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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?

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

The vast majority of the tax breaks currently under debate 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 are often extended by Congress for one or two years at a time, thus earning the name "tax extenders." While they vary in purpose and amount, the temporary nature of the tax extenders means that Congress often considers them 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 2013, meaning they are not currently in effect for the 2014 tax year. Lawmakers are currently working out whether they will extend the tax extenders package for tax years 2014 (retroactively) and 2015, or even whether they will make some or all of them permanent.

If lawmakers want to retroactively extend the package for 2014, they face pressure to do so quickly. The IRS says that the longer Congress waits to extend the package, the more likely that it will cause problems and refund delays for the 2014 tax year.

Why are the tax extenders temporary?

Congress can choose to make tax breaks temporary or permanent. While the majority of tax breaks are permanent, meaning they continue 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 made temporary and not permanent because Congress is not sure how they will impact the economy or change behavior. Making them temporary allows lawmakers an opportunity to determine their effectiveness before deciding to make them permanent. Some tax breaks may even be effective on a temporary basis, but become less effective over time. And some are enacted on a temporary basis to provide additional economic stimulus in the face of an economic downturn.

There are downsides to making tax breaks temporary, too. Since tax breaks are meant to provide incentives for particular behavior, businesses and individuals face added uncertainty about how much future benefit they will get from that behavior when a tax break is temporary, which can make long-term planning difficult. Clearly, retroactively approving tax breaks – as Congress is now considering – can't provide a very effective incentive for the 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?

There are multiple options up for consideration in Congress that would extend different combinations of tax extenders either temporarily or permanently. The Senate proposed a bill that would extend most of the tax breaks for tax years 2014 and 2015 at a cost of about $85 billion for those two years. A second package originated in the House of Representatives, where lawmakers would make permanent certain expired tax breaks at a cost of $310 billion over ten years.[1] Neither of these options provides an offset, meaning they would not be paid for and would therefore add to the deficit. It's also entirely possible that what ends up passing will be some other combination of extensions that lawmakers negotiate.

To put the costs in context, the cost of all tax breaks – temporary and permanent – in fiscal year 2013 was $1.18 *trillion*. Meanwhile, the estimated cost of much debated "corporate inversion" – a maneuver where U.S. based corporations 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.

What are the biggest tax extenders?

The size of tax extenders is a complicated question, because 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 biggest potential cost for a tax extender is what's known as "bonus depreciation," which allows businesses to take a bigger deduction for equipment purchases. If bonus depreciation were made permanent, it would cost $263 billion over ten years. However, a one-year extension would

[1] Americans for Tax Fairness estimate the costs of making the entire tax extenders package permanent would cost nearly $700 billion over ten years.

cost only $5 billion. The Congressional Research Service notes that this tax break was intended as a temporary stimulus during the recession, and that it was probably not that effective. The non-partisan Center on Budget and Policy Priorities notes that making bonus depreciation retroactive to the start of 2014 "would give taxpayer funds to corporations as a windfall to companies for purchases they have already made." 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 15 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. While lawmakers differ on specific tax extenders, there is widespread support for many.

One argument against tax extenders is that the resulting lost revenue contributes to the deficit and national debt unless they are otherwise paid for. Even supporters of some tax extenders argue that they should only be continued if they are paid for.

What's next for tax extenders?

The tax extenders expired at the end of 2013, which means that if no action is taken, many corporations and individuals will pay more in federal taxes this year than they did in 2013. If Congress wants to make tax extenders effective for the 2014 tax year, the IRS says it must do so quickly or face delays in distributing 2014 tax refunds early next year. It's likely that whatever passes will happen late in the legislative session, which is slated to end by December 12th, or possibly even early next year, despite IRS warnings.

While the current debate is about tax extenders for tax breaks that expired at the end of 2013, there are smaller groups of current tax provisions that expire this year and in future years, as well. Extending these provisions (or not) is a recurring item of business for Congress.