The PREP Plan for Tax Extenders

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Before the end of the year, Congress will again consider renewal of the "tax extenders," a collection of more than 50 expired tax breaks for individuals and businesses. These tax breaks, which are often extended a year or two at a time, range from the research and experimentation (R&E) tax credit and a deduction for teachers that buy school supplies to special depreciation for NASCAR tracks and racehorses.

Reinstating the normal tax extenders retroactively for 2015 and extending them through the end of 2016 without offsets would cost nearly $95 billion over ten years. A permanent extension would cost nearly $500 billion. If temporary stimulus-era provisions and refundable tax credits were also continued, the cost would rise to almost $1 trillion. CRFB's *Paying for Reform and Extension Policies (PREP) Plan*, originally released in the fall of 2014, offers a better approach.

The PREP Plan includes principles that should be used for tax extenders legislation. It is paid for using $95 billion of offsets that increase tax compliance and decrease avoidance and includes a process for tax reform to happen in 2016.

Principles for Addressing Tax Extenders

1. Address tax extenders permanently in the context of tax reform
2. Fully offset the cost of any continuations without undermining tax reform
3. Include a fast-track process to achieve comprehensive tax reform

Policy	Ten-Year Savings
Extend Normal Tax Extenders Through 2016	**-$95 billion**
Improve Tax Reporting and Enforcement	**$40 billion**
Increase program integrity spending	$35 billion
Improve various reporting and enforcement rules	$5 billion
Increase oversight and accountability of the IRS	*
Close Loopholes that Promote Tax Avoidance	**$50 billion**
Close the "John Edwards/Newt Gingrich" S-Corp loophole	$15 billion
Close the carried interest loophole	$15 billion
Tighten deduction limits for executive pay	$10 billion
Close other loopholes which encourage evasion	$10 billion
Restrict Inversions	**$5 billion**
Enact a one-year inversion ban	*
Reduce the profitability of inversions	$5 billion
TOTAL OFFSETS	**$95 billion**
Establish Fast-Track Process for Tax Reform	**TBD**

*less than $500 million in costs or savings

Details of the PREP Plan

The *PREP Plan* assumes policymakers will enact a clean two-year extension of all the expired regular extenders. We assume bonus depreciation, which was originally put in place to help strengthen the economy during the recession, remains expired. In total, this would cost about $95 billion over the next decade, before interest. *Note: we are not endorsing the choice to extend all expired regular extenders, just showing how it could be paid for.*

The *PREP Plan* offsets this $95 billion cost by generating an equivalent amount of revenue with enforcement and savings from refundable credits. To ensure this package does not interfere with decisions that should be made in tax reform, its policies increase compliance within the current confines of the tax code (or spirit thereof). In other words, the package does not adjust tax rates, change the design or size of any tax expenditure, or otherwise alter the structure of the code. Instead, it increases enforcement, improves rules, and closes loopholes so that individuals and businesses pay the taxes they should be paying under the current code.

Many components of the plan have bipartisan support and draw from either the President's budget or former Ways & Means Chairman Dave Camp's (R-MI) Tax Reform Act of 2014. The PREP Plan also includes a fast-track process for broader tax reform, and it restricts "inversions" to allow time for that reform to be put into place.

Principles for Addressing Tax Extenders

1. **Address tax extenders permanently in the context of tax reform**. With a few exceptions, there is little logic to writing tax policy for one or two years at a time. Comprehensive tax reform should decide whether to repeal, reform, or make permanent most tax extenders, and it should do so in the context of other decisions about tax rates, breaks, and the structure of the code.

2. **Fully offset the cost of any continuations without undermining tax reform.** Tax reform will not be possible before the expired provisions must be addressed. In the meantime, any extension should be not undermine future tax reform efforts and should be fully paid for so as not to add to the debt.

3. **Include a fast-track process to achieve comprehensive tax reform.** The need to act quickly is not an excuse to abandon efforts to reform a tax code that is complicated, anti-growth, and in many ways broken. Temporary action on extenders should advance a plan that would broaden the tax base, lower rates, promote economic growth, and reduce the deficit.

Improve Tax Reporting and Enforcement ***($40 billion)***

Increase program integrity spending ($35 billion): The *PREP Plan* reduces the amount of unpaid taxes by providing dedicated mandatory funding for the Internal Revenue Service (IRS) to audit and enforce tax compliance. The IRS estimates that every $1 spent on program integrity can generate $6 of revenue.

Improve various reporting and enforcement rules ($5 billion): The *PREP Plan* makes statutory changes to close the tax gap such as improving reporting on tuition and increasing various tax penalties.

Increase oversight and accountability of the IRS: The *PREP Plan* includes increased internal and external oversight over the IRS along with the new funding.

<u>Close Loopholes that Promote Tax Avoidance</u> ***($50 billion)***

Close the "John Edwards/Newt Gingrich" S-Corp loophole ($15 billion): The *PREP Plan* prevents self-employed individuals from avoiding payroll taxes by disguising wages as "business income."

Close the carried interest loophole ($15 billion): The *PREP Plan* prevents hedge fund and private equity partners from paying lower rates by structuring their earned income as capital gains.

Tighten deduction limits for executive pay ($10 billion): The *PREP Plan* removes exceptions to limits on the amount of wages a company can deduct as a business expense for its highest-paid employees.

Close other loopholes which encourage evasion ($10 billion): The *PREP Plan* closes a variety of other loopholes by preventing investors from using shell companies to evade taxes, stopping cruise ship companies from using rules intended for cargo ships to avoid taxes, banning companies from borrowing simply to buy tax-exempt bonds, and preventing other tax evasion strategies.

<u>Restrict Inversions</u> ($5 billion)

Enact a one-year inversion ban (<$1 billion): Companies are again showing increased interest in corporate inversions: the practice of an American company moving its headquarters overseas, often to lower its U.S. tax bill. The *PREP Plan* calls for a one-year ban on inversions to give time for tax reform that will increase the competitiveness of our tax system and reduce the pressure for companies to invert.

Reduce profitability of inversions ($5 billion): The *PREP Plan* permanently limits "earnings stripping" among inverted companies, preventing them from deducting interest on intercompany loans designed to move income overseas.

<u>Promote Comprehensive Tax Reform</u> (to be determined by Congress)

Enact a "fast track" process for tax reform: The current tax code is complex, anti-growth, and in need of an overhaul. Yet tax reform has proved elusive so far. The President and Congress should agree to put tax reform near the top of their agenda and establish a fast-track process for business tax reform, individual tax reform, or both. Any tax reform should broaden the tax base, lower rates, promote economic growth, improve fairness and simplicity, and reduce the deficit.