

Economic Overview of Federal Tax Expenditures

Invest in Kids Working Group

February 20, 2007

Pay-Go Rules Require Pay-For's

Under tighter congressional Pay-Go rules, increasing Federal spending for early care and education will probably require offsets.

1. Raising Federal Tax Revenues
2. Eliminating Federal tax loopholes
3. Reducing other entitlement spending

Spending in appropriations bills is limited by the budget resolution spending levels, not by PAY-GO.

What are Federal Tax Expenditures?

Tax expenditures are defined in the Budget Act of 1974 (P.L.93-344) as:

“revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability.”

They are large, and like Social Security and Medicare, they are “entitlements” because they are not subject to annual Congressional review and because their spending level is determined by beneficiary eligibility.

Federal Tax Expenditures Totaled \$945 billion in FY06 and \$6 trillion over Five Years, FY08-12

The Congressional Research Service found that tax expenditures in FY06 totaled:

7.2% of GDP;

39.3% of federal revenues;

4 times the \$248 b. federal deficit.

President Bush's FY08 Budget estimates tax expenditures cost \$6 trillion over 5 years, FY08-12.

http://www.opencrs.com/rpts/RL33641_20060913.pdf

<http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/receipts.pdf>

The Largest Tax Expenditures

5-year Treasury Department estimates, FY08-12, \$-billion

1.	Employer deduction for health care	\$1,006 b.
2.	Home mortgage interest deduction	\$ 520 b.
3.	Accelerated depreciation of equipment	\$ 422 b.
4.	Charitable deduction, ex. education, health	\$ 265 b.
5.	Capital gains preference, ex. Ag., timber, etc.	\$ 252 b.
6.	401(k) pension plans	\$ 250 b.
7.	Employer pension plans	\$ 229 b.
8.	Net imputed rental income exclusion	\$ 220 b.
9.	Home sales capital gains exclusion	\$ 215 b.
10.	State and local tax deduction	\$ 193 b.

Source: <http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/receipts.pdf>

Some Examples of Tax Expenditures

With 10 year revenue estimates

1. Special Rules for Extractive Industries -- \$19 bln
2. Partial Credit Union Tax Exemption -- \$15 bln
3. Lenient Tax Shelters Standards -- \$7.8 bln
4. Special Rules for the Timber Industry -- \$5 bln
5. Corporate Jet Loophole -- \$3 bln

Source: Paul Weinstein, "Family Friendly Tax Reform", Policy Report, PPI, April 12, 2005
http://www.ppionline.org/ppi_ci.cfm?knlgAreaID=125&subsecID=163&contentID=253276

1. Special Rules for Extractive Industries

Definition: Mining exploration and developments costs are expensed under present law.

Economic Pros and Cons:

Normally, expenses associated with producing income in the future are capitalized to match income with expense. However, expensing has been allowed because mining income is uncertain and difficult to predict. Expensing is also allowed to encourage the development of new reserves to help avert future shortages.

Expensing loses more revenue than can be justified by the economic benefits.

Source: Congressional Budget Office "Budget Options: February, 2005, p.302.

<http://www.cbo.gov/ftpdocs/60xx/doc6075/RevenueOptions.pdf>

2. Credit Union Tax Exemption

Definition: Credit unions have always been exempt from federal income tax.

Economic Pros and Cons:

Credit unions are non-profit and distinguishable from taxable banks because of their mutual ownership.

However, credit unions perform the same function as banks with profits distributed as lower interest rates and fees.

Credit unions would argue they are community based, and non-profit, which makes them different than today's banks.

Source: Congressional Budget Office "Budget Options: February, 2005, p.301.
<http://www.cbo.gov/ftpdocs/60xx/doc6075/RevenueOptions.pdf>

3. Lenient Tax Shelters Standards

Definition: There currently is no single definition of a tax shelter

Economic Pros and Cons: Clarifying the definition would bring more certainty to business and increase revenues to the Treasury.

Source: Joint Committee on Taxation, JSC-02-05, January 27, 2005, pp. 14-30.
<http://www.house.gov/jct/s-2-05.pdf>

4. Special Rules for the Timber Industry

Definition: Timber income is usually taxed as long-term capital gains and timber expenses enjoy special treatment, either expensing or depletion.

Economic Pros and Cons:

Like mining, timber income is uncertain and difficult to predict and has traditionally enjoyed capital gains status.

These cost of these tax benefits may outweigh the economic benefits.

Source: Committee on the Budget, United States Senate, "Tax Expenditures: Compendium of Background Material on Individual Provisions", December 2006, Prepared by the Congressional Research Service, S.Prt. 109-072, pp. 189-191.

5. Corporate Jet Loophole

Definition: The **corporate jet loophole** allows companies to take a full tax deduction for the cost of owning and operating a corporate aircraft, even when it is being used for personal use.

Economic Pros and Cons: Companies argue the use of corporate jets is “cost of business” and the tax code should treat it as such. They would argue that determining the difference between personal and business use is complicated, and unclear in many cases. Opponents would argue that corporate aircraft is a luxury, and that allowing tax preferences for the maintenance and owning of such aircraft is economically unfair to taxpayers.

Source: Testimony of Congressman Rahm Emanuel before the Ways and Means Committee on September 23, 2004. <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=1927> 11