BACKGROUNDER
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The Tax Relief for American Families and Workers Act: Light on Tax Relief and Heavy on Welfare Expansion

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KEY TAKEAWAYS

In the Tax Relief for American Families and Workers Act (TRAFWA), 91.5 percent of the "family benefits" are cash welfare, not tax relief for working families.

Because of the retroactive and temporary nature of most of the expensing provisions, the proposed TRAFWA would lead to little or no economic growth.

The bill would generate $155 billion in new federal deficits through fiscal year 2025, adding upward pressure on inflation and interest.

The House Ways and Means Committee passed the Tax Relief for American Families and Workers Act of 2024 (TRAFWA) out of committee.[1] The bill expands the Additional Child Tax Credit (the portion of the credit that is available as cash payments to individuals with no income tax liability); it adds a small, temporary cost-of-living adjustment to the Child Tax Credit amount; it expands the Low-Income Housing Tax Credit; and it retroactively extends expiring business expensing provisions for research and development and short-lived capital, among other changes. To *partially* pay for the welfare expansions and tax cuts, the bill would advance the deadline, from 2025 to January 2024, for companies to retroactively claim the Employee Retention Credit, an expired tax credit that was meant to incentivize companies to keep employees on payroll in the face of pandemic-related shutdowns.

The text for this legislation was released on January 17, and, given the time-sensitive nature of some of its provisions, its supporters hope to move the bill through Congress quickly so that it is signed into law in time for the changes to be reflected in IRS forms during the current tax-filing season. Given the consequential changes that the legislation would make, it is imperative that Congress have a clear understanding of what is in the bill and to consider what its effects are likely to be. This *Backgrounder* describes each of the major elements of the legislation, and analyzes the likely impacts of the various provisions, highlights the bill's key shortcomings that Congress must address as well as some positive aspects of the bill.

Family and Welfare-Related Provisions

This section first describes the Child Tax Credit (CTC) and the Additional Child Tax Credit (ACTC) under current law. It then describes how the CTC and ACTC would change if the TRAFWA became law. Finally, it analyzes how the changes to the ACTC would affect certain features of the welfare system, including work requirements, stacking of benefits, payments to illegal immigrants, and effects on marriage and families.

The Child Tax Credit and the Additional Child Tax Credit: Current Law. Under current law, taxpayers can offset up to $2,000 of income tax liability per qualifying child using the Child Tax Credit (CTC). Alternatively, low-income taxpayers who do not pay any income taxes and thus have nothing to offset may claim the Additional Child Tax Credit (ACTC). The maximum amount of the ACTC is somewhat smaller than the regular CTC, at $1,600 per child. A modest work requirement applies in most cases, so that individuals must earn at least $2,500 of income to receive any of the ACTC. The credit then phases in at a rate of $15 per $100 of earned income above $2,500. For an individual or couple with one child, the $1,600 credit fully phases in at $13,167 of earned income.

Notably, the ACTC is just one of many benefits available to low-income families. Many families that receive the ACTC also receive benefits from numerous other welfare programs, including the Earned Income Tax Credit (EITC), the Supplemental Nutrition Assistance Program (SNAP, known as food stamps), Medicaid, public housing benefits, Temporary Assistance for Needy Families (TANF), and the Special Supplemental Nutrition Program for Women, Infants, and Children (WIC), to name a few. The interaction of the Ways and Means bill's welfare benefits with these programs is discussed below.

Changes to the Child Tax Credit and the Additional Child Tax Credit. This section describes the tax changes to the CTC under the TRAFWA followed by the welfare expansions to the ACTC.

Changes to the Child Tax Credit. The TRAFWA would make one change to the CTC, applying a cost-of-living increase to the per-child amount in the 2024 and 2025 tax years (affecting 2025 and 2026 tax filings). The cost-of-living change in the TRAFWA would be rounded down to the nearest $100, so that the credit would likely increase from $2,000 to $2,100 for both years. This change would be temporary, expiring after the 2025 tax year. Based on estimates from the Joint Committee on Taxation (JCT), the expected budgetary impact of this change is about $2.7 billion, representing roughly 8.5 percent of the expected deficit impact of the CTC and ACTC changes. As described below, the welfare increases in the ACTC would be more than 10 times as large and contribute to 91.5 percent of the expected deficit impact of the changes to the CTC and ACTC.[2]

Welfare Changes to the Additional Child Tax Credit. The TRAFWA includes three separate expansions of welfare through changes to the ACTC. First, it increases the per-child benefit amount from $1,600 to $1,800 in 2023, to $1,900 in 2024, and then to $2,000 in 2025. After applying inflation adjustments, the 2025 ACTC benefit amount would likely be $2,100, the same as the CTC. By equating the welfare benefit with the tax offset, this change would further muddle the distinction in many Americans' minds between tax relief and cash benefits. The bill's title, which includes the phrase "tax relief," but no mention of welfare, demonstrates this point.

The second welfare expansion provision involves a more rapid phase-in of the ACTC. While the bill would maintain the $2,500 minimum income requirement to receive any of the credit, instead of phasing in at 15 percent of income, it would phase in at 15 percent multiplied by the number of children claimed. The phase-in for a taxpayer with three children, for example, would be 45 percent of earned income above $2,500. The three child tax benefits would fully phase in to the maximum value of $6,000 by $16,000 of household income.[3] When combined with an EITC of $7,200, this person would receive nearly as much cash benefits ($13,200) from these two "tax provisions" alone (not counting traditional welfare benefits) as her entire household's earned income. As the size of payments grows, the incentive for fraud in the program increases, as discussed in the section on "Weakening Work Requirements" below.

The third welfare expansion provision would allow taxpayers to claim an ACTC based on either their current year's earned income or their prior year's earned income, whichever is higher. This expansion would water down the already flimsy work requirements associated with the ACTC. If this provision goes into effect, working every other year would be sufficient to allow taxpayers to claim these child benefits. For example, the taxpayer with three children and $16,000 of income in 2024 could claim the $6,000 ACTC in 2025 with zero work effort that year. This provision would apply for tax years 2024 and 2025, allowing taxpayers to use 2023 and 2024 income, respectively.

Impact of the TRAFWA Changes on the Welfare System. This section describes the relative size of the expansion of the welfare state under the TRAFWA, the bill's weakening of work requirements, its contribution to excessive benefits, its subsidization of illegal immigrants, its embrace of liberal priorities, and the harm it would cause to marriage and families.

Welfare, Not Tax Relief. Although the bill claims that its aim is to provide "tax relief" to families with children, it contains very little tax relief for working families. Instead, nearly 91.5 percent of the "family benefits" in the bill are cash welfare payments to families who pay no federal income taxes (and zero or little Social Security tax). Over three years, the bill provides only $2.85 billion in income tax relief to families with children. By contrast, the bill *provides $30.6 billion in new welfare cash payments*. If these new cash welfare benefits were extended over 10 years (which is very likely), the total cost would exceed $140 billion.

Weakening Work Requirements. The bill greatly expands the erroneously named ACTC. The ACTC is a simple cash-welfare-benefit program that has nothing to do with taxes. The current ACTC program has a weak work requirement riddled with extensive fraud.[4] The bill deliberately weakens this already weak work requirement.

Under current law, parents are ostensibly required to work to obtain ACTC benefits; benefits increase as earnings increase. However, this work requirement is highly porous and readily evaded through fraud. In the current program only 55 percent of benefits for single parents appear to go to eligible parents.[5] Altogether, the data suggest that as many as 6 million tax filers who receive cash payments from the ACTC and EITC for children are not eligible for these benefits. Most are not the custodial parents of the child. (It is often asserted that the error rate in these programs is due to the complexity of the tax code; this is not true. Most "errors" are the result of obvious false statements about income and residence of the tax filer.)

Often the actual custodial single parent will transfer eligibility for the benefit and the work requirement to relatives or other adults who do not even live with the child. The transferred benefit is then shared with the non-working single parent. A work requirement that can be easily "transferred" to others is not a serious requirement. Remarkably, the Ways and Means bill takes this already porous and fraud-filled work requirement and further weakens it by insisting that recipients need only work every other year instead of every year.

Excessive Benefits. The bill accepts the liberal premise that the current $1.2 trillion welfare state is not large enough: Instead, more money must be spent, primarily to subsidize single parents. But welfare benefits are already very large. For example, in 2023, a single mother with two school-age children earning $15,000 per year would also receive $5,716 in cash payments from the EITC, $1,875 in cash payments from the ACTC, $6,470 in food stamps, and $1,415 in school nutrition benefits. Total cash and food aid would have equaled $15,476, more than doubling the parent's effective income. Combined effective income from gross earnings, cash, and food benefits less Federal Insurance Contributions Act (FICA) tax would have been $30,476.[6]

In addition, the family would also be eligible for Medicaid coverage worth, on average, around $14,950, bringing the effective income of the parent to $44,300. Altogether, these standard welfare benefits would triple the parent's income; total post-tax resources would come to around $44,300. In addition, some (but not all) such families would receive Section 8 or public housing aid with a net worth of around $10,000, bringing total potential resources to around $54,300.

But for the Left, welfare benefits can never be high enough. The Ways and Means bill concurs, and so would add another $1,875 to this family's income, bringing total post-tax resources to $46,184 ($56,180, if the family receives housing aid). However, the main problem is not simply the immediate increase in welfare benefits. Rather, the critical issue is that by camouflaging its welfare increases as "tax relief" and by failing to acknowledge or even hint at the large pile of aid benefits already received by its beneficiaries, the bill creates fertile ground for even larger welfare expansions in the future.

Subsidizing Illegal Aliens. Under current law, illegal aliens who have children that were born in the U.S. (and many do) can claim welfare benefits from the ACTC. The Ways and Means bill expands these welfare payments for millions of people who are in the U.S. illegally, and for millions more entering in the future—exacerbating a current design flaw in the program.

Embracing Liberal Priorities. A prominent goal of the Left is to remove work requirements from welfare and to restore the work-free, unconditional cash aid that existed before welfare reform. President Joe Biden sought to advance this goal by creating a new "child allowance," which removed the work requirements from the ACTC and greatly increased benefits.

The Ways and Means bill moves toward fulfilling President Biden's aims. The bill embraces the premises and goals of the Biden plan to greatly increase cash welfare payments (predominantly for single parents) while weakening the already porous work requirements (as explained above). This bill obviously sets the ground for a future "compromise" that would fully enact the Biden "child allowance" program. Overall, this portion of the Ways and Means bill represents an enormous political and policy victory for President Biden.

Harming the Family. The Ways and Means welfare bill directly and explicitly repudiates the principles of successful welfare reform which have governed the welfare system since the mid-1990s. Welfare reform instituted in 1996 by a Republican Congress with broad bipartisan support established work requirements and time limits in the dominant welfare program: Aid to Families with Dependent Children (AFDC). More than 90 percent of recipients in this program were single-parent families.

A principal aim of the reform was to halt the rapid and alarming disintegration of marriage. Family collapse had been steadily advancing for decades. Work requirements reduced the utility of being a single parent on welfare and raised the relative utility of being married to a working husband. Welfare reform was a dramatic success in saving the family. The ongoing rapid collapse in married families with children came to an abrupt halt. Family structure stabilized. As a result of the changes prompted by welfare reform, some 9 million additional children reside in married families rather than single-parent families today.

Before reform, roughly one in 10 children were born to non-married teenage girls. After reform, this number quickly fell by 60 percent; non-marital teen abortions fell at a similar rate. The non-marital pregnancy rate had been rising for decades. After reform, this trend promptly reversed course and began to steadily fall. The steady decline in the non-marital pregnancy rate initiated and promoted by welfare reform has contributed to 10 million fewer abortions over nearly three decades.[7]

The dramatic positive progress in strengthening marriage and reducing teen births and abortions occurred because welfare reform reduced the utility of being a single mother on welfare and increased the relative utility of the alternative: marrying and living with the child's father. Yet, the Ways and Means bill increases effective welfare subsidies to single parents relative to married families and weakens work requirements which predominantly affect single parents. It threatens family formation in the future.

The bad elements of ACTC exist in current law. This bill does not address those shortcomings at all and actually makes them worse by decreasing work requirements to every other year and increasing the welfare benefit amounts. Overall, the Ways and Means welfare bill fails to implement the principles that conservatives have stood for in welfare and family policy for three decades.

Business-Tax Provisions

This section describes the business tax provisions in the TRAFWA. These include three expensing provisions, an increase in allowable business interest deductions, an expansion of the Low-Income Housing Tax Credit, U.S.-Taiwan double tax relief, and changes related to the employee retention credit. This section also discusses the budget and economic impact of the TRAFWA.

Expensing and Interest Deduction Provisions. Three provisions in the TRAFWA involve extensions of policies that were all in effect as of 2021, but which have since expired or at least begun to phase out, specifically: (1) the deduction for research and experimental (R&E) expenditures; (2) bonus depreciation for short-lived capital assets; and (3) the increased interest-deduction limitation. Another provision in the TRAFWA, the Section 179 deduction, relates to expensing for small and midsize businesses.

Deduction for Research and Experimental Expenditures. Until 2021, businesses could fully deduct R&E expenditures in the year that business incurred them. Beginning in 2022, businesses were required to amortize R&E performed domestically over five years and non-domestic R&E over 15 years. In the case of a $10 million expenditure on domestic R&E in 2022, $1 million of the cost would be allocated as a deduction in 2022, $2 million each year would be deducted from 2023 to 2026, and the final $1 million would be deducted in 2027.[8]

The TRAFWA would revert back to full deductibility of domestic R&E expenditures. So, instead of having to allocate a 2024 R&E expenditure between 2024 and 2029, a taxpayer could deduct the full 2024 R&E expenditure immediately in the 2024 tax year. This is the correct policy. Most valid business expenses can be deducted when calculating businesses' taxable income, and there is no strong rationale for denying that treatment in the case of R&E.

However, there are two major shortcomings to the timing of this policy change. First, the change would only be in effect for the 2024 and 2025 tax years before expiring. The main advantage of allowing R&E deductibility is that it removes the tax disadvantage of these expenditures relative to other businesses expenditures, so that companies are unencumbered from making the best business decisions, as opposed to making tax-driven decisions. However, a short two-year extension sets up a scenario where companies may make tax-driven decisions in the other direction. They would tend to overspend on R&E in 2024 and 2025 relative to other expenditures, because R&E would be set to face less favorable treatment starting in 2026, without future congressional action.

Such a short-term change should not be expected to drive any meaningful long-term economic growth. In its analysis of the bill, the JCT states:

> While the temporary business provisions in the second subtitle decrease the cost of capital and encourage investment in the first three years after enactment, some of this increased investment reflects a forward timing shift of planned investment rather than additional investment that would only occur upon enactment of the bill... The Joint Committee staff estimates that while the bill would increase the aggregate stock of capital relative to the baseline forecast over the first half of the budget window, the size of the effect is too small to be significant over that period as well as on average over the budget window.[9]

The second major shortcoming of the change to R&E is that the changes would apply retroactively to 2022 and 2023. There is no pro-growth benefit to such after-the-fact tax cuts since investment cannot be increased retroactively. While it is regrettable that the tax code in 2022 and 2023 did not allow companies to fully and immediately deduct these expenses, paying out tens of billions of dollars to these companies in 2024 alone accomplishes very little in terms of creating jobs, raising wages, or improving incentives. In the words of the pro-business *Wall Street Journal* editorial board, it is a "sop to companies that already made investment decisions."[10]

Bonus Depreciation for Short-Lived Capital Assets. The Tax Cuts and Jobs Act of 2017 allowed "bonus depreciation" for equipment, machinery, and certain other qualified assets with a depreciation recovery period of 20 years or less. As with the deduction for R&E, this is the correct policy as it would put expenditures for equipment and machinery on parity with most other business expenses.[11] Instead of long, drawn-out depreciation schedules, under bonus depreciation companies can fully expense the qualifying expenditures in the year they place these assets in service. Bonus depreciation was enacted in tax year 2018, but under current policy gradually sunsets between 2023 and 2026 before fully phasing out in 2027.

The TRAFWA would temporarily pause the gradual phase-out of bonus depreciation in 2024 and 2025 and would retroactively eliminate the partial phase out in 2023. The bonus depreciation changes have the same drawbacks as the R&E changes: The changes are temporary and retroactive. However, the downsides of the bonus depreciation extension are not as serious as the downsides of the R&E extension.

Companies are already dealing with gradually phasing out bonus depreciation, so temporary and evolving tax policy is already baked into the cake. Proponents of the legislation argue that by making these changes it essentially changes the baseline for more durable tax reform in 2025. Under current law, in 2023, businesses could have taken advantage of 80 percent of bonus depreciation, and that percentage is currently set to decline by 20 percentage points each year. Under the TRAFWA, businesses would have access to 100 percent bonus depreciation through 2025, but that would fall to 20 percent in 2026 before fully expiring in 2027. With or without the TRAFWA, the looming expiration of bonus depreciation puts companies in a state of flux. The TRAFWA's retroactive changes to bonus depreciation are also relatively small compared to the forward-looking (though temporary) changes to bonus depreciation. The bill includes only one year of retroactive changes to bonus depreciation. Since bonus depreciation had only just begun phasing out (by 20 percent), only a small amount of the budget impact from bonus depreciation is retroactive.

Increased Interest-Deduction Limitation. Under current law, companies face a limitation on the amount of interest expenses they may deduct. Specifically, interest expenses cannot exceed 30 percent of earnings before interest and taxes (EBIT). Under the current EBIT rules, the deduction limitation decreases as the volume of a firm's depreciation and amortization increases. The TRAFWA would remove depreciation and amortization from the interest limit calculation, restoring the more generous limitation of 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA), which was in effect as of the end of 2021.

Expanding interest deductibility, in the context of the current tax code, has a sound economic basis. Interest income is generally taxable to the party receiving interest payments, so interest expenditures should be generally deductible to the businesses bearing the interest expense. The increase in the business interest deduction limitation in and of itself is fine policy.

However, as with the expensing provisions described above, the major problem with the change to the business interest limitation is that the temporary, forward-looking 2024 and 2025 changes are paired with retroactive changes applying to 2022 and 2023. To the extent that flaws in interest treatment in 2022 and 2023 biased past financing decisions, it is too late to fix that in 2024. Roughly half of the budgetary effect of the business interest deduction limitation is due to the retroactive changes. Again, the theory of proponents is that the changes in 2024 and 2025 could be extended with tax reform in 2025. In effect, it would become the new status quo, the new baseline.

Increase in Limitation on Expensing of Depreciable Assets. Under current law, businesses can fully and immediately deduct up to $1 million of qualifying short-lived capital expenses they place in service during a year. This Section 179 deduction protects small and some mid-sized businesses from having to apply the cumbersome depreciation calculations that apply to businesses with more physical capital expenditures. The $1 million of allowable Section 179 deductions is reduced dollar for dollar once companies' qualifying expenses surpass $2.5 million.

The TRAFWA would increase the maximum allowable Section 179 deduction from $1 million to $1.29 million and would increase the $2.5 million threshold to $3.22 million. It would then apply regular inflation adjustments to these amounts beginning after 2024. Unlike the previously mentioned business provisions, this would be a permanent change. This is good tax policy, particularly as it is permanent. It also focuses on small businesses, which are critical to building a growing and free-market economy.

Expansion of the Low-Income Housing Tax Credit. This section describes the Low-Income Housing Tax Credit under current law and the changes to the credit under the TRAFWA.

Current Law. The Low-Income Housing Tax Credit (LIHTC) is an annual tax credit (a dollar-for-dollar tax reduction) delivered over 10 years to compensate developers for 30 percent of the costs of the low-income housing units in a development funded with tax-exempt private activity bonds or 90 percent of the costs of the low-income housing units in a development receiving a credit allocation from the state housing finance authority. Qualification for the LIHTC requires agreeing to set aside varying percentages of housing in a development project for those earning within government-specified income limits. If a project is funded at least 50 percent by the tax-exempt private activity bonds, the LIHTC can equal 4 percent of the total costs of the entire development. For housing projects that receive a credit allocation from the state housing finance authority, the LIHTC equals 9 percent of the entire development if not financed with tax-exempt bonds.

The dollar-for-dollar reduction in tax liability courtesy of the LIHTC artificially increases the return on capital for investors in these favored projects. This can be substantial. Consider a $20 million project funded with 20 percent equity ($4 million) and 80 percent debt ($16 million). Even without the developer padding costs to increase the value of the LIHTC, a tax credit equal to 9 percent of the of the total cost of the development equals $1.8 million—or an additional 45 percent return over 10 years on equity invested. This enhanced return can be even greater if a developer—who may be both the investor and a contractor—pads his costs to increase the size of the tax credit.

In most cases, local and state housing authorities hand these credits out to politically connected developers within the state. The developers then sell the "tax credits" to other firms with actual tax liabilities for cash. The developers take the cash and build low-income quasi-public housing. It is an overly complex mechanism that allows the government to count the budget costs of quasi-public housing as lower taxes instead of higher federal spending.

Changes to the Low-Income Housing Tax Credit. The TRAFWA expands LIHTC in two major ways. First, the TRAFWA would reduce the tax-exempt bond funding requirement to 30 percent from 50 percent for projects financed by bonds issued before 2026. This would allow more projects partially financed by tax-exempt private activity bonds to also benefit from the LIHTC subsidy.

Notably, real estate developers using tax-exempt bonds for financing benefit immensely from this taxpayer-funded interest payment subsidy. Purchasers of tax-exempt bonds demand less interest than similar investments. As such, the option to finance a real estate project by offering these bonds substantially increases the potential returns to the equity investors in a project. Lower interest payments on the debt financing equals more profit to the equity financiers. For example, a high-income investor with a combined state and federal marginal income tax of 40 percent would be indifferent between a 10 percent annual yield on a development bond and a 6 percent yield if the interest payments are tax-exempt. What does this lower threshold mean for a hypothetical $20 million project funded 20 percent with investor equity ($4 million), 50 percent non-exempt bonds ($10 million), and 30 percent tax-exempt bonds ($6 million)? Under current law, this project does not qualify for LIHTC tax credit because less than 50 percent of the project is funded with tax-exempt bonds. The TRAFWA would allow the developer to take advantage of the LIHTC, yielding another $800,000 over the 10-year period (4 percent of $20 million)—an additional subsidy equal to 20 percent of the $4 million equity invested. In short, the LIHTC is a giveaway to developers.

Rather than expanding the LIHTC, Congress should eliminate it entirely. Expanding affordable housing requires eliminating state, local, and federal barriers to construction and curtailing government subsidies of the housing finance market. If policymakers choose to use taxpayer resources to provide housing, direct subsidy programs—such as Section 8 housing vouchers—are a far more efficient mechanism for assisting those deemed in need.

Amended Claims for the Employee Retention Credit. Provisions in the TRAFWA are intended to clamp down on amended (and often erroneous) employee retention credit (ERC) claims. This section describes the ERC under current law, the IRS's response to the explosion in amended claim for the ERC after the expiration of the ERC, changes to the ERC under the TRAFWA, and the legitimacy of using this provision to pay for the tax reductions and welfare expansions in the bill.

Current Law. The only revenue raiser in the TRAFWA involves changes to the employee retention credit (ERC). The ERC is a temporary COVID-19-era tax credit that paid companies as much as $26,000 annually per qualifying employee while the program was in effect in 2020 and 2021. The credit was intended to incentivize companies to keep employees on payroll in the face of pandemic-related shutdowns. To qualify for the credit, companies must have faced fully suspended or partially suspended operations due to government shutdowns or significant declines in gross revenues relative to the prior year. The ERC expired on September 30, 2021; however, the 2020 and 2021 credit remain open to employers filing amended returns with ERC claims.

During 2020 and 2021, relatively few employers applied for the credit. However, after it expired, the IRS has been flooded with amended ERC claims. A cottage industry of companies dedicated exclusively to helping small businesses file for this one credit helped to spur this rush of amended claims. By September 2023, the IRS had already processed an estimated $230 billion in claims, and by the end of 2023 it faced a backlog of more than 1 million claims, suggesting that the total cost of the ERC program will likely swell to well above $300 billion, if not $400 billion, between already processed claims, filed but unprocessed claims, and future amended claims.[12] Under current law the deadline for most taxpayers' amended 2020 claims is April 15, 2024, and the deadline for amended 2021 claims is April 15, 2025.[13]

IRS Response to Explosion of ERC Claims. While being inundated with ERC claims in 2022 and 2023, the IRS put aggressive pitches from ERC promoters on its "Dirty Dozen" list of tax scams, calling out "blatant attempts by promoters to con ineligible people to claim the credit."[14] Unfortunately for the IRS, the dubious and fraudulent claims are not easy to distinguish from legitimate amended ERC claims by small businesses that only learned they qualified for the credit after it had expired. This challenge partly stems from ambiguity in the ERC statute.

The IRS placed a temporary moratorium on new ERC claims on September 14, 2023, through the end of 2023.[15] The IRS said it would shift its focus to reviewing claims for compliance concerns, focusing on certain blatant violations, such as entities that were not in existence or which had no paid employees during the period. The IRS also began allowing business owners who had been pressured or duped into an inaccurate claim to avoid penalties or interest if they withdrew their claims.[16] In December, the IRS also initiated a voluntary disclosure program, open through March 22, 2024, in which certain employers with buyers' remorse about receiving ERC refunds could repay 80 percent of their dubious ERC claim without having to pay interest or penalties.[17] Those entering the voluntary disclosure program also would not owe taxes on the 20 percent of the refund they retained.

Changes to Current Law: Earlier Deadline for Amended Claims. The TRAFWA would accelerate the deadline for employers to file amended ERC claims to January 31, 2024. This would not affect already processed ERC claims or the claims already in the IRS backlog, but it would stop the spigot of new retroactive ERC claims.

This would be a positive development and, frankly, overdue. The ERC was supposedly implemented as a stopgap measure to help employers through the pandemic. The pandemic is long past, and it is long past time to put a stop to new ERC claims. Good governance should demand it.

Changes to Current Law: Heightened Penalties and Disclosure Requirements. The TRAFWA would also increase penalties for "ERC promoters" who knowingly understate the tax liability of another person from $1,000 to $200,000 in the case of someone who provides aid or assistance on any ERC claim.[18] To qualify as an ERC promoter, a company must have received more than 50 percent of gross receipts from ERC claims or 20 percent of gross receipts from ERC claims if aggregate gross receipts are greater than $500,000.

The bill would increase disclosure requirements for ERC promoters by treating ERCs as reportable transactions. This is a category of transactions that are viewed as high risk for tax avoidance or evasion. The IRS requires taxpayers to disclose certain information related to reportable transactions. The current Reportable Transaction Disclosure Statement (which currently does not apply to ERC promoters) is IRS Form 8886.[19]

The heightened penalties and disclosure requirements may assist the IRS in rooting out and dissuading some bad actors. However, conservatives should have some apprehension in relying too heavily on IRS crackdowns as a funding mechanism for other tax cuts or spending increases. Any revenue that is expected from these provisions is highly uncertain. Even if the revenues are higher than expected due to a harsh crackdown by the IRS, conservatives should understand that this would come with some cost. Of course, the IRS would target the ERC mills which are bad actors. However, as with any increase in IRS enforcement, some honest taxpayers would be caught in the crosshairs. Time that taxpayers must spend dealing with the IRS is valuable and should not be ignored when weighing the legislation's costs against its benefits.

Legitimately "Paid For"? Two things can be true at once. Congress should absolutely stop the spigot on new ERC claims by accelerating the deadline for filing amended returns with ERC claims as soon as possible. It is also disingenuous to claim that this bill is "paid for" or fiscally responsible based on this revenue raiser. As already noted, basic good governance would dictate that Congress should advance the deadline. To apply any "savings" from an ERC program that has experienced severalfold cost overruns toward a new round of spending increases is *not* fiscally responsible.

In 2020 and 2021, the JCT estimated the aggregate cost of the ERC (including its 2020 creation and 2021 expansion) would be about $77 billion over the bill's lifetime.[20] Now that multiple hundreds of billions of dollars have been spent on the program, the JCT is estimating that $78 billion of savings is available to pay for the latest legislation.[21] This should cast some doubt on the reliability of JCT's estimates. As explained under "Deficit and Inflation Impact" below, even if the ERC pay-for is accepted as legitimate and even if JCT's estimates are correct, the bill would still add to short-term deficits and to long-term debt by increasing net interest expenses.

U.S.-Taiwan Double Tax Relief. The United States currently has tax treaties with each of its top 10 trading partners except Taiwan and Vietnam.[22] The TRAFWA would provide double taxation relief for individuals and companies that are residents of Taiwan that would otherwise face taxation in both countries. This double tax relief would require reciprocity from Taiwan before it could take effect.

A double tax treaty with Taiwan would accomplish a major bilateral priority of the U.S. and Taiwan. It would strengthen the U.S.–Taiwan trade relationship and could, for example, help to expedite the development of U.S.-based semiconductor operations by facilitating the integration of Taiwanese talent and expertise. This is sound policy.

Budget and Economic Impact. This section describes the deficit and inflation impacts of the TRAFWA, and its macroeconomic impact.

Deficit and Inflation Impact. The JCT's formal estimate shows a 10-year deficit impact of only $399 million. However, the 10-year aggregate estimate obscures the uneven distribution of the bill's deficits. According to the JCT, the bill would generate increased federal deficits of $117.5 billion in FY 2024 and an additional $37.8 billion in FY 2025.[23]

These deficits can be expected to drive further inflation and increasing interest rates as the government generates new money or money substitutes that are divorced from increases in real productive capacity and as it crowds out private borrowing.

In total, the TRAFWA would increase near-term federal deficits by $155.3 billion over the next 20 months.[24] Using the Congressional Budget Office's (CBO's) latest debt-service model, this would result in an additional $22.3 billion in federal net interest cost through the 10-year budget window.[25] However, these would likely be substantially higher as the CBO is now projecting rates on 10-year Treasury Notes to be 18 percent higher through 2025 than they were projecting when they published the latest version of the debt service model.[26]

While the 10-year cost estimate is important only for congressional consideration rules, the near-term deficits have the most influence over the economy. By virtue of the government's sole legal authority to either tax or create new money at its discretion, it can guarantee repayment of loans in a way that no private business or household can. As such, as federal deficits increase, the government crowds out private borrowing, redirecting capital away from businesses looking to expand and families looking to buy a home.

A dire example of this can be seen in the case of the COVID-19 spending packages as mortgage rates soared from 3.08 percent to 7.1 percent over a 13-month period of rising federal deficits that were largely not soaked up by Federal Reserve money creation.[27] Though the exact timing and magnitude of how future federal deficits will impact bonds market is uncertain, previous cases can provide some insight.

For example, during the first half of January 2022, the publicly held federal debt not held by the Federal Reserve rose by roughly as much as the projected near-term deficits of the TRAFWA. During this time, average 30-year mortgage rates adjusted upward by roughly 0.3 percentage points. While that may not seem very large, that could translate into roughly an extra $24,000 of lifetime interest costs on a median price house bought today with 20 percent down and based on current average 30-year mortgage rates.

Though this is only one vignette of what deficits have meant for private lending, it and the COVID-19-era experience demonstrate the harm to economic growth and household wellbeing of increasing near-term federal deficits.

During this period, federal deficits harmed Americans primarily through rising interest rates. However, the new future deficits created by this bill would likely result in a combination of higher consumer price levels and higher interest rates. This would depend, in part, on how accommodative the Federal Reserve is in creating new money to soak up these deficits.

Thus, it would be prudent for policymakers to consider the expected inflationary and interest rate pressures from this bill as mitigating, to one extent or another, positive economic outcomes that may otherwise be expected from other parts of the bill.

Macroeconomic Impact. Pro-growth tax reforms can expand the income tax base and thereby offset revenue reductions from the reduction in taxes. Therefore, well-designed tax reforms can be worthwhile even if they include some upfront deficits. However, because the TRAFWA includes welfare expansion and retroactive, temporary tax relief at the expense of more permanent, pro-growth reforms to reduce biases in the tax code and improve incentives, it is unlikely that this bill would drive any significant positive long-term economic growth or job creation.[28]

Future Legislation

Most of the sunsetting individual provisions of the 2017 Tax Cuts and Jobs Act are set to expire after 2025. This would mean potential increases in individual tax rates, a reduction in the standard deduction, a reduction in the CTC, and more people being subject to the Alternative Minimum Tax and death taxes. This situation sets up an important inflection point where Congress will be forced to establish a future path for tax policy, or by default allow a massive tax increase to take place by doing nothing.

The TRAFWA would align even more tax and welfare provisions to expire in 2025. Its supporters expect that it will make it easier for Congress to pass a larger package with a permanent or long-term extension of the business tax provisions. This may be true. However, as the trend of omnibus appropriations bills demonstrate, a larger package may invite compromised principles and produce a package that is less conservative on balance.

Fiscal conservatives who are concerned about America's $34.1 trillion national debt should be focused more on the quality of the 2025 tax reforms than just the quantity of the tax cuts. A bigger package in 2025 may or may not be a good thing. If conservatives will now go along with expanding the welfare state and watering down work requirements to obtain relatively modest wins on business provisions, what will they give up when even more is on the line in 2025? Can the debt-ridden nation afford such a grand compromise?

Conclusion

Despite the bill's title, the Tax Relief for American Families and Workers Act offers little individual tax relief—but it does offer substantial welfare expansions. It continues a long-standing push by Congress to dress up welfare as "tax relief." The changes to the ACTC are a steppingstone to work free "child allowance" and eventually a universal basic income. The legislation fails to advance the principles of successful, pro-family welfare reform. The bill does include some beneficial provisions, including the forward-looking expensing provisions (temporary), the increase in the Section 179 deduction (made permanent), and double taxation relief for Taiwan (also permanent). Congress should also advance the deadline to file amended claims for the fraud-ridden COVID-19-era ERC, like this bill does. However, Congress should not treat sensible provisions, such as double taxation relief for Taiwan and stanching fraud in the ERC, as hostages of the harmful provisions in this bill.

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Endnotes

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2. Joint Committee on Taxation, "Estimated Revenue Effects of H.R. 7024, The 'Tax Relief For American Families and Workers Act of 2024,' Scheduled for Markup by the Committee on Ways and Means on January 19, 2024," January 17, 2024 https://www.jct.gov/publications/2024/jcx-3-24/ (accessed January 25, 2024).
3. This example assumes a $2,000 ACTC, which, depending on inflation adjustments, may reflect the 2024 tax year.
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5. Linked administrative data indicate that only 55 percent of EITC benefits to single household heads go to tax filers who are eligible for the payment. See Maggie R. Jones and James P. Ziliak, "The Antipoverty Impact of the EITC: New Estimates from Survey and Administrative Tax Records," University of Kentucky Center for Poverty Research Discussion Paper Series, DP2019-01, June 2020, p. 39, Table 4, http://ukcpr.org/research/poverty-inequality/inequality (accessed January 26, 2024). The informative Jones–Ziliak paper uses a special administrative linking file that joins Census and IRS data at the individual case level. This provides a more accurate picture of who actually receives the EITC. There is a great overlap between the EITC and ACTC; the categorical eligibility standards are the same. If 45 percent of EITC household head filers are ineligible, the same is likely to be true for the ACTC.
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