

The Biggest Tax Policy Mistake of the Year

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Abstract

In a contribution to the New York Times *Freakonomics* blog, Donald Marron identifies this year's biggest tax policy mistake: Washington's inability to decide what this year's tax law is. While politicians, analysts and the media endlessly debate how expiring tax cuts might affect taxpayers in 2011, we still don't know what the tax law is in 2010.

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With little time left on the legislative clock, policymakers will be hard-pressed to top the tax policy blunders they've already made this year. Most notable is their failure to decide what this year's tax law should be. While politicians, analysts and the media endlessly debate how expiring tax cuts might affect taxpayers in 2011, the real disgrace is that we still don't know what the tax law is in 2010.

Will our leaders really allow the alternative minimum tax to hit 27 million taxpayers this year, a whopping 23 million more than in 2009? Did the estate tax really expire back in January, making 2010 the year without an estate tax? Will companies really receive no tax credits for their investments in research and development?

Under existing law, the answer to each of these questions is yes. Unless Congress acts, the AMT will expand its reach almost 500 percent, George Steinbrenner's estate will pay no estate tax, and America's most innovative companies will go without the R&E tax credit. But in today's world, existing law doesn't mean much until Congress throws in the legislative towel. The upcoming lame-duck session will thus feature healthy debate about patching the AMT, retroactively resuscitating the estate tax and extending a host of expired business tax credits — all policies that would determine 2010 taxes.

Such retroactive policymaking is an embarrassment. In a well-functioning democracy, policymakers should establish the laws of the land in advance so that families and businesses can knowledgeably plan their activities. Surprises may sometimes necessitate mid-course corrections. An economic downturn may justify mid-year tax cuts, or a sudden crisis may require mid-year tax increases. But persistent retroactive lawmaking undermines the core idea that ours is a nation of law.

Needless uncertainty also creates real costs. Uncertainty about the R&E tax credit, for example, limits its usefulness as an incentive. If businesses think that it might expire, they have less reason to take it into account when planning their research efforts. That can turn a helpful incentive into a pointless giveaway.

Needless delay also undermines the IRS's ability to implement the tax system. In 2007, for example, Congress fiddled until just before Christmas before deciding to enact that year's AMT patch. Because of that delay, affected taxpayers couldn't begin filing their returns until February 15, when IRS computers finally reflected the new law.

Congress has made a huge mistake by leaving taxpayers in limbo for more than 10 months. Let's hope they resolve that quickly when they return for what promises to be a frantic lame-duck session.

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