WHY REAUTHORIZATION NEGOTIATIONS ARE FAILING:
The Pay-fors Just Don't Add Up

June 15, 2012

Introduction

Congress continues to meet behind closed doors in a Conference Committee to hash out the details of a transportation bill reauthorization. Though there is no clear indication as to how things will end up, one thing is certain: neither the House nor the Senate have proposed a package of pay-fors that will satisfy anybody with even the most rudimentary understanding of finance or mathematics. The story remains a familiar one: Congress wants to spend more money than it has.

Paying for the reauthorization remains likely the largest of several large hurdles if Congress is going to complete a reauthorization. The existing bill was enacted in 2005 and expired on September 30, 2009; since then, Congress has extended the program nine times, and it appears likely another extension will be required to keep the program operating past its current June 30, 2012 expiration date.

This analysis focuses on the Senate proposal, since the bill the House brought to the Conference Committee does not contain a financing section. In addition, the pay-fors the House proposed – including several energy development proposals and cutting transit off from gas tax revenues – faced extremely long odds in the Senate anyway.

The transportation program is funded largely with revenue from the federal gasoline tax, which has been 18.4 cents per gallon since 1993. Since it hasn't been indexed for inflation, the buying power of the tax has steadily eroded. In addition, today's vehicles are more fuel efficient and the number of miles driven has been flat, both of which results in less gas tax revenue. As a result, there is less money available to fund the nation's transportation requirements. Since the Highway Trust Fund was established in 1956, gas tax revenue was the lone source of transportation funding, until 2008, when revenue fell short of spending. Instead of reducing spending, Congress dipped into the nation's general tax revenue and made three transfers to the HTF totaling $34.5 billion.

The shortfall in gas tax revenue persists. As a result, there is a gap between the amount of money flowing into the HTF and how much Congress wants to spend. The transportation bill proposed by the Senate outspends gas tax revenues by approximately $14 billion. The Senate Finance Committee proposal contains a number of provisions that would seek to close that gap.

Behind The Numbers[1]: Senate Bill Fails Taxpayers

The most significant and fatal flaws of the Senate Finance package:

1. **Spends more than gasoline tax revenues.** Historically, federal taxes on gasoline and diesel (and fees on things like truck tires) have been the sole source of federal surface transportation spending. In recent years, greater automobile efficiency and flat driving levels have resulted in slower rates of growth of available transportation money. Congressional desire to spend money now outpaces available trust fund dollars. There is little appetite in Congress to reduce spending or increase the gasoline tax, leaving a shortfall that must be filled.

   As a result, Congress must fill the gap between desired levels of spending and expected HTF revenues.

2. **To fill this gap, Congress relies heavily on a transfer of general funds.** In fact, <u>the biggest source of new funding for the Highway Trust Fund in the Senate bill is to simply transfer nearly $5 billion from the Treasury to the HTF</u>. This continues a recent trend of Congress using general tax revenues to cover transportation costs that have historically been covered by the federal gas tax.

   That's not the only hit the Treasury will take as a result of the Senate bill. In addition to the transfer mentioned above, the Senate proposal will transfer almost an equal amount to the Highway Trust Fund from two taxes that are currently collected into the Treasury and would now go into the HTF.

   <u>In all, the Senate bill would transfer nearly $11 billion from the Treasury into the HTF.</u>

   This would create a significant hole in the federal budget, which needs to be – in Congressional parlance – "offset" with spending cuts or increased revenues in another part of the budget. In this case, Congress relies on a number of tax code changes that they anticipate will increase future tax collections.

[1] A number of sources were used to compile the numbers and analysis used in this report. These are *Transportation Weekly*; *Washington Letter on Transportation* (published by the Carmen Group) via Ken Orski at *Innovation NewsBriefs*; Joint Committee on Taxation (JCT); and the Senate Finance Committee.

3. **The biggest problem with the Senate's approach is that it uses <u>ten years</u> of these revenue raisers to pay for just <u>16 months</u> of transportation funding.** As the box on the right shows, <u>less than 20 percent of the increased revenue will be collected before the Senate reauthorization expires</u>, while more than half of the total costs to the Treasury (and nearly 90 percent of the straight transfer to the HTF) will be realized during the same period. Put another way: much of the money will be spent right away, while much of the revenue will take a decade to collect.

Costs vs. Revenues, Treasury			
Costs to Treasury	FY 12-13 (millions)	10 Years (millions)	% During Bill Life
Straight Transfer to HTF	$4,460	$4,970	89.74%
Existing Taxes Transfer to HTF	$1,726	$5,217	
Tax Code Changes	$216	$1,420	
Total, Costs to Treasury	$6,402	$11,607	55.16%
Collections to Treasury	$3,266	$17,061	19.14%

   And while the spending that will occur is real, a significant portion of the expected increase in revenues is speculative at best. Any time Congress relies on collection of delinquent taxes to pay for increased federal spending, there is little or no way to tell if the increased revenues were ever realized. And even if it was possible to tell, since the spending will have already occurred in the first 16 months, there is no way to adjust the spending if tax collections don't keep pace. This is a Congressional shell game that allows them to pay on Tuesday for a hamburger today (apologies to Wimpy).

   An additional problem with the Senate approach: unlike the gasoline tax, which is paid for by transportation system users, many of these new revenue sources are not transportation-related, and therefore take us farther away from users paying for the system.

4. **The Senate bill also spends money beyond the core transportation bill**, the result of a number of tax code changes[2] and distribution of money collected from penalties resulting from the Deepwater Horizon oil spill in the Gulf.[3] This pushes even higher the amount that must be offset.

[2] Unlike the tax code changes that resulted in increased revenues as discussed earlier, the Senate also included a number of tax preferences that would have the effect of reducing overall tax collections. In addition to the amounts transferred from the Treasury to the HTF, the cost of these tax provisions must also be offset by the Senate, as they amount to "spending."

[3] This spending need not be offset, however, because it distributes funds that were collected from a new revenue source.

Spending & Revenue Provisions in Senate Reauthorization[4]

▪ New Sources of Revenue for Highway Trust Fund

Biggest source of HTF funding: General funds transfer ($4.97B)

What it does: Transfers to the HTF nearly $5 billion from general funds of the Treasury.

Committee: "…additional revenue totaling $4.97 billion from the general fund is also transferred."

Analysis: In recent years, the federal transportation program has required transfers of $34.5 billion to keep the account from going bust. This provision simply continues this trend and keeps the transportation program dependent on general funds, and further eroding the user pays principle.

Most justified use of funds: LUST Trust Fund transfer and dedication of future receipts ($3.685B)

What it does: Transfers to the HTF $3 billion from the leaking underground storage tank (LUST) Trust Fund (established in 1986 to support States and EPA to clean up leaks from underground storage tanks) and reduces the current one-tenth of one-cent per gallon contribution into the LUST Trust Fund by one-third.

Committee: "Revenues deposited in the LUST Trust Fund have exceeded outlays and the Fund has a surplus balance…The Committee believes that since the LUST tax is collected on motor fuels, it is appropriate to fund highway projects with a portion of such motor fuel tax receipts."

Analysis: This is a justified source of revenue because it is money derived from the gas tax. Congress only appropriates approximately $100 million each year from the fund, so there is currently a $3.745 billion surplus. Current revenue into the trust fund including interest is over $300 million per year. It doesn't seem inappropriate to use that surplus to fund the transportation program, so long as the LUST Trust Fund is maintained at an appropriate level to continue an adequate level of funding for the clean-up of these underground storage tanks.

Decent justification: Dedication of gas guzzler tax to HTF ($0.697B)

What it does: Transfers to the HTF the "gas guzzler" tax that is imposed on automobiles that weigh less than 6,000 pounds and get less than 22.5 miles per gallon. The current tax starts at $1,000 (per vehicle) and reaches $7,700 for vehicles with fuel economy less than 12.5 miles per gallon.

Committee: "The gas guzzler tax serves as a deterrent to purchasing fuel inefficient vehicles, thus encouraging the purchase of more fuel efficient vehicles, which in turn reduces motor fuel tax contributions to the Highway Trust Fund."

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[4] Dollar amounts are 10 year numbers. For a breakdown of 2 year and 10 year numbers, see chart at the end of this document.

Analysis: Though this is a bit more of stretch, this provision is at least transportation-related and has a connection to collection of gas tax. By taxing inefficient vehicles at a higher rate, this encourages consumers to purchase more fuel efficient vehicles. When vehicles use less fuel, that results in less income into the HTF. The problem with this provision, however, is that it is deficit spending, since the revenue from this provision has been going into the Treasury since its inception.

<u>No justification: Dedication of imported car tariffs ($4.52B)</u>

What it does: Transfers to the HTF the tariff on certain imported passenger vehicles (namely, those with 1000 to 1500cc engines, and those with engines greater than 3000cc).

Committee: "To assist in keeping the Highway Trust Fund solvent, the Committee believes it is appropriate to dedicate certain customs duties collected on imported vehicles to the Highway Trust Fund."

Analysis: Even the Committee didn't try to provide a justification for this one. This is a blatant grab of general funds, with no tie-in to the HTF.

Total, new transfers to HTF: $13.872B (two years: $9.279B)

- # Additional Spending

<u>RESTORE Act: $3.627B</u>
<u>National Endowment for the Oceans, Coasts, and Great Lakes: Unknown</u>

What it does: The Resources and Ecosystems Sustainability, Tourist Opportunity, and Revived Economies of the Gulf States (RESTORE) Act creates a Gulf Coast Restoration Trust Fund to collect the penalties collected under the Clean Water Act as a result of the Deepwater Horizon accident. The RESTORE Act directs 80 percent of these funds to the Gulf States, to be used for coastal restoration, flood protection, tourism promotion, and more. Additionally, interest derived from the Trust Fund will fund the National Endowment for the Oceans, Coasts, and Great Lakes, expected to be "tens of millions" of dollars in its first years.

Committee: These provisions are not included in the Senate Finance package, but are separate sections of the Senate proposal (RESTORE Act is in MAP-21 Subtitle F – Gulf Coast Restoration; Endowment is in Sec. 1603(4)).

Analysis: Both provisions spend "new" federal money, and neither relies on the nation's transportation program for funding. But there is significant question as to why these are included in a bill to authorize transportation spending.

<u>Reauthorization of Land and Water Conservation Fund: $1.4B (over 2 years)</u>

What it does: The Senate bill includes $1.4B in funding for the Land and Water Conservation Fund over the next two years, and reauthorized the program through 2022. This program is funded with a portion of revenues from offshore oil and gas development.

Committee: This provision is not included in the Senate Finance package, but is a separate section of the Senate proposal (Sec. 1701).

Analysis: This does not rely on transportation dollars for funding, which raises questions as to why it is included a transportation reauthorization bill.

Small Issuer Exemption Extension: $0.761B

What it does: Financial institutions can deduct the interest paid on bonds purchased from so-called "small issuers," which incentivizes the purchase of those bonds. This provision modifies the definition of "small issuer" to include a greater number of issuing entities. This increases the number of tax-deductible bonds that can be sold, and therefore results in greater cost (in the form of foregone tax revenue) to the Treasury.

Committee: "The Committee believes that it is appropriate to increase the volume limitation for qualified small issuers and make other modifications to the aggregation rules…"

Analysis: This provision does have some connection to the transportation program in that some of these bonds would likely be for infrastructure costs. This provision might be better left to tax reform legislation, however.

Bond Exemption for Sewage/Water Supply Facilities: $0.305B

What it does: Eliminates (until 2018) the current cap on the volume of bonds that can be issued for water facility and sewage projects.

Committee: "It is anticipated that exempting these types of bonds from the volume limitation will encourage issuers to undertake more infrastructure spending for sewage and water facilities."

Analysis: This provision does not belong in a transportation authorization bill.

Tax-Exempt Bond AMT Preference: $0.215B

What it does: Provides relief from Alternative Minimum Tax (AMT) for investors in private activity bonds (PABs) through 2012.

Committee: "The Committee believes that the AMT treatment of interest on tax-exempt bonds restricts the number of persons willing to hold tax-exempt bonds, resulting in higher financing costs."

Analysis: This provision does have some connection to the transportation program in that some of these bonds would likely be for infrastructure costs. This provision might be better left to tax reform legislation, however.

Transit Benefit Parity: $0.139B

What it does: Makes the amount of employer-provided transportation benefit that can be provided tax free equal between transit and parking benefits through 2012. Currently, the limit is $125 for transit and $240 for parking.

Committee: "Maintaining parity in transportation benefits provides American workers with an incentive to use public transportation and vanpools for their commute rather than driving to work in their personal vehicles. The Committee believes that this provision will help to ease traffic congestion and reduce America's dependence on foreign sources of oil."

Analysis: Though the transportation bill is a justifiable place to deal with this provision, current funding challenges argue that parity should be reached without increasing spending by balancing the benefit at some amount lower than $240. For example, there would be a net savings if the parking benefit was reduced to $125.

Total, new spending: $1.42B (two years: $0.216B)

- ## New Revenue

Pension Stabilization: $9.394B

What it does: This provision changes the calculation that determines the amount of money companies must set aside for their defined contribution accounts (pensions). These contributions are legally defined based relative to interest rates. Historically low interest rates in the past couple of years would have resulted in markedly higher contributions. This provision would reduce the amount companies are required to contribute. Since pension contributions are not taxed, this temporary reduction increases the amount of taxable income and therefore increases tax collections by the Treasury.

Committee: "This would stabilize the fluctuation of interest rates from year to year, resulting in less decline when there is a sharp drop in interest rates and less of an increase when there is a sharp increase in interest rates."

Analysis: Though many "pay-for" tax provisions are highly speculative (cutting down on fraud, for example), this one is likely to result in the assumed increase in tax receipts. That aside, this provision has absolutely nothing to do with transportation nor is it tied to the use of the transportation system. In addition, the nation's Pension Benefit Guaranty Corporation (PBGC), which guarantees pension benefits when a company goes bankrupt, has a $23 billion deficit. Any changes to the nation's pension requirements would seem better targeted to filling this hole.

Delay Implementation of Worldwide Interest Allocation Rules: $3.627B

What it does: In 2004, Congress passed a jobs bill which changed the tax code for taxpayers with interest expenses from foreign sources, allowing them to use the so-called "worldwide method." This will result in lower taxation for some corporations, and thereby reduce overall tax receipts by the Treasury. This change was supposed to go into effect in 2008, but has been delayed several times. In the current bill, Congress would again block implementation and use the savings as an offset for transportation spending.

Committee: The worldwide method is generally preferred by U.S. corporations with foreign subsidiaries, because using the worldwide method typically results in less of a restriction on the use of the foreign tax credit.

Analysis: This is a ridiculous provision. If Congress has decided that solving the double taxation on foreign investments is not a priority, that is its prerogative. But to block the implementation and use the savings to justify other spending is ludicrous. Even worse, Congress has already spent a decade's worth of "savings" from blocking this provision. The transportation bill would block it all the way out to 2022! Furthermore, the issues over territorial or worldwide taxation will be central in any tax reform measure and should be decided there.

Tax Enforcement Measures Against Foreign Entities: $1.022B

What it does: Allows Treasury to utilize "special measures" that currently can be taken against foreign governments or institutions to stop money laundering to also be used to deter tax evasion.

Committee: "This means that provisions and penalties that were established to deter money laundering could now be levied to deter tax evasion."

Analysis: This provision bears no relationship to transportation funding, and any back taxes collected as a result of this provision would be better applied to reducing the nation's $15 trillion debt.

Levy on Payments to Medicare Providers: $0.841B

What it does: Allows Treasury to levy up to 100 percent (current limit is 15 percent) of the payment owed to a Medicare service provider to collect unpaid taxes owed by that provider.

Committee: "The Committee believes that the rate of nonpayment of Federal taxes by Medicare providers is not acceptable. The Committee further believes that such payments should be subject to ongoing levy in full."

Analysis: This provision bears no relationship to transportation funding, and any back taxes collected as a result of this provision would be better applied to reducing the nation's $15 trillion debt.

Revoke Passports of Tax Delinquents: $0.743B

What it does: Makes any individual with tax debt in excess of $50,000 ineligible for acquisition and renewal of a U.S. passport, and permits the Federal government to revoke the passport of such individual upon their reentry into the country. This is similar to an existing provision that denies new passports to individuals who owe more than $2,500 in child support payments.

Committee: “The Committee believes that tax compliance will increase if issuance of a passport is linked to payment of one’s tax debts.”

Analysis: This provision bears no relationship to transportation funding, and any back taxes collected as a result of this provision would be better applied to reducing the nation’s $15 trillion debt.

<u>Federal “Phased Retirement” Allowance: $0.459B</u>

What it does: An optional program to allow Federal employees nearing retirement age to ease into retirement over the course of several months or even years, by transitioning from full-time employment to part-time employment before full retirement. Employees that take this option would be required to spend at least 20 percent of their time mentoring younger employees. An employee that works half time, for example, would be entitled to receive half of their retirement benefit.

Committee: “Under this provision, employees who are otherwise eligible for retirement benefits could continue working on a reduced schedule and collect a corresponding percentage of their retirement benefits… This results in lower outlays by the federal retirement fund and lower contributions by federal agencies to the fund.”

Analysis: This provision bears no relationship to transportation funding. Any savings from this approach would be better used to help close the nearly trillion dollar hole in the federal employee pension fund or reduce the nation’s $15 trillion debt.

<u>Pension Assets to Retiree Health Accounts $0.363B</u>

What it does: Temporarily extends the ability of employers to use excess pension assets to fund retiree health benefits and expands the provision to allow similar transfers for retiree life insurance. This is only allowed if the pension fund has assets equal to more than 120 percent of liabilities.

Committee: “The Committee believes that it is appropriate to provide a temporary extension of the present law…[and]… believes it is appropriate to permit an employer to make such a transfer to a separate account under a defined benefit plan to fund group-term life insurance…”.

Analysis: This provision bears no relationship to transportation funding. Any savings from this approach would be better used to help reduce the nation’s $15 trillion debt.

<u>Life Insurance Policy Sales Tax Reporting $0.244B</u>

What it does: Changes the reporting requirement when one life insurance company sells the policy to a third party (not the insured). The intent is to clarify the amount of taxable profit from the sale of the policy. Does not apply to the initial sale of insurance to an individual, but when the issuer sells the policy to another corporation.

Committee: "The proposal is designed to aid the seller in determining the amount of taxable profit from the sale of the policy by providing the seller information about the purchase price and basis in the policy."

Analysis: This provision bears no relationship to transportation funding. Any savings from this approach would be better used to help reduce the nation's $15 trillion debt.

Corporate Securities Tax Changes $0.244B

What it does: Treats as taxable certain assets of companies involved in certain corporate reorganizations.

Committee: "[U]nder present law, securities of the controlled corporation might be issued to and in some situations retained by the distributing corporation without treating such securities as equivalent to the receipt of taxable property. The Committee also is concerned that present law may encourage excessive leverage in some divisive D reorganization situations."

Analysis: This provision bears no relationship to transportation funding. Any savings from this approach would be better used to help reduce the nation's $15 trillion debt.

Cigarette Machine Tax Rules Changes/Roll-Your-Own Tobacco Tax Treatment $0.099B

What it does: Taxes businesses that sell cigarettes produced by so-called "speed rolling" cigarette machines as cigarette manufacturers, thereby making that business responsible for federal excise taxes. This closes a tax loophole that was created in a bill that raised taxes on rolling tobacco to fund expansion of a children's health-insurance program, but did not raise the tax on pipe tobacco. The speed rolling machines can produce 200 cigarettes in approximately 10 minutes using pipe tobacco, resulting in dramatically lower tax on the final product.

Committee: "The proposal would expand the definition of a tobacco manufacturer to include businesses operating a roll-your-own machine. As such, the machine's owner would be responsible for federal excise taxes on the tobacco products manufactured using his or her machine."

Analysis: This provision bears no relationship to transportation funding. Any savings from this approach would be better used to help reduce the nation's $15 trillion debt.

Thrift Savings Accounts Tax Rules Changes: $0.025B

What it does: Allows the IRS to levy federal employees Thrift Savings Plans for collection of unpaid taxes.

Committee: "This amendment to title 5, United States Code, provides that monies in the Thrift Savings Fund accounts of Federal employees shall be subject to legal process by the IRS for payment of delinquent taxes, thus explicitly allowing the Thrift Investment Board to honor an IRS notice of levy."

Analysis: This provision bears no relationship to transportation funding, and any back taxes collected as a result of this provision would be better applied to reducing the nation's $15 trillion debt.

Total, New Revenue: $17,061B (two years: $3,266B)

Appendix A. Chart of Spending and Revenues in Senate Finance Reauthorization Bill

Proposed Provision	FY 12-13 Total (millions)	10 Year Total (millions)	Percent collected/spent during life of bill	Brief Description
Spending				
Dedication of 1/3 of LUST Tax Receipts	$93	$685	13.58%	LUST to HTF
Dedication of Gas Guzzler Tax to HTF	$131	$697	18.79%	GF to HTF
Dedication of Imported Car Tariffs to HTF	$1,595	$4,520	35.29%	GF to HTF
Transfer of LUST Balances to HTF	$3,000	$3,000	100.00%	LUST to HTF
Transfer of General Fund Balances to HTF	$4,460	$4,970	89.74%	GF to HTF
Small Issuer Exemption Extension	-$38	-$761	4.99%	Tax expenditure
Tax-Exempt Bond AMT Preference	-$34	-$215	15.81%	Tax expenditure
Transit Benefit Parity	-$139	-$139	100.00%	Tax expenditure
PAB Volume Cap Exemption	-$5	-$305	1.64%	Tax expenditure
Revenue				
Pension Stabilization	$2,872	$9,394	30.57%	New Money
Interest Allocation Delay	$0	$3,627	0.00%	New Money
Tax Enforcement Overseas	$195	$1,022	19.08%	New Money
Levy on Payments to Medicare Providers	$109	$841	12.96%	New Money
Revoke Passports of Tax Delinquents	$69	$743	9.29%	New Money
Phase Retirement	$9	$459	1.96%	New Money
Pension Assets to Retiree Health Accounts	$0	$363	0.00%	New Money
Insurance Policy Resale Reporting	-$20	$244	0.00%	New Money
Controlled Corporation Security Treatment	$12	$244	4.92%	New Money
Roll-Your-Own Tobacco Tax Treatment	$18	$99	18.18%	New Money
IRS Levies and TSPs	$2	$25	8.00%	New Money