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Analysis: The Retirement, Savings, and Other Tax Relief Act of 2018

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The House Ways and Means Committee is making a last-ditch effort to revive a list of special interest tax provisions. The temporary tax subsidies are attached to retirement savings reforms, corrections to last year's landmark tax reform, and reforms to parts of the IRS bureaucracy. The bill includes a few necessary corrections but misses important opportunities at the cost of perpetuating Congress' ritual of extending temporary tax subsidies for special interests called "tax extenders."

The Retirement, Savings, and Other Tax Relief Act (Tax Relief Act) of 2018 addresses expiring tax extenders, includes temporary tax relief for disaster areas, makes reforms to retirement saving rules, expands deductions for start-ups, and makes technical corrections to the Tax Cuts and Jobs Act (TJCA) of 2017.

The bill does not make any of the important provisions of the TCJA permanent, and does not include an important Universal Savings Account (USA) proposal that was included in Tax Reform 2.0, which passed the House in September 2018. The tax extenders are mostly renewed for just one year, leaving the recurring subsides in need of action again next year, and the bill does not address the many new temporary tax provisions created in the TCJA.

This paper, in its entirety, can be found at **http://report.heritage.org/ib4927**

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Extends Temporary Tax Subsidies

Every few years, Congress engages in a ritual extension of expiring tax provisions. The last time Congress passed an extenders package, at the end of 2015, Republicans promised that confusion over temporary tax policy "ends with this bill" and would be permanently addressed in last year's tax reform.[1] The Tax Relief Act breaks that promise and continues the old Washington tradition by retroactively extending 24 tax subsidies and modifying two others.

The bill retroactively extends 24 special interest tax privileges that expired at the end of 2017 for one year. Congress will have to revisit these same provisions again next year. The temporarily revived tax subsides include economic development tax credits and green energy tax credits. The Tax Relief Act would scale back and make permanent a tax credit for certain railroad track maintenance, and extend the biodiesel and renewable diesel credits in full through 2021, and then phase out diesel credits by 2025.

Almost every extender in this year's package grants an economic privilege tailored to some particular group or business interest. By picking winners and losers, these corrupt policies distort efficient market outcomes. They thereby hamper economic growth and reduce opportunity for individuals and businesses that Congress did not shower with special favors.[2]

Periodic temporary extensions are a poor way to construct tax policy, budget policy, and economic policy. Temporary re-authorizations mask the true cost of what are effectively permanent policy features. They provide an opening for poli-

ticians to request patronage from special interests on a semiannual basis, and create economic uncertainty, which distorts long-term financial business planning and can slow economic growth because businesses need policy certainty to make long-term investments.[3] Congress should allow all 26 of the tax extenders included in the bill to expire.

Savings Reforms Are a Good Start But Fall Short

Personal retirement savings accounts, such as 401(k)s and individual retirement accounts (IRAs), are crucial for personal retirement savings because they shield investments from being taxed twice and thus encourage people to save for their own retirement. The bill makes important reforms to simplify some areas of retirement savings, but stops short of expanding the ability to save more widely through a USA.

The most significant reforms to retirement savings included in the bill allow small employers to pool together to offer retirement benefits. Many Americans, especially those employed by small businesses, are not able to take advantage of retirement plans due to their complexity and high compliance costs. Pooling and a new safe harbor election would help expand retirement savings account access to more Americans.

The bill builds on the core components of the Senate's 2018 Retirement Enhancement and Savings Act by repealing the maximum age for new contributions to traditional IRAs and adding new exemptions from minimum distribution requirements for retirees who are currently forced to draw down their savings or face penalties, as well as other modifications. The reforms stop well ahead of the much-needed complete overhaul of retirement taxation, but they are a small step in the right direction.[4]

The bill also allows families to withdraw up to $7,500 from their own retirement accounts to support parental leave for the birth or adoption of a child, and increases the retirement account loan threshold for victims of recent natural disasters to $100,000. These reforms allow families more flexibility to access their own money in times of need.

To even better meet the same goal of helping families save for their own priorities, the bill should also include the previously proposed USA. These simplified accounts would allow taxpayers to contribute after-tax income to savings accounts, and withdrawals would be tax-free and not reserved strictly for retirement.[5] USAs reduce taxes on savings and help families build their own financial security through a single, simple, and flexible savings account.

Helps Start-Ups, Leaves Other Investments Behind

The Tax Relief Act would allow new businesses and entrepreneurs to write off more of their initial start-up costs. Currently, new businesses are only able to deduct up to $5,000 of their initial start-up expenses, forcing them to write off the remainder over the next 15 years. This makes it more expensive to start new businesses. The bill would allow new entrepreneurs to deduct up to $20,000 of their start-up costs and increase their ability to transfer other benefits, such as operating losses and tax credits, to new owners.

The changes would certainly benefit fledgling businesses, but there is another piece missing from the bill. Much like writing off start-up expenses, expensing for established businesses is important to continue current levels of business investment. Expensing is only temporary in last year's tax reform. The Tax Relief Act should make expensing permanent.

1. Naomi Jagoda and Cristina Marcos, "House Approves $622B Tax Plan," *The Hill*, December 17, 2015, https://thehill.com/policy/finance/263590-house-approves-622b-tax-package (accessed November 28, 2018).
2. Adam N. Michel, "Stop Extending Bad Policy—Let the Tax Extenders Die," Heritage Foundation *Issue Brief* No. 4809, January 17, 2018, https://www.heritage.org/taxes/report/stop-extending-bad-policy-let-the-tax-extenders-die.
3. Seth H. Giertz and Jacob Feldman, "The Costs of Tax Policy Uncertainty and the Need for Tax Reform," *Tax Notes*, February 25, 2013, pp. 951–963, https://digitalcommons.unl.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1088&context=econfacpub (accessed January 16, 2018).
4. Erica York, "Senate Finance Retirement Savings Bill Falls Short of Offering Comprehensive Solutions," Tax Foundation, March 14, 2018, https://taxfoundation.org/senate-finance-retirement-savings-bill-falls-short-offering-comprehensive-solutions/ (accessed November 28, 2018).
5. Adam N. Michel, "Universal Savings Accounts Can Help All Americans Build Savings," Heritage Foundation *Backgrounder*, forthcoming.

Expensing would allow businesses to deduct their costs immediately. The old, pre-TCJA tax law made businesses wait for years before deducting their investment costs from their taxable income. This had the effect of needlessly increasing the cost of investing in anything, from new equipment and machinery to expanding or updating existing workspaces.

Expensing makes it more affordable for new businesses to open and for mature businesses to upgrade and expand their operations—something that results in more jobs and enables employers to raise wages.

Technical Corrections

Last year's tax reform, the Tax Cuts and Jobs Act, inevitably included several drafting errors and oversights. The Tax Relief Act includes five of the better-known technical corrections. The first fixes the "retail glitch," which unintentionally denied the benefit of expensing to building improvements, called qualified improvement property.[6] Corrections also address the effective date for new limitations made to deductions for business net operating losses and a limitation on the ability to pay liabilities on deemed repatriation over the intended eight years.[7] The last two allow sexual harassment victims to deduct legal fees and address one of many problems with new pass-through deduction. These are all necessary fixes, but the list should be more comprehensive. Congress should also include fixes to prevent state tax-credit scholarship programs from being hurt by the new state and local tax deduction cap, and clarify ambiguities in the new international taxes, such as attribution and aggregation rules, among many others.[8]

IRS Reform

The second division of the bill, titled the Taxpayers First Act of 2018, includes a long list of reforms to the IRS. The IRS is certainly in need of modernization. However, most problems that individuals and businesses encounter when they interact with the IRS are a product of the overly complex and dysfunctional tax code. True IRS reform must be accompanied by a dramatic simplification of the U.S. tax system, a goal that was largely unmet in the 2017 tax reform.

The bill would create a new independent office for taxpayer appeals, focus on improving IRS customer service through congressional oversight, require the agency to develop a reorganization plan by September 2020, and implement various modernizations for increased cybersecurity in the 21st century.

Does Not Make TCJA Permanent

The TCJA reduced federal income tax rates, increased the standard deduction, doubled the child tax credit, repealed the personal and dependent exemptions, and capped the deduction for state and local taxes. Procedural rules in the Senate and an unwillingness to constrain spending forced Congress to make the majority of the TCJA temporary. Much of the law expires in 2025, and Americans' taxes are scheduled to increase in 2026.

The first priority for Congress should be to make the already agreed-upon provisions in the TCJA permanent.[9] This most recent bill fails to make any of the TCJA permanent, while re-animating expired tax subsidies at the expense of more comprehensive reform.

There are many worthy reforms in the Tax Relief Act and the Taxpayer First Act. However, Congress should not package sensible changes and technical corrections with unnecessary tax subsidies and temporary extensions that clutter the tax code and distort business investment. Instead, Congress should look to other more comprehensive reforms that help all Americans rather than picking winners and losers though the tax code.

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6. Erica York, "Technical Corrections to Tax Law Likely Addressed in Lame Duck Session," Tax Foundation, November 13, 2018, https://taxfoundation.org/technical-corrections-tax-law-lame-duck-session/ (accessed November 28, 2018).
7. Richard Rubin, "IRS Is Wrongly Denying Tax Refunds, Some Companies Say," *The Wall Street Journal*, September 25, 2018, https://www.wsj.com/articles/irs-is-wrongly-denying-tax-refunds-some-companies-say-1537869600 (accessed November 28, 2018).
8. Adam N. Michel, Lindsey Burke, and Jonathan Butcher, "A Technical Correction to Address the Impact of the State and Local Tax Deduction Cap on State-Based Tax Credit Scholarship Programs," Heritage Foundation *Backgrounder* No. 3350, September 13, 2018, https://www.heritage.org/education/report/technical-correction-address-the-impact-the-state-and-local-tax-deduction-cap, and Laura Davison, "Most Wanted: Tax Pros' Technical Corrections Wish List (Corrected)," Bloomberg BNA, April 13, 2018, https://www.bna.com/wanted-tax-pros-n57982091110/ (accessed November 28. 2018).
9. Adam N. Michel, "Four Priorities for Tax Reform 2.0—and Seven Supporting Reforms," Heritage Foundation *Issue Brief* No. 4888, July 16, 2018, https://www.heritage.org/taxes/report/four-priorities-tax-reform-20-and-seven-supporting-reforms.