

Invest in Kids / PAES Update:
Weinstein Presentation on Federal Tax Expenditures
February 20, 2007

A central challenge to funding increased early care and education expenditures at the federal level is the lack of funds. In order to increase ECE spending, spending elsewhere must be cut. To justify this cut, economic arguments will have to be made that show the economic returns on ECE spending are greater than those on certain existing spending. We have to be able to show with clear evidence that quality spending to strengthen parenting, healthcare, nurturing, and education of young children has greater economic development and growth benefits than spending in many existing areas.

An important aspect of the federal budget's structure is the distinction between Discretionary and Mandatory spending, and within the second category tax loopholes and subsidies constitute a large component. Paul Weinstein of the Progressive Policy Institute in his presentation, "Economic Overview of Federal Tax Expenditures" explained the workings of the Mandatory spending side of the federal budget. He focused particularly on the tighter congressional "Pay-Go" rules, and explained why increasing federal spending for early care and education will probably require offsets. These offsets may be created by raising federal tax revenues, eliminating tax loopholes, or reducing other entitlement spending.

Paul explained that the federal tax expenditures have become more popular throughout the years and in fiscal year (FY) 2006 they totaled over \$945 billion. President Bush's FY 2008 budget estimates that tax expenditures will cost over \$6 trillion over the five years, from FY 2008 to FY 2012. The largest tax expenditures include employer deductions for health care, home mortgage interest deductions, and charitable deductions. Paul indicated it will be easier to reform the whole tax code at once, rather than piece by piece. He then described the following five tax expenditures in detail:

Special rules for extractive industries: Currently, mining exploration and developments costs are expensed under present law. This expensing is allowed because mining income is uncertain and difficult to predict and will encourage the development of new reserves to help avert future shortages. Unfortunately, expensing loses more revenue than can be justified by the economic benefits.

Large credit union tax exemption: Presently all credit unions are exempt from federal income tax because they are non-profit and distinguishable from taxable banks (because of their mutual ownership). Large credit unions, however, operate almost identically to commercial banks. Politically popular with Democrats, credit unions have a strong lobby. However, from an economic standpoint it is hard to justify not taxing large credit unions like banks.

Lenient tax shelters: Since there is no single meaning of a tax shelter, clarifying the definition would bring more certainty to business and increase revenues to the Treasury.

The government could help close this estimated \$285 billion gap by increasing regulation and enacting the following rules:

- 3rd party verification—Having accountants send capital gains income to the IRS. This verification is similar to W-2 and 1099 income reports.
- Hire more IRS agents—Each new employee hired brings in more revenue for the country.

Special rules for the timber industry: Timber income is usually taxed as long-term capital gains and timber expenses enjoy special treatment, either expensing or depletion. Like mining, timber income is uncertain and difficult to predict and has traditionally enjoyed capital gains status; however, these cost of these tax benefits may outweigh the economic benefits.

Corporate Jet Loophole: Companies are allowed 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. Companies argue the use of corporate jets is “cost of business” and the tax code should treat it as such. Determining the difference between personal and business use is complicated, and unclear in many cases; however, corporate aircraft is a luxury and allowing tax preferences for the maintenance and owning of such aircraft is economically unfair to taxpayers.

After the formal presentation, the working group discussed the following topics:

Budget Crisis—How do they work? Each crisis is unique and different people are involved in different ones. For example, the 1997 State Children’s Health Insurance Plan came out of a budget crisis that involved both political parties.

Big Money—Where will we find the “big money” down the road? Gene Stuerle showed how there is a danger with lists like these that imply you can get by without having to make tough choices. Perhaps in addition to getting rid of large tax expenditures, we will have to use a value added tax (VAT). While Medicaid and Medicare are both politically and policy-wise hard to fix, Social Security is only politically hard to fix.

Research Base—Which of the areas has the strongest research behind its costs outweighing its benefits?

- Extractive/timber industry—The Congressional Budget Office (CBO) has published research in their Budget Options reports.
- Credit Union—This area is complicated by many of its benefits being hard to quantify and no one feels sorry for bankers (the main competitor). Furthermore, the politicians are heavily influenced by the workers who campaign for the credit unions.
- Tax Shelters—Although there is a lot of overall research on why to get rid of tax shelters; research is less clear on specific issues.

Best Strategy for the Partnership’s message—Make sure that when a politician goes into a meeting they are convinced why early care and education should be a budgetary priority. However, Partnership members shouldn’t necessarily tell politicians where to

find the money; advocates should instead highlight the 30 loopholes and let the politicians make the tough decision.

Next Budget Battle—Paul believes that the next real window for a new budget will be in 2009 with the next presidential administration.