# Urban-Brookings Tax Policy Center

## Tax Stimulus Report Card: Conference Bill

**The Urban Brookings Tax Policy Center** has graded the key tax provisions of the Conference stimulus bill (the "American Recovery and Reinvestment Tax Act of 2009", as amended). Our grades reflect how well these measures would boost the economy in the short run per dollar of budget cost (sometimes called "bang for the buck"). For grading purposes, we assume that each provision will expire as scheduled and consider only the effects on aggregate demand (consumption or investment) or employment in the short-term. Each grade depends on both timeliness and targeting. To receive an A, a provision would have to begin quickly and go primarily to people who would most likely spend it or to businesses that would most likely use funds to retain workers or expand. We do not consider the long-term effects on the economy. An attached write-up describes current law, the proposed change, and the short- and long-term effects on the budget, the economy, fairness, and tax complexity. There, we also discuss the likelihood that each proposal would actually expire as scheduled and, for some provisions, explain what changes would raise the grade to an A.

Our report card is preliminary and does not include all of the provisions in the bill – most notably we omit provisions related to the marketability and issuance of state and local debt and recovery zone credits. We may evaluate additional provisions and adjust our grades and analysis as we learn more about the proposals.

**This evaluation of the Conference's tax stimulus provisions is preliminary and based on Senate Finance Committee's summary of the bill and proposed legislative language. We will revise the report as we get more information and will add additional provisions when we evaluate them.**

| Tax provision | Stimulus effect | Ten-year revenue cost* | Comments (see attached write-ups for details) |
|---|---|---|---|
| **Individual Income Tax Provisions** | | | |
| "Making Work Pay" tax credit | B+ | $ 116.2 B | Could start quickly. Payment in small increments may increase stimulus effect but two-year limit and high-income eligibility reduces impact. |
| Increase in earned income tax credit | B | $4.7 B | Highly targeted. Gives cash assistance to low-income families most likely to spend quickly, but slow to start. |
| Increase eligibility for the refundable portion of child credit | B+ | $14.8 B | Highly targeted, though less so than the Ways and Means proposal—giving cash assistance only to lowest-income families most likely to spend quickly, but slow to start. Likely pressure to make permanent. |
| "American Opportunity" education tax credit | C | $13.9 B | Slow to start. Refundable, so it goes to low-income students. Low-income households likely to spend quickly but only when funds become available. |
| Homeownership Tax Credit | C | $6.6 B | Small short-run stimulus to weak housing market. Large windfall gains to people who would buy anyway. Eliminating repayment simplifies administration. |
| Temporary Suspension of Taxation of Unemployment Benefits | B- | $4.7B | Generally not effective until early 2010. Goes to households whose income has fallen, increasing stimulus effect. Would be much better if reformulated as an increase in benefits. |
| Automobile Sales Tax Deduction | C- | $1.7 B | Likely only small increase in demand for new vehicles. Benefits go to single industry. Most value for high-income taxpayers who are more likely to buy vehicles, with or without tax subsidy. |
| Extend the alternative minimum tax patch through 2009 | D- | $69.8 B | Neither timely nor targeted; makes no sense as economic stimulus. |

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# URBAN-BROOKINGS TAX POLICY CENTER

| Tax provision | Stimulus effect | Ten-year revenue cost* | Comments (see attached write-ups for details) |
|---|---|---|---|
| **Business Tax Provisions** | | | |
| Extension of enhanced small businesses expensing | C | $0.04 B | Simplifies tax filing for small businesses and may encourage some businesses to accelerate decisions to invest in capital equipment. Impact is expected to be small and much of tax benefit is likely to go to businesses that would have invested anyway. |
| Extension of bonus depreciation | C | $5.1 B | Previous experience suggests that investment effects would be modest at best. Severity of downturn decreases the stimulus potential. |
| Five-year carryback of net operating losses for small businesses | C | $0.9 B | Increases effectiveness of temporary investment incentives such as bonus depreciation and expensing. By increasing cash flow to businesses, it could also stimulate new investment but the effect is likely to be modest. |
| Incentives to hire unemployed veterans and disconnected youth | D | $0.2 B | Based on past experience with this wage subsidy, it is unlikely to generate jobs for the target groups. |
| Deferral of certain income from discharge of indebtedness | C- | $1.6 B | May help some companies deleverage, but much of the benefit would go to those businesses that least need assistance. |
| Recovery Zone Bonds | C- | $5.4B | Well targeted at states and municipalities most in need of economic stimulus but slow to start and unlikely to generate much new investment. Could draw funds away from better opportunities. Direct spending would be better. |
| Increase in New Markets Tax Credit | C+ | $0.8 B | Any effect would likely be small and not occur quickly. Well-targeted to communities likely to be most burdened by economic downturn. Reduces borrowing costs for developers active in low-income communities. |
| **Renewable Energy Provisions** | | | |
| Reinvestment in renewable energy | C | $20.0 B | Some new investment would be added, but some projects may take time to gear up. |
| | | | |
| Tax Proposals Not Evaluated | -- | $20.3 B | |
| | | | |
| All Conference Tax Proposals | -- | $286.9 B | Tax provisions account for 36 percent of the cost of the Conference stimulus bill. |

* We cite "10-year" revenue estimates but the values reported include both the 10-year budget window—2010-2019—and 2009, because significant revenue reductions occur in the latter year.

[1]Revenue estimates from Joint Committee on Taxation, H*Estimated Budget Effects of the Revenue Provisions Contained in the Conference Agreement for H.R. 1, the "American Recovery and Reinvestment Tax Act of 2009"H*, JCX-19-09, February 12, 2009. Hhttp://www.jct.gov/x-19-09.pdfH

Text of the tax provisions in the stimulus bill as enacted is available HhereH in PDF format

# Tax Stimulus Report Card
## Conference Bill
**as of February 13, 2009**


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### Introduction

The Tax Policy Center has graded the key tax provisions of the Conference stimulus bill (the "American Recovery and Reinvestment Tax Plan of 2009"). Our grades, which rely on the Finance and Ways and Means Committees' summary of the bill and proposed legislative language, focus on how well these measures would boost the economy in the short run.

In the long run, economies grow by expanding their capacity to produce goods and services. This involves increasing the supply of capital and labor, developing new technologies and moving resources to industries and regions where they can be employed best. This is a problem of raising aggregate supply of labor and capital.

The current economic problem, however, is not a lack of capacity or supply but rather a lack of aggregate demand that is reflected in the underuse of existing capacity: unemployment rates are high, capacity utilization rates in manufacturing are low, and consumer confidence is dismal. In the current environment, the most promising way of turning the economy around is to raise aggregate demand by stimulating consumer spending, business hiring and investment, and purchases by federal, state and local governments. This will raise demand for goods and increase use of existing capacity.

Therefore, a good provision boosts aggregate demand, has a high "bang for the buck"—that is, stimulates a substantial amount of spending per dollar of tax cut—and expires after the recession is over. Individual tax cuts with high bang for the buck target those most likely to spend the money and do so in a timely way. Business tax cuts with high bang for the buck encourage new investment and hiring rather than subsidize spending that would have occurred anyway.

These grades are preliminary and we may adjust them as we learn more about the proposals and their economic effects. In addition, TPC will update its Report Card as more information becomes available.

**Note: This paper cites "10-year" revenue estimates but, because significant revenue losses occur in 2009, the 10-year values reported include both the 10-year budget window—2010-2019—and 2009.**

## "MAKING WORK PAY" TAX CREDIT

### Key Points

- Workers can receive an income tax credit equal to 6.2 percent of earned income up to a maximum credit of $400 ($800 for couples).
- The credit could start quickly if implemented through reduced withholding. Otherwise, taxpayers would likely not benefit until they file their tax returns the following year, in which case the stimulus effect would be significantly delayed.
- Delivery in small increments through reduced withholding—rather than in a lump sum as a tax refund—might encourage recipients to spend the credit rather than save more or pay down debt.
- A temporary credit induces less additional spending than a permanent credit.
- The credit could induce some low-income people to work and partially offsets the regressivity of the payroll tax.
- JCT estimates that the proposal would cost $116.2 billion over 10 years, making it by far the largest tax provision. (If made permanent, the long-term costs would be very large—an estimated $640 billion more through 2018.)

### Current Law

The "Making Work Pay" tax credit is a new credit.

### Stimulus Proposal

The "Making Work Pay" (MWP) tax credit would implement part of President Obama's campaign proposal to offset part of the Social Security taxes paid by low- and middle-income workers.

MWP would provide a refundable tax credit in 2009 and 2010 equal to 6.2 percent of earnings (the employee share of the Social Security payroll tax), up to a maximum credit of $400 for individuals ($800 for couples). Neither nonresident aliens nor people claimed as dependents by other taxpayers are eligible for the credit.

The credit would phase out at a rate of 2 percent of income over $150,000 for married couples filing joint tax returns and $75,000 for others. Therefore, couples with income above $190,000 and others with income above $95,000 would not get the credit.

The credit would be reduced by the amount of any economic recovery payments made to recipients of Social Security, Veterans Administration payments, or Railroad Retirement and by the amount of the temporary refundable tax credit provided to certain government retirees.

The legislative language does not specify how workers would receive the credit, but the conference report says that the Internal Revenue Service (IRS) should adjust withholding tables to advance the full amount of the credit to workers evenly over the rest of 2009. As a result, recipients would quickly benefit from the credit through larger paychecks.

### Discussion

Assuming that taxpayers receive the credit over time through reduced withholding, the new credit could quickly boost take-home pay. If implemented for the last six months of 2009, IRS adjustments to withholding tables would reduce the amount withheld from workers' checks by about $15 a week and thus deliver the $400 by the end of the year. (Weekly paycheck increases would be half as large in 2010 because they would apply throughout the year.) Because each payment would be small, recipients might be more likely to spend the added income rather than saving it or paying down credit card or other debts. Evidence from behavioral economics suggests that taxpayers view small increments to after-tax pay as income, to be spent, whereas they tend to view lump-sum payments as wealth, to be saved. (James Surowiecki summarizes this point in "A Smarter Stimulus.") Thus, the reduction in withholding would likely be an especially effective way to deliver stimulus.

Workers with little or no withholding now could not get the full credit through reduced withholding and would receive some or all of the credit only when they file their income tax returns the next year. In that case, the 2009 credit would not arrive until 2010, delaying any stimulative effect. Furthermore, because they would typically get the credit as a single large payment, recipients would be more likely to save it or use it to pay down their debts, which would not stimulate the economy. In addition, the fact that the credit disappears after two years makes it less likely that recipients will increase their spending. Permanent tax cuts can affect behavior more than temporary ones do.

The credit could begin quickly because employers could readily reduce withholding. Workers who hold multiple jobs and high-income workers for whom the credit would phase out would require special treatment to avoid under-withholding. In addition, because the credit for married couples is based on joint earnings, it would be difficult to adjust withholding tables to get the right result for both single- and dual-worker couples. The income caps will complicate withholding tables further by making it hard to know which couples will have too much income to claim the credit. Depending on how the IRS implements withholding changes, married taxpayers may find that they have the wrong amount of tax withheld.

The credit would have some beneficial effects beyond the stimulus because it would partially offset the regressivity of payroll taxes and encourage low-income people to work. However, because it would not be limited to low-income workers, the credit would substantially reduce federal tax revenues. If it were made permanent—as President Obama proposed during the campaign—the credit would continue to reduce revenues—by an estimated $640 billion between 2011 and 2018—even after the economy has turned around and when the country will need to restore fiscal balance.

**Grade: B+**

This proposal gets high marks for timeliness, assuming the IRS implements it quickly by adjusting tax withholding tables. That mechanism would also maximize the chances that the credit would be spent rather than saved. As a refundable tax credit, the proposal would aid many low-income workers who are most likely to spend the money. However, the credit would also be available to many higher-income workers who are less likely to spend the additional income. Were the credit better targeted, it would have been graded an A.

## INCREASE IN EARNED INCOME TAX CREDIT

### Key Points

- This proposal would increase the earned income tax credit (EITC) for families with three or more children from 40 to 45 percent of qualifying earnings. It would also increase the income range over which the EITC phases out for married couples to $5,000 more than that for single people, up from the 2009 level of $3,120.
- Increases to the EITC focus resources on relatively low-income families, who are most likely to spend the money.
- Marriage-penalty relief furthers efforts started with EGTRRA to keep low-income families from losing their EITC because of marriage.
- JCT estimates that the proposal would cost $4.7 billion over 10 years.

### Current Law

The earned income tax credit (EITC) subsidizes earnings for low-income working families. The credit equals a fixed percentage of earnings until the credit reaches a maximum; both the percentage and the maximum credit depend on the number of children in the family. Maximum credits in 2009 are $457 for workers with no children, $3,043 for families with one child, and $5,028 for those with two or more children. Larger families get no additional credit. The credit stays at that maximum as income rises up to the phase-out threshold, above which the credit falls with each additional dollar of income until it disappears entirely. The phaseout begins at a higher income for married couples than for single parents. The credit is fully refundable: any excess beyond a family's income tax liability is paid as a tax refund.

The table below summarizes the EITC parameters in 2009.

| Number of children | Credit rate (percent) | Income level for maximum credit | Maximum credit | Phase-out rate (percent) | Phase-out range* | |
|---|---|---|---|---|---|---|
| | | | | | Beginning income | Ending income |
| None | 7.65 | 5,970 | 457 | 7.65 | 7,470 | 13,440 |
| One | 34 | 8,950 | 3,043 | 15.98 | 16,420 | 35,643 |
| Two or more | 40 | 12,570 | 5,028 | 21.06 | 16,420 | 40,295 |

*The phase-out range for married couples begins and ends $3,120 higher than the values listed in this table. All dollar levels are adjusted annually for inflation.

### Stimulus Proposal

The proposal would increase the earned income tax credit rate for working families with three or more children to 45 percent in 2009 and 2010. The maximum credit for families with three or more children would increase from $5,028 to $5,657. It would also increase the phase-out income levels for all married couples filing a joint tax return (regardless of the number of children) to $5,000 above the thresholds for single filers in 2009 and 2010.

**Discussion**

The EITC helps low-income families, but its structure ignores the greater needs of larger families. The credit goes to families with relatively low income—no more than $43,415—for whom having an additional child could impose significant demands on scarce resources.

Under the proposal, all families with three or more children who currently qualify for the EITC would receive a larger credit, and more families would become eligible for the credit because the phase-out range would extend over about $2,000 more income than the current credit for affected families.

The EITC may impose substantial marriage penalties on low-income families. When two low-income individuals marry, they may get a smaller or no EITC because of their higher combined earnings. The 2001 tax act increased the income level at which the credit begins to phase out for married couples to $3,120 above that for single people in 2009. The stimulus bill would further mitigate the marriage penalty by raising that higher phase-out start for couples to $5,000 above that for single people and thus make the credit available to more married tax filers.

The proposal is highly targeted, providing benefits to poor families, who are most likely to spend the additional income. Research based on credit card data showed that low-income households spent about 75 percent of their rebates from the 2001 tax stimulus (Johnson, Parker, and Souleles 2006). Shapiro and Slemrod (2003), however, found that low-income families spent much less than three-fourths of their 2001 rebates and not much more than higher-income families.

The larger EITC would increase the benefits of working and could thus induce some very low income people to look for jobs. In an ordinary time, that would help boost the economy. Given the currently high unemployment rate, however, new job seekers are unlikely to find work so the economy would get little stimulus through this mechanism.

There is likely to be substantial pressure to extend the credit beyond two years. That would increase long-term revenue losses, but it would also improve fairness for large families by recognizing their relatively greater needs and would mitigate some marriage penalties.

**Grade: B**

This provision is targeted on low-income households that are likely to spend additional income. The proposal would receive a higher grade if money could be distributed to affected families quickly—for example, through rebates based on 2008 income levels. More than 98 percent of recipients get the EITC as a refund at filing time, so the higher credit would not affect most recipients until they file their tax returns in 2010.

## INCREASE ELIGIBILITY FOR THE REFUNDABLE PORTION OF THE CHILD TAX CREDIT

### Key Points

- This proposal would reduce the income threshold at which the Child Tax Credit (CTC) begins to phase in from $12,550 in 2009 and an estimated $12,600 in 2010 to $3,000 and would therefore extend the credit to poorer working families.
- This is the most highly targeted of the tax provisions – though less targeted than the parallel Ways and Means proposal, because it would exclusively help low-income working families with children, who would tend to spend most or all of the additional funds.
- The stimulus would be delayed because the credit would generally only come after recipients file their tax returns the following year.
- JCT estimates that the proposal will cost $14.8 over 10 years.

### Current Law

Families with children under age 17 can claim a Child Tax Credit (CTC) of up to $1,000 per child. The credit is reduced by 5 percent of adjusted gross income over $110,000 for married couples ($75,000 for single parents). If the credit exceeds taxes owed, families can receive some or all of the balance as a refund, known as the Additional Child Tax Credit (ACTC). The ACTC is limited to 15 percent of earnings above a threshold—$12,550 in 2009—that is indexed to inflation. The point at which the ACTC begins to phase-in coincides with the end of the phase-in range of the earned income tax credit (EITC) for families with two or more children, providing a smooth transition between the two credits for these families. For families with one child, however, there is a $3,600 gap between the $8,950 end of the EITC phase-in and the $12,550 start of the ACTC phase-in.

### Stimulus Proposal

The proposal would reduce the start of the phase-in for the ACTC to $3,000 through 2010 so that families would start getting at least a partial credit at lower earnings levels than they do under current law.

### Discussion

The CTC is the largest tax code provision benefiting families with children, distributing about $45 billion to 31 million families in 2007. As currently structured, higher-income families are much more likely to benefit than lower-income families. In 2007, when the ACTC threshold was $11,750, only 8.2 percent of families with eligible children in the lowest quintile—or fifth—of the income distribution received any benefit from the credit, compared to nearly all families in the middle income quintile (see TPC table T07-0296). On top of that, many low-income families who receive the credit get less than its full $1,000 value because their income falls in the phase-in range.

This proposal is the most targeted part of the stimulus package, providing assistance exclusively to poor families (though not to those earning less than $3,000 per year), who are most likely to spend additional income. Research based on credit card data showed that low-income households spent about 75 percent of their rebates from the 2001 tax stimulus (Johnson, Parker, and Souleles 2006). Beneficiaries of this proposal have even lower incomes than the low-income recipients of the earlier tax rebate and would likely spend an even larger share of any additional credit this proposal would provide. On the other hand, survey data contradict that research, suggesting instead that low-income families spent much less than three-fourths of their 2001 rebates and not much more than higher-income families (Shapiro and Slemrod 2003). However, low-income survey respondents were also generally better off than most of the people who will benefit from this proposal so how they reacted to the 2001 rebates may not be relevant; the very low income households newly eligible for the CTC could well spend most of their additional credits and thus help to stimulate the economy.

The lower phase-in threshold would increase the benefits of working and could thus induce some very low income people to look for jobs. In an ordinary time, that would help boost the economy. In today's weak economy with its high unemployment rate, however, new job seekers are unlikely to find work so the economy would get little stimulus through this mechanism.

The proposal gets marked down because most families would receive no benefit until they file their tax returns in 2010. The stimulus could be made timelier (and thus more effective) if the first installment were paid out as rebate checks based on 2008 incomes.

There would be strong pressure to extend the credit beyond two years. That would significantly increase the long-term revenue cost, but it would make the tax system fairer – allowing more families with children to receive the credit. If the $3,000 threshold were made permanent, it would have mixed effects on economic efficiency. Most lower-income households in the phase-in range would have a greater incentive to work, but some households in the phase-out range for the EITC could face disincentives to work more since the CTC would be fully phased-in prior to the EITC beginning to phase-out, rather than overlapping for a range of income.

**Grade: B+**

This provision is the most highly targeted in the stimulus package. The proposal would receive an A- grade if the first installment were distributed based on 2008 tax returns and the phase-in threshold were lowered to zero as the House had proposed.

## "AMERICAN OPPORTUNITY" TAX CREDIT

### Key Points

- Raises maximum education credit from $1,800 to $2,500 and extends to four years.
- Makes credit partially refundable so lowest-income students could benefit.
- Greatest impact if available at beginning of school term; timing might delay effects.
- Expiration could leave students without adequate funding to complete studies.
- JCT estimates that the proposal would cost $13.9 billion over 10 years.

### Current Law

The Hope credit provides a tax credit of up to $1,800 for each of the first two years of postsecondary education. The credit equals 100 percent of the first $1,200 of tuition and fees plus 50 percent of the next $1,200. Students must attend school at least half time. The credit does not apply to expenses covered by other tax-preferred vehicles such as 529 plans and Coverdell Savings Accounts. Taxpayers may only claim one of the Hope credit, lifetime learning credit, or a deduction for tuition expenses for each qualifying student on their tax returns in one year. They may, however, use different options for different students or in different years. Because the credit is not refundable, it provides little or no assistance to low-income households.

### Stimulus Proposal

The "American Opportunity" tax credit (AOTC) would provide a partially refundable tax credit in 2009 and 2010 equal to 100 percent of the first $2,000 plus 25 percent of the next $2,000 spent on tuition, fees, and course materials during each of the first four years of postsecondary education. The maximum credit would thus be $2,500 a year. As is currently the case for the Hope credit, taxpayers could not claim the credit for any expenses paid using funds from other tax-preferred vehicles such as 529 plans and Coverdell Savings Accounts, nor could they use more than one of the AOTC, the lifetime learning credit, and the deduction for tuition expenses for a student in a given year.

Forty percent of the AOTC would be refundable and thus available to households with little or no tax liability. The maximum amount of refundable credit would be $1,000.

The credit would phase out evenly for married couples filing joint tax returns with income between $160,000 and $180,000 and for others with income between $80,000 and $90,000. Couples with income above $180,000 and others with income above $90,000 would not get the credit.

The AOTC has a similar structure to President Obama's campaign proposal for a fully refundable American Dream tax credit. However, the AOTC would be smaller (a maximum of $2,500 versus $4,000) and only partially refundable. In addition, unlike the president's proposal, it would not go directly to educational institutions but rather would be paid as a credit claimed on the household's tax return.

### Discussion

The AOTC would provide additional financial assistance for students pursuing postsecondary education, raising the maximum tax credit from $1,800 to $2,500 per year and extending the credit to cover four years of postsecondary schooling. Because the credit would be 40 percent refundable, low-income students could benefit up to $1,000 each year; the AOTC would thus reach all the way down the income distribution, unlike the current non-refundable Hope credit. Extending the credit to cover four years of schooling for the next two years might enable some students currently enrolled to complete their postsecondary education. Research suggests that aid could increase student persistence but that the effect is not large (Hossler et al. 2008).

Because it would provide funds through the income tax, the credit might take time to become effective as a stimulus. Taxpayers generally do not adjust their tax withholding immediately when their tax liability goes down and thus would benefit from the credit only when they file their tax returns the following year. To the extent that low-income students need funds at the time they enroll, the delayed receipt of the credit could limit its value in enabling people to attend school. Paying the credit directly to the school once the student enrolls—as President Obama proposed during the election campaign—would give low-income students financial aid when they need it and could help more people to afford college, although it would create new administrative challenges to the IRS.

For students already in school or planning to attend, the credit would represent a windfall, a portion of which might be spent, albeit with a significant lag. However, because most students take out student loans to attend college, the credit might simply replace those loans and thus have no stimulative effect. If, however, students are having trouble getting loans because of the problems in financial markets, the expanded credit could increase enrollments.

With high unemployment, this might be a particularly good time to encourage people to attend college. With labor temporarily in surplus, there is little cost to the economy from encouraging more people to temporarily exit the work force. And students who attend college develop skills and credentials that add to their labor productivity and incomes over the long term.

Research suggests that the Hope credit caused colleges to raise tuition more than they otherwise would have (Long 2004). In the current economic environment with reduced state funding for colleges and shrunken endowments, the higher tuition could translate directly into increased spending by schools. That effect could enhance the AOTC's impact as a stimulus but could also reduce enrollment of low-income students.

The long-run impact of the proposal would be mixed. On the one hand, it could induce people to begin their postsecondary education, although evidence from the use of Hope credits suggests that the credit would have little effect on enrollment (Long 2004; Baum and McPherson 2008). Once enrolled, however, students would be more likely to complete their schooling, even if the credit expired. Some students would complete their degrees using the credit and would thus be likely to get better jobs than otherwise. And even students who did not complete their schooling would have improved their skills and their job opportunities. On the other hand, expiration of the credit could leave needy students without funds to continue their studies. There would likely be strong pressure to extend the credit beyond its proposed two-year life.

**Grade: C**

The credit is a windfall to students who had planned to attend college anyway (or to their families) and some of that windfall would likely be spent, providing a modest stimulus. The credit could also lead colleges to raise tuition and spend the extra funds, which would also help the economy. However, much of the credit is likely to go to reduce student loan burdens. Moreover, the credits would come with a significant lag since they would generally become available only at tax filing time. Although not considered in the grade, the proposal deserves extra credit for making it easier for unemployed or underemployed workers to enhance their skills and might offset some of the student loan market's problems caused by the financial market meltdown.

## REFUNDABLE FIRST-TIME HOME BUYER CREDIT

### Key Points

- The proposal converts the first-time home buyer credit from an interest-free loan to a cash grant in the form of a refundable tax credit of 10 percent of home purchase price, up to a maximum $8,000 credit, for qualifying first-time home buyers who purchase a home between January 1 and November 30, 2009.
- The provision is likely to speed up some home purchases, providing a very modest temporary boost to the housing market.
- There is likely to be pressure to extend this provision beyond its scheduled expiration date.
- JCT estimate that the proposal would cost $6.6 billion over 10 years.

### Current Law

First-time home buyers are allowed a refundable tax credit equal to the lesser of $7,500 ($3,750 for married-filing-separate returns) or 10 percent of the purchase price of a principal residence. The credit phases out for individual taxpayers with modified adjusted gross income between $75,000 and $95,000 ($150,000 and $170,000 for joint filers). To qualify, the taxpayer must not have owned a home during the three years prior to purchase. In addition, taxpayers are ineligible if they claim the D.C. home buyer credit (a $5,000 nonrefundable tax credit for qualifying purchases in Washington, D.C.) or if their home is financed with tax-exempt mortgage revenue bonds (low-interest rate mortgages).

The credit is recaptured ratably over 15 years starting in the second year after purchase. That is, the credit is basically an interest-free loan, paid back in installments over 15 years. If the taxpayer sells the home or stops using it as a principal residence, any remaining credit must be repaid. However, the amount repaid is limited to the gain (if any) on sale. (To calculate gain, the taxpayer's cost basis is reduced by the amount of the credit.) There is no recapture if a taxpayer dies.

The provision applies to purchase between April 9, 2008, and June 30, 2009. Taxpayers who buy a home in 2009 may elect to claim the credit on their 2008 tax returns (with recapture starting in 2010).

### Proposal

The proposal would increase the maximum credit to $8,000 ($4,000 for married-filing-separate returns), extend the eligibility of the credit through November 2009, and waive the repayment requirement for qualifying homes purchased between January 1 and November 30, 2009, and held for at least three years. Qualifying purchasers in 2009 may elect to claim the credit on their 2008 tax returns. Effectively, the home buyer credit would be converted from an interest-free loan into a cash grant. The credit would also be allowed for properties financed with mortgage revenue bonds.

### Discussion

The proposal would temporarily increase the demand for owner-occupied housing by reducing the after-tax cost for qualifying home purchasers. The higher demand is likely to increase the sale price and shorten the average time on the market of more affordable owner-occupied housing units. That is, part of the benefit of the tax subsidy will accrue to home sellers, especially those with “starter homes.” However, since first-time home buyers are a small part of the housing market, the effect on prices is likely to be very modest. To the extent that the credit encourages people to move from renting to owning, it is likely to also increase rental vacancy rates, depressing slightly the value of rental real estate. Thus, the overall effect of housing prices is likely to be very small. In addition, taxpayers eligible for the credit are likely to buy somewhat better (more expensive) homes than they would without the credit.

The proposal would provide a windfall to qualifying taxpayers who already planned to buy a home and it would encourage some taxpayers who were thinking about buying to speed up their purchases so the sale could be completed by November 30. If taxpayers expect that the credit will expire as scheduled, it would build in an automatic after-tax price increase—offsetting the deflationary expectations in the housing market. Currently, with house prices falling, buyers may perceive that they are better off waiting, which further weakens demand for housing and can lead to further price declines. If the credit expires as scheduled on December 1, home buyers could save $8,000 if they buy before November 30.

While the temporary proposal would have little effect on the housing market, the windfalls to first-time home buyers would provide a modest stimulus. It is not particularly well targeted, but it would be timely. Although the tax credit would be fully refundable, potentially helping households with modest incomes, most low-income people cannot afford to purchase a home (and many would have difficulty finding a mortgage even if they wanted to buy), so the credit would primarily go to middle-income families. The credit could, however, be claimed on 2008 tax returns, meaning that it could raise after-tax incomes fairly quickly if taxpayers either completed their sale before they file or if they chose to file an amended tax return after qualifying for the credit. There are also programs in place that allow the credit to be used as part of a down-payment on a home through short-term loan programs. Individuals who purchase their homes using either a HUD-sponsored FHA-insured loan or using mortgages financed by states using tax-exempt debt may be able to monetize the expected credit at the time of purchase using state.

There will likely be pressure on policymakers to extend the scheduled expiration date beyond November 30. Some purchases in the works by November 30 will not be completed in time to qualify and those buyers will lobby for extension. Home sellers, builders, and realtors will also want to extend the expiration date because the real estate market is likely to remain soft for quite some time, and the drop off in demand on December 1 would tend to depress the market again.

As a long-term measure, however, the proposal would increase the tilt in the tax code in favor of owner-occupied housing. Owner-occupied housing is very heavily subsidized, resulting in too much investment in homes and not enough in other productive assets. This is both inefficient and inequitable. (If the cost of a permanent home buyer credit were financed by reductions in other housing tax expenditures, such as the mortgage interest deduction, the proposal could improve equity by retargeting housing subsidies at those with lower incomes and expand homeownership (see Gale et al. 2007).)

However, the credit as modified is much simpler than the original provision. Recapture over 15 years requires fairly extensive record keeping and annual reporting, which, under this proposal, would not be necessary for taxpayers who remain in their homes for at least three years.

**Grade: C**

The proposal would raise incomes of some middle-income families, boosting consumption slightly, and it would be very timely. However, it is likely to do little to solve the housing market's problems. There is a substantial risk that the credit would be extended, which would be undesirable unless other housing tax subsidies were scaled back.

## TEMPORARY SUSPENSION OF TAXATION OF UNEMPLOYMENT BENEFITS KEY POINTS

### Key Points

- Exempts from income taxation up to $2,400 of unemployment compensation received by each beneficiary during 2009.
- Tax savings depend on tax bracket so low-income unemployed get smallest benefit. Maximum benefit would be $240 for households in 10 percent tax bracket and $840 for those in 35 percent top tax bracket. Those with income too low to have tax liability before credits would get no benefit.
- The stimulus effect would not occur quickly because most taxpayers would not benefit until they file their 2009 tax returns in 2010.
- Spending the same amount of money to increase unemployment benefits would have faster and greater stimulus effect by delivering funds more quickly and targeting more income to low-income households that would more likely spend additional money.
- JCT estimates that the proposal would cost $4.7 billion over 10 years.

### Current Law

Unemployment compensation is currently fully subject to federal income taxation.

### Stimulus Proposal

The proposal would exempt from federal income taxation up to $2,400 of unemployment compensation received by each unemployed worker. Most taxpayers would benefit from that exclusion when they file their 2009 federal tax returns in early 2010.

### Discussion

Because the exclusion would reduce taxable income, its value to taxpayers would depend on their tax bracket. Those facing a 10 percent tax rate would save up to $240 in federal taxes while those in the 35 percent top tax bracket would see their tax bills drop by up to $840. Households with no taxable income—including unemployment compensation and after subtracting exemptions and deductions—would not benefit at all from the provision.

Unemployed workers receive unemployment compensation without any withholding for potential income tax liability. As a result, any benefit from not taxing some or all of the compensation typically would come only when they file tax returns and either get a larger refund or have to pay less additional tax. Taxpayers who have other income subject to withholding could reduce the amount withheld but few people would likely do so. Thus, most of the additional money that unemployed workers would get from this provision would not come until they file their 2009 tax returns a year or more from now. That delay would postpone any stimulus effect of the tax change.

Unemployed workers experience a marked drop in income, even counting unemployment compensation. Most states limit unemployment benefits to about half of previous earnings, subject to state maximums. In December 2008, nearly 19 million people received unemployment compensation averaging just under $300. Because their income has fallen, recipients would likely spend much of their benefits and would also likely spend any tax savings. This provision is thus well targeted and would be effective as stimulus if it were timelier.

A more effective stimulus would come from using the same amount of money to increase unemployment compensation. That would make funds available immediately. It would also redistribute benefits from high-income recipients to those with lower income by separating the value of the provision from recipients' tax rates. Because low-income households are more likely to spend additional income than high-income households, that change would also increase the amount of stimulus.

**Grade: B-**

The provision is well targeted on households whose income has fallen because of unemployment but the fact that benefits are proportional to tax rates means that larger gains would go to high-income taxpayers, thus weakening any stimulus effect. Because most households would see no income change until they file their tax returns in 2010, the provision's impact would be delayed. Using the same amount of money to increase unemployment benefits for all recipients would improve both the targeting and timeliness of the provision and earn an "A."

## AUTOMOBILE SALES TAX DEDUCTION

### Key Points

- Proposal would allow taxpayers who purchase new domestic or foreign cars and light trucks within one year of the bill's date of enactment to deduct sales tax paid on those purchases on their individual income tax returns.
- The deduction would be "above-the-line," available to both taxpayers who itemize their deductions and those who claim the standard deduction.
- Single taxpayers with income up to $135,000 and couples with income up to $260,000 would be eligible to claim the deduction.
- Buyers may take a deduction for the purchase of new cars or light trucks with a total value of up to $49,500.
- By reducing the after-tax cost of new cars and light trucks, the proposal might increase auto purchases and stimulate demand for an industry greatly affected by credit problems and the economic crisis but those effects would likely be small.
- Much of benefit would go to households that would buy new vehicles anyway. Furthermore, allowing the deduction for purchases made since last November raises proposal's cost without affecting sales of new vehicles.
- JCT estimates that the provision is estimated to cost $1.7 billion over ten years.

### Current Law

Current tax law contains no comparable provision.

### Proposal

The proposal would allow people who purchase new cars or light trucks within one year of the bill's enactment to deduct from taxable income all state and local sales and excise taxes for those purchases, up to a cumulative purchase price of $49,500. The deduction would be available to all taxpayers, whether or not they itemize their deductions, and would include purchases of both domestic and foreign vehicles. The deduction would phase out proportionately for single taxpayers with income between $125,000 and $135,000 and for couples with income between $250,000 and $260,000.

### Discussion

The automobile industry just completed one of its worst years on record and all three domestic automobile companies are struggling. This proposal would encourage people to buy new cars and light trucks by temporarily reducing the after-tax cost through an income tax deduction for any state and local sales and excise taxes for qualifying vehicles bought during the applicable time period. Any increase in demand is highly uncertain, however, given the precarious state of the economy and many households' finances.

The deduction would disproportionately benefit high-income taxpayers. Because the new deduction would reduce taxable income, its value would depend on the taxpayer's tax bracket. Purchasers who pay $1,000 in sales taxes would save $250 if they are in the 25 percent top tax bracket but only $100 if they are in the 10 percent tax bracket. The largest benefit would thus go to households most likely to buy new cars in the absence of a tax benefit. Furthermore, lower-income households are much less likely to buy new vehicles and claim the deduction, although they would benefit to the extent that increased purchases of new cars and trucks would likely push down the cost of used vehicles.

Taxpayers who already itemize a deduction for state sales tax—typically residents of the nine states that have low or no income tax—would generally not benefit from the sales tax deduction. They already may deduct sales tax paid on large purchases such as vehicles. Some people who would deduct state sales tax instead of income tax could find it advantageous to switch to deducting state income tax plus sales tax on vehicle purchases, but having to make that decision would complicate their tax filing.

The deduction's stimulative effect on vehicle purchases would be reduced because most car buyers would not see any benefit until they file their 2009 tax returns in 2010. Deferring the benefit would affect low- and middle-income households most since they are most likely to be cash-constrained, particularly during the current economic downturn.

**Grade: C-**

Proposal would increase sales of qualifying vehicles but would disproportionately benefit middle- and high-income households.

## EXTEND THE ALTERNATIVE MINIMUM TAX PATCH THROUGH 2009

### Key Points

- The provision would raise the income levels at which the alternative minimum tax (AMT) starts to apply for one year, through 2009, preventing 26 million taxpayers from being hit by the tax.
- Although potentially justifiable on other grounds, the provision would provide virtually no economic stimulus. Because the patch is perennially extended, it would have no effect on behavior in 2009. Almost 80 percent of the benefits would go to the richest 20 percent of households, who would be least likely to spend the additional funds and stimulate demand.
- JCT estimates the cost of the patch at $69.8 billion over 10 years. That high cost could crowd out other tax cuts that *would* provide effective stimulus.

### Current Law

Individuals must compute their taxes under both the regular tax and the alternative minimum tax. If the tentative alternative minimum tax exceeds the regular tax, taxpayers must pay the higher amount. The AMT requires taxpayers to add a number of otherwise untaxed items (including personal exemptions, state and local tax deductions and certain other deductions) to their taxable income and disallows some tax credits, but taxpayers may also claim a special AMT exemption.

Since 2001, the AMT exemption has been temporarily increased for a year or two at a time to prevent large numbers of taxpayers from becoming subject to the tax. In 2008, the exemption was $69,950 for joint returns and $46,200 for singles and heads of household. The AMT exemption is set to return in 2009, to its 2000 level—$45,000 for couples and $33,750 for singles and heads of household—which TPC projects will increase the number of taxpayers subject to the AMT from 4 million in 2008 to 30 million in 2009.

In general, nonrefundable personal tax credits are not allowed in calculating tentative AMT. Another “temporary” and perpetually extended provision has prevented that provision from taking affect since 1998, but that also expired at the end of 2008. Thus, taxpayers subject to the AMT may lose part or all of the benefit of the value of tax credits for childcare and education, for example.

### Proposal

The proposal would extend for one year the so-called “patch” that protects most taxpayers from the AMT. The 2008 thresholds would be indexed for inflation, increasing to $46,700 for individuals and to $70,950 for couples in 2009. Personal nonrefundable tax credits would also be allowed against the AMT through 2009.

### Discussion

The AMT is a complex, inefficient, and unfair levy that has little justification on tax policy grounds. It includes enormous marriage penalties for some couples, penalizes families with children and those who live in high-tax states, and does little to advance its ostensible goal of reining in tax shelters. (Burman 2007) The tax discourages work and saving because affected taxpayers face higher effective marginal tax rates than they would under the regular income tax. Although it makes the tax system more progressive overall, it leaves the very rich largely unscathed.  Those making $200,000 per year are far more likely to be affected by the tax than those earning $2 million.

Indexing the AMT would provide virtually no economic stimulus. More than 80 percent of the benefits of this provision would go to the highest-income 20 percent of households, and more than half would go to the top 10 percent.  These households are least likely to spend any temporary tax savings.  Furthermore, because Congress has patched the AMT every year, few taxpayers who would otherwise owe AMT are aware that they would pay higher taxes without the patch. As a result, they do not pay higher estimated taxes or behave any differently.  If, in the absence of a patch, they were subjected to the AMT on their 2009 tax returns (and thus owed higher taxes), they might be affected in 2010 when they file their returns, but, even then, most of the additional tax is likely to be paid out of savings.

Congress is certain to extend the AMT patch, whether or not it is in the stimulus bill, so it is hardly a short-term measure. The revenue cost of future extensions will grow dramatically, placing added burdens on our long-term fiscal situation.  The best solution for the long-term would be to eliminate the AMT altogether and offset the revenue loss by broadening the tax base.

**Grade: D-**

While extending the AMT patch might make eminent sense on policy grounds, it makes no sense as economic stimulus.  It is neither timely nor targeted.

## EXTENSION OF ENHANCED EXPENSING FOR SMALL BUSINESS

### Key Points

- The proposal would extend the 2008 limits on the amount of investment that small businesses can expense, rather than depreciate through the end of 2009.
- Both the stimulus effect and revenue cost would be very modest.
- Although it would be easy to let the higher limits expire, past history suggests Congress often extends expiring tax benefits.
- JCT estimates that the proposal would cost $41 million through 2019.

### Current Law

Under Section 179 of the Internal Revenue Code, businesses may expense, or immediately deduct, the first $25,000 of investments in machinery and equipment. The amount of qualifying investment eligible for the deduction decreases dollar for dollar for amounts in excess of $200,000, so that businesses investing more than $225,000 receive no immediate deduction.

In 2003, Congress increased the amount of Section 179 expensing to $100,000 and raised the start of the phase-out range to $400,000, through the end of tax year 2009. The economic stimulus package that Congress enacted in January 2008 raised these limits for tax year 2008 to $250,000 and $800,000.

The table below summarizes Section 179 limits under current law:

| Year(s) | Expensing limit | Start of phase-out | End of phaseout |
|---|---:|---:|---:|
| 2004–07 | $100,000 | $400,000 | $500,000 |
| 2008 | $250,000 | $800,000 | $1,050,000 |
| 2009 | $100,000 | $400,000 | $500,000 |
| 2010 and later | $25,000 | $200,000 | $225,000 |

### Stimulus Proposal

The proposal would extend the 2008 limits through the end of tax year 2009. The proposal is estimated to cost $41 million through 2019. The revenue loss would be $1.1 billion in fiscal years 2009 and 2010, but revenue would be recovered in later years when businesses would otherwise be claiming depreciation deductions.

### Discussion

Section 179 expensing reduces the cost of capital for businesses that use qualifying machinery and equipment and reduces compliance costs by eliminating the need to apply tax depreciation rules and keep track of the adjusted basis of assets. It produces little benefit for those whose capital consists mainly of structures or inventory and no benefit for businesses whose investment exceeds the end of the phase-out limit. The benefit of expensing is larger for longer-lived equipment than for shorter-lived equipment, such as computers, that could otherwise be amortized over three years.

At a 10-year cost of $41 million, the proposal would have a very minor effect on the long-term budget picture and provide little net subsidy to businesses. Some businesses, however, could experience a large one-year drop in the cost of capital for some investments.

It is hard to know how much this proposal would boost the economy. There have been no studies on the effect of Section 179 expensing on the long-term level or timing of investment. Lower capital costs should encourage some additional investment, but much of the tax benefit would go to investments that would have been undertaken even if taxpayers had to depreciate them. A temporary tax incentive could accelerate some investment. However, since generous expensing rules have been in place for several years, some capital purchases that may otherwise have been accelerated already have occurred.

Some believe that expensing should be the rule for all investments, not just those made by small businesses. Expensing is equivalent to exempting the normal return on investment and would be the norm if the tax base were consumption rather than income. However, enacting expensing alone, without making other conforming changes, such as eliminating deductions for interest expense, can create inefficient arbitrage opportunities. Under such a system, investments could be profitable even if they earned sub-par returns because of the tax deductions that they generated. This is a primary concern about expanding the scope of small business expensing provisions. The gains from simplicity have to be weighed against the costs of expanding tax-shelter opportunities.

While the proposal is designed to be temporary, the higher limits originally enacted in 2003 were extended in 2005 and then raised in 2008. If taxpayers believe these higher limits will be permanent, their short-term stimulus effect would be smaller because taxpayers would have no incentive to accelerate the timing of investments.

**Grade: C**

The proposal would simplify tax filing for small businesses and may encourage some businesses to accelerate decisions to invest in capital equipment. It will probably have little stimulatory effect and much of the tax benefit is likely to go to businesses that would have invested anyway.

## EXTENSION OF BONUS DEPRECIATION

### Key Points

- Businesses would be allowed to deduct their cost of capital equipment more quickly. They could write off half the cost of new investment in the year it is purchased.
- Temporarily reducing taxes on new investment encourages taxable businesses to make capital purchases now rather than delaying them. Increased investment now stimulates the economy.
- The provision only benefits businesses with positive taxable income. Businesses running large net operating losses relative to past income, which many now are, receive no immediate benefit from additional deductions.
- Previous experience suggests bonus depreciation has limited effectiveness, partly because accelerated deductions do not help companies with losses. Pairing this proposal with an extension of the net operating loss carry-back period for small businesses only does this little to change this.
- JCT estimates that the proposal would cost $5.1 billion over 10 years.

### Current Law

To determine taxable income, businesses subtract expenses from their receipts. While some business expenses are for items that are entirely used up during the year (e.g., materials and labor), other business expenses are for durable goods that last for many years. The expense for investment in capital equipment (e.g., tractors, computers and wind turbines) occurs over many years as the value of the investment is used up or depreciated. Under current law, businesses calculate taxable income by deducting capital costs over time according to a fixed depreciation schedule.

### Stimulus Proposal

The provision would speed up depreciation deductions by providing businesses with a "bonus" depreciation allowance equal to 50 percent of the cost of qualifying investments acquired in 2009. Businesses would deduct the remaining 50 percent of the investment's cost according to regular depreciation schedules.

### Discussion

Accelerating depreciation deductions does not increase the total amount a company can write off for a given investment. Instead, it allows businesses to deduct more of the cost now and less in the future. That reduces their current tax liabilities at the cost of higher taxes later. Since deductions today are worth more to taxable businesses than deductions in the future, the provision lowers the effective tax rate on new investment making investment more attractive. Lower taxes also increase cash flow.

Over the past decade, Congress has repeatedly allowed faster depreciation of capital assets to stimulate business investment. In 2002, Congress let businesses claim a "bonus" depreciation allowance equal to 30 percent of the cost of investment purchased between September 10, 2001, and September 11, 2002. The following year, Congress raised the deduction to 50 percent of qualified investments purchased after May 5, 2003, and before January 1, 2005. The 2008 economic stimulus package renewed the 50 percent deduction again, this time for qualifying investments made during 2008.

Economic research suggests that bonus depreciation enacted in 2002 and 2003 had relatively modest effects (CBO 2008). There are at least three reasons why: Businesses may have expected that Congress would extend the provisions, thus blunting their incentive to speed up investment. It takes time for businesses to make major investments, making it hard to fit them into specified time periods. Finally, many businesses may have had too little income to offset with these additional tax benefits, a problem that is especially acute during economic downturns.

Bonus depreciation could increase investment this year if businesses have projects they are willing to bring forward into 2009 and if they have income against which to use the deduction. However, many businesses are currently losing money and have no taxable income. A separate provision in the economic recovery package—the net operating loss carryback— would allow businesses with gross receipts of $15 million or less to offset up to five years of previous taxable income with current losses. That carry-back provision would extend the benefit to some businesses that were profitable in the past but are currently losing money, but most investments that could potentially benefit from bonus depreciation are made by businesses not eligible for the longer carryback period.

As recent history has made clear, Congress can turn bonus depreciation on and off as economic circumstances dictate. Paradoxically, that flexibility could render the policy less effective. If businesses expect that Congress will extend the provision as it has in the past, they may not accelerate their investment. As a result, the benefits of the provision may accrue primarily to investment that would have been made anyway, thereby undercutting the cost effectiveness of the tax incentive.

The temporary nature of the provision increases its strength as a stimulus but necessarily reduces its long-run impact. Expiration of bonus depreciation raises a firm's net cost of new investment back to its previous level and removes any further incentive to invest now rather than later. In fact, because the provision primarily leads businesses to move their investment up in time and not to increase overall investment, it may lead businesses to reduce investment when the provision expires. If the economy is still in recession at that point, this could be especially undesirable.

The revenue loss of the provision is front-loaded. Bonus depreciation decreases tax payments in the first years but increases payments in future years relative to current law.

**Grade: C**

Previous experience with bonus depreciation is not encouraging.

## 5-YEAR CARRYBACK OF NET OPERATING LOSSES FOR SMALL BUSINESSES

### Key Points

- Current law allows businesses to carry net operating losses back for two years to offset past taxable income. This proposal would allow small businesses the option of carrying back losses an additional three years. The provision would allow businesses to redo prior-year tax returns and get immediate cash refunds for previously unusable losses.
- The proposal would make temporary investment incentives such as bonus depreciation and expensing more effective, but only for some small businesses.
- The proposal would increase cash flow to some small businesses that are constrained in borrowing, enabling them to increase investment
- The increase in the carry-back period would benefit some previously profitable small businesses that face large losses now. Given the state of the economy, this may be insufficient to induce those businesses to invest more now. Large businesses, start-ups, small businesses that have large losses relative to past gains, and small businesses organized as partnerships or S-corporations whose owners have sufficient other income to offset business losses would receive no benefit from the provision.
- JCT estimates that the proposal will cost $0.9 billion over 10 years.

### Current Law

Businesses calculate taxable income by subtracting expenses from revenues. While net income is taxed immediately, net operating losses do not qualify for immediate refunds on current tax returns. However, businesses may effectively receive a refund to the extent that they can be "carried back" against income taxed in previous years. Under current law, businesses may use current losses to offset only the past two years of profits. Losses that exceed the sum of the previous two years of positive income may be "carried forward" and used to offset taxable income earned in future years. Losses can currently be carried forward for twenty years (without interest, so their present value is lower than if they could be claimed immediately).

The net operating loss limitations apply both to corporations and to businesses organized as flow through enterprises (partnerships, subchapter S corporations, and small proprietorships). While businesses subject to corporate tax may offset losses only against profits, partners or shareholders in a flow-through enterprise may deduct their losses from the business against income from earnings, investments, and profits of other businesses they own. Most small businesses accounting for most of the revenue among small businesses are organized as flow-through enterprises.

### Stimulus Proposal

The provision would increase the net operating loss (NOL) carry-back period from two years to five years in the case of an NOL for any taxable year either beginning or ending in 2008. The benefit would apply to small businesses only. For the purpose of the provision, a business qualifies as "small" if its annual gross receipts is $15 million or less.

### Discussion

Businesses that are unable to absorb their current losses with past tax payments do not receive immediate benefits from investment tax incentives such as expensing or bonus depreciation. Unused deductions can't be used until future years. Because this blunts any stimulus provided by investment tax incentives, extending the carry-back period would enhance these incentives. The more generous carry-back period could allow a business to benefit immediately from temporary investment incentives.

The provision would also give an infusion of cash to some businesses that are running losses, which may promote investment. This might be especially important if those businesses have trouble borrowing because of financial market problems. The carry-back provision acts like an interest-free loan to these businesses. The Congressional Budget Office (2008) has concluded, however, that "effects of taxes on investment that stem from their impact on cash-flow are generally believed to be weaker, dollar for dollar, than those that stem from the direct effects of taxes on the cost of capital." But this relationship might be reversed when businesses are having difficulty obtaining external finance.

The provision would also help small businesses that were relatively healthy in the past but now have losses that are larger than recent profits or, for flow-through businesses, larger than the sum of recent profits and other income of owners. The provision would benefit old capital held by these businesses, but it is not clear whether it would induce them to undertake new investment. Large businesses, start-ups businesses that have large losses relative to past gains, and small businesses whose owners can offset their losses from the business with other income would receive no benefit from the provision.

The Job Creation and Worker Assistance Act of 2002 applied a five-year carry back to losses from 2001 and 2002. In 2003, the carry-back period reverted to two years. We are not aware of any research evaluating the effects of that tax law change on business investment.

Increasing the carry-back period is not necessarily bad tax policy. By not providing full refunds for losses, the government discriminates against risky investments relative to safe ones. Allowing full and immediate refunds of losses would level the playing field. But not all losses claimed by businesses are "real". Some are generated by differences between income measured for tax and accounting purposes. Other losses may not be genuine and are taken to reduce taxable income in an attempt to evade taxation. Limiting the carry-back period can be viewed as a compromise between discouraging tax evasion and not discouraging risk-taking. Extending the carry-back period reduces the penalty on risk-taking and provides for more neutral treatment between risky and safe investments.

The proposal would cost an estimated $947 million over 10 years. Revenue would fall by more than 4.7 billion in fiscal year 2009. The resulting reduction in the stock of losses that firms could deduct from future profits would yield revenue gains in later years, recouping most of the early revenue loss. As a result, the short-term stimulus effect is likely greater than the 10-year costs suggest, although still very modest.

**Grade: C**

Increases effectiveness of temporary investment incentives such as bonus depreciation and expensing but only for some small businesses. By increasing cash flow to some small businesses that cannot borrow, it could also stimulate new investment but the effect would be modest at best given current economic downturn and the limited amount of investment that benefits.

## INCENTIVES TO HIRE UNEMPLOYED VETERANS AND DISCONNECTED YOUTH

### Key points

- The Work Opportunity Tax Credit offers subsidies to businesses that hire certain disadvantaged workers. The provision would expand the target groups of the credit to include a broader category of youth ("disconnected youth") and unemployed veterans. The maximum credit available is $2,400.
- Research suggests that the credit has not been effective in improving employment outcomes. Few businesses have used the Work Opportunity Tax Credit. The credit only benefits businesses with positive tax liability and the maximum credit of $2,400 is not likely to be enough to encourage hiring from these target groups.
- To the extent that any new hiring is induced, the jobs will go to low-income individuals who are likely to spend their earnings, providing a modest stimulus.
- JCT estimates that the proposal would cost $231 million over 10 years.

### Current law

The Work Opportunity Tax Credit (WOTC) is available for employers hiring individuals from one or more of nine targeted groups including welfare recipients, food stamp recipients (age 18-39), poor and disabled veterans, youth from disadvantaged geographic areas, Supplemental Security Income recipients, and qualified ex-felons. An individual is not treated as a member of the target group unless she or he received a certification from a designated local agency before starting work or the employer completed a request for certification within four weeks of hiring the employee.

The credit is determined by the amount of qualified wages paid by the employer. Certified employees must work a minimum of 120 hours. Generally, the subsidy level is 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages up to $6,000, resulting in a maximum subsidy of $2,400 per qualified worker. The credit applies only to qualified first-year wages except in the case of workers who have received Temporary Assistance for Needy Families (TANF) for an extended period of time. Employers who hire these individuals receive a larger credit that covers both first and second year wages

### Stimulus Proposal

The proposal would expand the target group to include disconnected youth and unemployed, recently discharged veterans hired in 2009 or 2010. Individuals would qualify as unemployed veterans if they were discharged or released from active duty during the five years before being hired and received unemployment compensation for not less than four weeks during the year before being hired. Individuals would qualify as disconnected youths if they are at 16 and not yet 25 when hired, have not been regularly employed or attending school in the past 6 months, and lack basic skills.

### Discussion

The small literature on the WOTC credit suggests that the credit has been vastly underutilized and has had no meaningful impact on employment rates among the disadvantaged (GAO 2002; Department of Labor 2001; Hamersma 2005). Few businesses participate in the program. GAO reported that in 1999, only about one out of 790 corporations and one out of 3,450 individuals with a business affiliation claimed the credit. Hamersma (2005) found that disadvantaged youth were especially unlikely to benefit from the credit. The relatively few workers whose employers have participated in the program did enjoy modestly higher earnings.

The proposal would substantially expand the population eligible for the credit. Veterans whose families were receiving (or recently received) Food Stamps and certain disabled veterans qualify under current law. Under the stimulus proposal, all recent veterans who are currently unemployed would qualify. Under current law, individuals between the ages of 18 and 39 who either (i) receive or recently received TANF payments or food stamps or (ii) live in disadvantaged communities qualify for the credit. Under the proposal, anyone between the ages of 16 and 24 who is not in school or working when hired qualifies if they lack basic skills. Both groups are likely to spend any additional income they earn as a result of the credit.

Although the expansion makes more potential workers eligible, the maximum credit of $2,400 is not likely to encourage many businesses to hire these workers in today's deep recession. Many businesses will not have sufficient tax liability to claim the credit (although under current law they can carry the credit back one year and forward 20 years). On the other hand, businesses that are profitable and do owe tax will receive a benefit for hiring workers they would have employed anyway.

**Grade: D**

Based on past experience, this wage subsidy is not likely to be effective in generating jobs for the newly expanded target group. Further, the credit may subsidize hiring that would have occurred anyway.

## DEFERRAL OF CERTAIN INCOME FROM DISCHARGE OF INDEBTEDNESS

### Key points

- Provision would allow businesses to defer tax on income that is recognized when they buy back or exchange their debt at a discount in either 2009 or 2010.
- Deleveraging is beneficial in today's economy. However, since debt repurchase or exchange benefits companies by boosting earnings, these transactions may already be occurring without the new tax break. Thus, the additional tax benefit may be a windfall to companies that are already buying back their debt.
- Deferring tax could remove an impediment that keeps firms from shedding devalued debt and improving their balance sheets.
- JCT estimates the proposal would cost $1.6 billion over 10 years.

### Current Law

Under current law, if a borrower or related party buys back or exchanges its own debt at less than the issue price, it must pay tax on the difference between the original price and the debt's current value when purchased or exchanged.

For example, consider a business that borrowed $100,000 three years ago. Today, due to the credit crunch, interest rates on corporate debt are far higher than they were. And, as a result of the recession, the firm's credit rating may be much lower. Consequently, that $100,000 bond may now be worth only $60,000. If the issuer buys back that debt at today's price (or exchanges it for other debt also worth $60,000), the $40,000 difference is considered income and is subject to tax.

The Internal Revenue Code has, in the past, allowed all businesses in these circumstances to defer income even if they repurchased their debt at a discount. However, today, debt forgiveness results in income except under limited circumstances such as bankruptcy.

### Stimulus Proposal

The proposal would permit any business to defer income if it buys back or exchanges its own debt at a discount in 2009 and 2010. Any income realized in 2009 due to a debt buyback must be included ratably in income in each of the five taxable years beginning five years after the year of realization. Any income realized in 2010 due to a debt buyback must be included ratably in income in each of the five taxable years beginning four years after the year of realization.

### Discussion

Supporters of this proposal argue that it would encourage firms to repurchase or exchange debt, which would make them more liquid and put them in a better position to withstand the economic downturn. In 2007, Congress allowed homeowners to avoid tax in cases where lenders restructured their mortgages.

However, because these transactions may both reduce leverage and boost earnings, they appear to already be occurring, despite the tax businesses must pay on the trades. Thus, in many cases the new tax benefit may subsidize debt repurchase or exchange that would occur anyway, resulting in a windfall and generating little new economic activity.

In addition, the beneficiaries of this tax break are those firms that have sufficient cash to repurchase debt. Almost by definition, these businesses are in less need of assistance than cash-constrained competitors. Similarly, this tax break would provide no additional cash flow to unprofitable companies that are paying no tax.

**Grade: C-**

This proposal may help some companies deleverage, but much of the benefit would go to those businesses that least need assistance.

## RECOVERY ZONE BONDS

**Key Points:**

- The proposal would give state and local governments authority to issue $25 billion in federally-subsidized or tax-preferred bonds to encourage increased economic activity within depressed areas.
- The proposal would allocate $10 billion for recovery zone development bonds and $15 billion for recovery zone facility bonds; governments would have to issue all bonds in 2009 or 2010.
- The bonds must support economic development within recovery zones, defined as areas "having significant poverty, unemployment, home foreclosures, or general distress" or those areas classified as an empowerment zone.
- Allocation of new lending authority among the states would be based on 2008 employment losses; states would generally apportion authority among counties and municipalities based on employment declines. Each state would receive at least 0.9 percent of the total allocation.
- The provision is well-targeted to regions most adversely affected by the economic downturn, but is unlikely to quickly inject new capital into the economy or to generate significant new demand for investment.
- JCT estimates these provisions will cost $5.4 billion over 10 years.

**Current Law:**

State and local governments may issue unlimited amounts of tax-exempt bonds for "public" activities, but they face limits on tax-exempt bonds that finance qualified private activities (when the government is essentially acting as a conduit between lenders and private industry). Because investors pay no tax on these bonds, municipalities can use them to borrow at lower interest rates than apply to taxable bonds with similar risk.

The Taxpayer Relief Act of 1997 created tax credit bonds (TCBs), which give investors tax credits in place of interest payments. A bondholder may claim the credit—which is a percentage of the bond's face value—for a specified period after purchasing the bond. Examples of TCBs include Qualified Zone Academy Bonds and Clean Renewable Energy Bonds.

The tax credits for TCBs are taxable income for bond owners and the credit rate must therefore exceed the interest rate paid on tax-exempt municipal bonds. The Treasury Department determines TCB credit rates, setting them at a level that makes TCBs competitive with comparable types of bonds.

**Stimulus Bill:**

The stimulus bill would give states and municipalities authority to issue $10 billion in bonds for recovery zone development and $15 billion of tax-exempt private activity bonds for recovery zone facilities. The stimulus bill would also expand the availability and marketability of various types of governmental bonds—including the new recovery zone bonds—in a number of ways. For example, it would give states and municipalities authority to issue a new type of TCB where the tax credit received by the bond holder would be a percentage of the interest paid by the local government. For bonds issued in 2009 and 2010, the issuing authority could elect to receive the credit (which would be a percentage of the interest cost) itself; such a provision would subsidize the interest paid to the borrower.

The bonds, which authorities must issue before 2011, would have to be used for economic development within a "recovery zone," defined as an area "having significant poverty, unemployment, home foreclosures, or general distress" or an area currently defined as an empowerment zone.

Borrowing authority would be allocated among states on the basis of relative job loss in 2008, with greater authority going to states that lost proportionately more jobs. Authority within each state would be allocated among metropolitan areas and counties station a similar basis. Each state would receive at least 0.9 percent of the aggregate allocation for each of the two types of bonds.

**Discussion:**

Increasing the ability of state and local governments to issue new tax-advantaged or subsidized debt could provide economic stimulus, but only slowly and at the cost of reduced investment elsewhere. It takes time to issue new bonds and the proposal would give state and local governments nearly two years to do so. As a result, much of the new funding would become available only after significant delay. Furthermore, even more time would elapse before the new capital would actually generate more economic activity.

In addition, it is unclear if the proposal would help impoverished areas, regardless of the time lag. Private-activity bonds introduce economic inefficiency into the bond market (Johnson 2007), either because the project would have been undertaken anyway or because the subsidized project draws capital away from more valuable activities. The provision might therefore simply shift capital among projects without generating much or any additional economic activity. In general, direct spending on worthwhile infrastructure and investment projects would be much more effective in stimulating the economy.

Despite the drawbacks in design, the provision is well-targeted at those states and municipalities most in need of an economic stimulus. Because allocations of authorized bonds would depend on the number of jobs lost over the past year, the provision would channel funds to those areas most in need of stimulus. However, lost jobs does not guarantee the existence of worthwhile investment projects, and funding for investment is best evaluated on the merits of the investment, not the tax advantages.

**Grade: C-**

Despite being well-targeted at states and municipalities most in need of economic stimulus, this provision would be unlikely to generate significant new investment and would likely shift funds away from investments funded by taxable borrowing. Direct spending could stimulate investment in depressed areas faster without drawing as many resources away from other activities.

## INCREASE FUNDING FOR NEW MARKETS TAX CREDIT

**Key Points**:

- The New Markets Tax Credit provides a non-refundable tax credit to individuals and corporations who purchase equity in entities that invest in low-income communities. Investors receive a non-refundable credit equal to 5 percent of the investment amount in each of the first three years following the initial investment, and a credit equal to 6 percent in years four through seven. Credits in 2009 may count against the AMT.
- The stimulus plan would raise the limit on investment funds that receive tax benefits from \$3.5 billion to \$5.0 billion in 2008 and 2009 ─ an increase of \$3.0 billion in tax-advantaged investment. The total investment generated for low-income communities would likely be significantly higher.
- Delivery of the benefits would likely take several years, and might not result in significant new aggregate investment.
- JCT estimates that this provision would cost \$815 million over 10 years.

**Current Law**:

The New Markets Tax Credit (NMTC) was designed to stimulate the flow of capital into low-income and economically-distressed areas by providing investors with a tax incentive for investing in qualified Community Development Entities (CDEs). The CDEs, in turn, directly provide capital to low-income areas by investing in projects or organizations located or operating in qualified census tracts. Investors receive a tax credit equal to 5 percent of the investment amount in each of the first three years following the initial investment, and a credit equal to 6 percent of the investment amount in each of the following four years. In total, investors receive a credit equal to 39 percent of the initial investment amount. Investors are required to maintain their investment in the CDE for the entire seven-year period.

CDEs are certified by a branch of the Treasury, the Community Development Financial Institutions Fund (CDFI), and participate in a competitive process for the right to receive tax-preferred financing. A qualified CDE is an corporation, partnership, or other entity that is engaged in the development of a low-income area, defined as a census tract with a poverty rate in excess of 20 percent, or with a median family income below the greater of the median income for metropolitan areas or statewide median income (only the latter criterion is used for non-metro areas). Qualifying CDEs must invest at least 85 percent of their tax-preferred financing in the development of a low-income community. CDEs may be community development banks, venture funds, or for-profit subsidiaries of community development corporations, among others. Through 2008, CDFI has authorized \$19.5 billion in NMTC financing.

**Stimulus Proposal:**

The stimulus proposal would increase the amount of allowable tax-preferred investment to \$5 billion in calendar years 2008 and 2009, an increase of \$1.5 billion in each year. Tax credits for investment in 2009, made after the date of enactment, could be claimed against the AMT. JCT estimates the 10-year cost of the provision would be \$815 million.

**Discussion:**

The goal of the NMTC is to increase the after-tax attractiveness of investment in low-income communities. Available only to investors buying equity in enterprises devoted to investment in economically-distressed communities, the Credit is designed to be narrowly-targeted towards those Census tracts with high poverty rates and/or lower levels of median income. Under the stimulus proposal, an additional $3.0 billion in investment in low-income communities will be granted tax-preferred status.

There are several reasons to doubt the ability of the Credit to act as an effective stimulus tool. For one, on net, the NMTC appears to have drawn capital away from other investments, without generating much new investment activity. A recent GAO study found that "the most likely effect of the credit is that corporate investors, which make the majority of investments in CDEs, are shifting investment into low-income communities from higher income communities" (GAO 2007). The study also concluded that the primary use of the allocations was to provide loans for the development of commercial real estate, while investment in business and entrepreneurs was less prevalent. Furthermore, Armistad (2005) found that a large proportion of census tracts ─ approximately 40 percent ─ are eligible as potential destinations for qualified investment, raising questions about the ability of the credit to help truly distressed areas.

At the same time, there are several reasons to be optimistic about the credit's potential. Bershadker et al. (2008) found that the NMTC is an effective stimulant for investment in low-income communities, estimating that each $1 in federal tax expenditure for the program resulted in $14 in investment in low-income communities. The Governmental Accountability Office (2007) concluded that despite the broad criteria for eligibility, as noted above, poorer areas are more likely to be targeted for investment. And Armistead (2005) found that the NMTC was an effective means of making borrowing more accessible to investors and developers, dropping the cost of borrowing by 250 to 500 basis points.

The program failed to meet our criteria for an optimal stimulus. First, and most important, it will likely be slower in stimulating new investment than other stimulus proposals. Qualified entities must first apply for tax-preferred status, attract investors in the various investment projects, and then allocate funds for investment. Berkshadker et al. (2008) found that for a recent round of allocations, only 51.7 percent of the allocated capital has been raised within 19 months after being declared eligible for the program.

Second, as noted above, preliminary evaluations indicate that the credit has created little new aggregate investment. As a result, the NMTC may actually hurt broad-based economic growth if it draws capital away from more productive investments.

On the other hand,, the program may have merit if it results in increased economic activity in the nation's most economically-distressed areas; those likely to have high unemployment rates and other related economic challenges. Despite the program's broad definition of a distressed area, initial evaluations indicate that the program is an effective means of transferring capital to some of the nation's areas most in need of aid.

**Grade: C+**

The provision would take a long tune to have any effect and even then the effect would likely be small. It would direct tax benefits to communities likely to be most burdened by the economic downturn and would reduce borrowing costs for developers active in low-income communities.

## RENEWABLE ENERGY INCENTIVES

### Key Points

- The proposals would extend and modify existing tax incentives for energy conservation and renewable energy and add some new ones.
- Any investment subsidy provides some short-term stimulus, but "green" jobs do no more than other jobs to promote economic recovery and investments in new and alternative technologies may be slower in coming.
- Tax incentives for renewable energy and conservation reduce fossil fuel use, potentially slow global warming, reduce dependence on oil imports, and could spur the development of new technologies that can sustain themselves in the future without credits. However, the proposed credits are not large enough to have much impact on global warming or oil imports and are less cost-effective than policies that directly raise prices of fossil fuels, such as a carbon tax or tradable permits that limit total carbon emissions.
- JCT estimates that the tax incentives for conservation and renewable energy would cost $20.0 billion over 10 years. The extension of the production credit for electricity produced from renewable resources accounts for almost two-thirds of the total cost.

### Current Law

There are many tax incentives that promote energy conservation and renewable energy. Among these are business credits for electricity produced from renewable energy (wind power, geothermal etc.), investments in renewable energy property, and tax-exemption of bonds to finance certain renewable energy property. Individuals can receive credits for purchases of alternative fuel vehicles (electric cars, hybrid vehicles, plug-in hybrid electric vehicles, and fuel cell vehicles), and for a wide variety of energy-saving residential investments (such as solar and photovoltaic energy systems; high-efficiency water heaters, heating, and air conditioning systems; storm windows, storm doors, insulation, and other energy-saving property). The Energy Policy Act of 2005 added new and expanded tax subsidies for alternative energy production and conservation investments by businesses and households and for some traditional energy sources ("clean coal" and natural gas refining), at a revenue cost then estimated at $8 billion over 5 years and $14 billion over 10 years.

Many of these incentives are scheduled to expire after short periods. These sunset provisions limit revenue loss, but may also limit the credits' effectiveness.

### Stimulus Proposal

The proposal would extend and modify a number of existing tax incentives for renewable energy production and conservation and add some new ones. These include:

- Extending a credit for electricity produced from renewable resources through 2012 for wind energy and through 2013 for other qualifying renewable energy sources (The credit is now due to expire at the end of 2010).
- Allowing businesses to claim a 30 percent investment credit for property used to produce electricity from renewable sources (in addition to solar, which already receives the credit) in the year the property is installed through 2012 for wind energy property and through 2013 for other renewable energy property. Taxpayers could use this one-time credit if they find it

more advantageous than the production credit (above) that is claimed over time as electricity is generated from the property.

- Removing the current cap on the business investment tax credit for small wind property and eliminating the current law basis reduction for subsidized energy financing.
- Removing dollar caps on the 30 percent residential credit for solar thermal, geothermal, and small wind property and the basis reduction for property that receives subsidized financing.
- Increasing the credit for specified energy-efficient property to 30 percent for 2009 and 2010, up to a per-dwelling limit of $1500 per taxpayer , while capping the credit for certain specified investments..
- Increasing through 2010 the tax credit to 50 percent up to a maximum of $50,000 ($200,000 for hydrogen) for business alternative refueling property (benefiting gas stations that install alternative fuels pumps that dispense E85 fuel, hydrogen, and natural gas) and raising the credit rate to 50 percent and the maximum credit to $2,000 for individual refueling property.
- Increasing the credit for plug-in electric drive vehicles to $2,500 plus $417 for each additional kilowatt hour of battery capacity between 5 kilowatt hours and 16 kilowatt hours and raising to 200,000 the vehicle limit for the credit, (once a firm has sold the limited amount of qualifying vehicles, the credit phases out over the next year), allowing the credit against the alternative minimum tax, providing a tax credit for plug-in electric drive conversion kits, and expanding credit eligibility to some plug-in vehicles that would not otherwise qualify.
- Authorizing the issuance of additional tax-exempt bonds to fund qualified energy conservation and renewable energy projects.
- Modifying the current law carbon sequestration credit to require that carbon dioxide used as a tertiary injectant be sequestered in permanent geologic storage.
- Raising the tax-free benefit employers can provide for transit to the amount allowable for parking and clarifying that certain transit benefits apply to federal employees.

### Discussion

While any investment or production tax credit can boost the economy by lowering costs of capital or production, credits limited to new energy technologies may generate less short-run stimulus than other incentives. It may take more time for these projects to gear up and for new investors to perceive that the credit would make an otherwise unprofitable technology profitable. Many of the incentives are temporary, which may spur an acceleration of investment, but also could deter new activities that require multi-year subsidies. Because some of the proposals prevent existing subsidies from expiring, they could maintain some credit-dependent activities that would otherwise cease. However, they would also support investments that would be profitable without the credits.

The incentives may promote more energy conservation and renewable energy and thereby help retard global warming and reduce U.S. dependence on oil imported from insecure foreign sources. Prices of carbon-based fuels do not reflect either the long-term economic costs of global warming or the adverse effect on national security of increased dependence on imported oil.

However, these selective tax incentives may encourage the use of less efficient production technologies that do not reduce fossil fuel consumption much.

The most direct way to reduce over-consumption of carbon-based fuels (such as coal, oil, and gasoline) is to increase their price. This can be done either by new excise taxes or by "cap-and-trade" systems that, for example, allocate permits that limit total allowable carbon emissions, but allow them to be traded, thereby creating a cost to producers for carbon emissions and raising the price of carbon-based fuels. Higher fossil fuel prices reduce consumption in the short run by encouraging people to drive less or turn down their thermostats. They encourage investments in energy-efficient capital and alternative energy sources in the medium run and, most importantly, spur development of new technologies to replace fossil fuels in the long-run.

Instead of using taxes or emissions caps with tradable permits to raise energy prices, Congress has sought to reduce fossil fuel use by subsidizing alternative technologies and conservation. In general, these subsidies are less cost-effective than price increases. They can encourage businesses and households to invest in specified energy-saving technologies, but they do not reduce overall consumption of energy-intensive goods and services or encourage energy savings, except through those technologies Congress has specifically chosen to subsidize. Moreover, some tax incentives have been found to have adverse effects. For example, heavily subsidized alcohol fuels such as ethanol have driven up food prices, contributing to global hunger. Such subsidies are very hard to remove once they have outlived their usefulness, since they develop powerful constituencies.

Some of the provisions create fewer distortions than others. In general, it is preferable to provide incentives for production rather than investment because production subsidies influence what is produced (for example, renewable energy), but not how it is produced (with capital or labor). Investment credits are more cost-effective than tax-exempt financing, because the benefits of tax-exempt financing are shared between high-income savers who receive higher after-tax returns and businesses that see a lower cost of capital. In that regard, the production credit for renewable energy may be relatively more cost-effective than others because it subsidizes output of a broad range of technologies that displace fossil fuels in electricity generation, without biasing choice towards one energy solution or altering relative prices of capital and labor in production.

**Grade: C**

Would spur some new investment that would help economic recovery, but some projects may take time to gear up. Although not included in the grade, the proposal gets extra credit to the extent that it would encourage investments that would reduce carbon emissions over the long term. However, there are far more effective means to achieve that end.

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