons to implement tax breaks temporarily, there are downsides, too. Since tax breaks are meant to provide incentives for particular behavior (for example: the home mortgage interest deduction encourages home buying), businesses and individuals face added uncertainty about how much future benefit they will receive from a particular behavior when a tax break is temporary. This makes long-term planning difficult. Clearly, retroactively approving tax breaks – as Congress is now considering for tax year 2015 – can't provide a very effective incentive for a desired behavior, and instead just rewards behavior that has already occurred.

One major question in the current debate is whether Congress will choose to make some, or all, of the current tax extenders permanent.

How much do the tax extenders cost?

While Congress has multiple options to consider (making the extenders retroactive for 2015, making them permanent, or making only some permanent), the 10-year cost of the tax extenders is $700 billion.

To put the costs in context, the cost of all tax breaks – temporary and permanent – in fiscal year 2013 *alone* was $1.18 *trillion*. Meanwhile, the estimated cost of "corporate inversions" – a maneuver where U.S. based corporations (such as Pfizer) arrange to be purchased by smaller overseas corporations to avoid paying U.S. taxes – is about $20 billion over ten years. So, the tax extenders are bigger than corporate inversions, but small in the scheme of all tax breaks.

Compared to other federal spending, the cost of the tax extenders could make a big difference: $700 billion over ten years is also roughly how much the U.S. would spend on education if it continues funding at current levels.

What are the biggest tax extenders?

The size of tax extenders is a complicated question. It depends on how long they are extended, and we don't yet know what Congress will choose to do.

We do know that the most expensive tax extender is what's known as "bonus depreciation," which gives businesses a bigger deduction for equipment purchases. If bonus depreciation were made permanent, it would cost $280 billion over ten years. Originally passed as a stimulus during the recession, making this tax break retroactive just hands money to businesses without encouraging any future growth. What's more, making bonus depreciation permanent means it would no longer have potential as a special incentive to stimulate the economy in the case of another recession.

Another large and much-discussed tax extender is the Research and Development (R&D) tax credit. It incentivizes corporations to take up research activities – such as research that might lead to new medicines or technologies – by reducing their taxes when they do so. This credit has been extended 16 times since 1981, and costs about $77 billion over ten years. There is widespread support for making this tax break permanent, but even supporters often note that it should be paid for.

Some controversial tax breaks in the package include the "Active Financing Exception" and the "CFC look-through" rule, both of which allow corporations to shift U.S. profits offshore to avoid taxes. Together, these two tax breaks cost $80 billion over ten years.

What are the arguments for and against tax extenders?

Tax extenders are supposed to encourage desirable behavior, such as additional investment by corporations, or work by individuals. There is widespread support for some tax extenders that are seen as effective, such as the Research and Development credit, from lawmakers across the ideological spectrum. Other tax extenders, such as bonus depreciation, are seen as less effective, but still receive support from those who benefit from it.

One argument against many tax extenders is that they are typically passed without being offset or paid for. This results in lost revenue that contributes to the deficit and national debt. Even supporters of some tax extenders argue that they should only be continued if they are paid for.

Another important point in the tax extenders debate is about refundable credits that primarily benefit middle- and low-income families. Tax breaks for corporations should not be made permanent without also making permanent improvements made to the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC), which are set to expire in 2017. If these improvements expire, millions of working families would owe more in taxes.