

TAX

DECODER

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DECEMBER 2014

INTRODUCTION

The U.S. tax code is so complicated most Americans pay someone else to complete their tax forms.¹ Even the members of Congress who are in charge of writing tax law admit they too cannot do their own taxes.² In fact, it is unlikely there is a single taxpayer, politician, lawyer, or economist who has read or completely understands the entire Internal Revenue Code, which is now more than four million words in length, filling 9,000 pages.³ By contrast, the federal income tax law in 1913 was just 27 pages long and could be read cover to cover by nearly every American.⁴

The tax code is not just complicated, it is unfair. More than \$1.7 trillion in federal income this year was collected from taxpayers,⁵ but this financial burden is not shared equally by all. Due to the code's complexity, your taxes are not a simple calculation of earnings and obligations. Instead, taxes are determined by how well you can take advantage of the hundreds of tax credits, deductions, exclusions, and carve-outs tucked into the code. As a result of all of these loopholes and giveaways, nearly half of American households pay no federal individual income tax,⁶ including over a thousand with an adjusted gross income of \$1 million.⁷

Median family income was \$51,000 in 2012.⁸ That same year, taxpayers had an average personal tax bill of \$12,759.⁹ Yet, some individuals and corporations paid almost nothing in taxes, while a few even received payments from the government.

Because many of those who pay no income taxes are at both ends of the economic ladder, those in the middle are squeezed the hardest. While it is fair to expect those who have more to pay more and for those who have less to pay less, every citizen should contribute in some manner.

Taxes should not be determined by who has access to the craftiest accountants, lobbyists and politicians. The tax code should be simple enough that everyone—including members of Congress—is capable of filling out their own tax return.

This report, TAX DECODER, is intended to decode the tax code for every taxpayer. It reveals more than 165 tax expenditures costing over \$900 billion this year and more than \$5 trillion over the next five years.

It is nearly impossible to know who is benefiting from the tax code because it lacks any real transparency or accountability. This is not unintentional. The Senate Finance Committee recently rejected an amendment that would have required the recipients of some tax credits to be publicly listed in the USAspending.gov website.¹⁰ The recipients of these tax breaks know who they are, so it seems reasonable for those who are paying the taxes to provide the benefits should know as well.

TAX DECODER attempts to provide a detailed and comprehensive overview of the code for all taxpayers. It includes the background, cost, and primary beneficiaries of each provision along with specific examples of some of the recipients of certain tax breaks. It covers well known tax provisions as well as others that are more obscure.

For example, the owners of lucrative professional sports franchises can write-off some of the costs of purchasing a team, while some multibillion dollar sports leagues pay very little in taxes. Hollywood movie makers aren't just collecting at the box office, they are also downloading tax subsidies from the IRS. Gamblers who lose at the casino or horse track can still win on their tax return by writing off gambling losses. There is no shortage of tax subsidies for the rich and famous, such as credits to renovate vacation homes and purchase luxury cars and deductions for yachts. McDonald's even received tax breaks to sell Chicken McNuggets overseas.¹¹

While many of these were created with the best of intentions, big spenders in Washington have often attempted to con fiscal conservative policymakers into believing that spending through the tax code is actually

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THIS REPORT PROVIDES A LIST OF OPTIONS FOR CONGRESS TO STREAMLINE AND SIMPLIFY THE TAX CODE TO ACHIEVE THAT GOAL. WHILE MANY OF THE TAX BREAKS IDENTIFIED THROUGHOUT THIS REPORT SHOULD BE PHASED OUT OR ELIMINATED, OTHERS COULD ALSO BE REFORMED TO BETTER ACHIEVE THEIR INTENDED PURPOSE.



cutting taxes. In fact, many tax provisions duplicate spending programs, providing financial assistance to the very same recipients for nearly identical purposes. For example, home ownership is supported within the tax code with the mortgage interest deduction, capital gains exclusion of profits from home sales, and deduction for property taxes, while dozens of federal spending programs at multiple departments also provide aid for homeownership.

And the real beneficiaries of many tax giveaways end up being not the intended recipients who need relief, but those who are already well-off. The New Markets Tax Credit was created to create jobs in low-income areas, but instead resulted in nearly \$1 billion being steered to wealthy investors and Wall Street banks. Likewise, the Research and Development Tax Credit was designed to encourage mid-sized companies to increase investments in research and development, but over 80 percent of the credit went to companies with \$250 million or more in annual sales in 2010.¹² Google, Intel, Boeing and Apple were the top recipients in 2011.¹³

“Even though lowering rates and getting rid of loopholes would raise incomes, reduce inequality, and bring down the deficit, too many Democrats and Republicans in Washington are addicted to loopholes to conceal spending in the tax code,” noted a former Democratic presidential economic adviser who pointed out how both parties have used tax preferences to increase spending over the past three decades.

All of these tax giveaways add up to nearly \$1 trillion in lost revenue every year.¹⁴ For each of these that benefit only one company or industry, other businesses must bear a disproportionately higher effective rate. Instead of artificially lowering the rates for select industries, companies or individuals, Congress should lower rates for all taxpayers in a fair and equitable manner.

The federal tax code is a necessary evil that should be used only to collect revenue to pay for legitimate, essential federal expenditures, such as our national defense. But Washington politicians have manipulated it for their own purposes, whether to support special interests or to encourage certain behaviors or discourage others.

As such, the tax code has become a powerful and elaborate system of rewards and punishments used to coerce Americans and manipulate the economy. A prime example is the tax penalty utilized to enforce the individual mandate requiring Americans to purchase health insurance contained within Obamacare. After all, what better enforcer is there than the most feared agency in the federal bureaucracy? Sixty percent of Americans fear an audit by the IRS according to the tax agency’s own polling and this percentage has steadily risen over the past five years.¹⁵ This is no surprise since in recent years some at the IRS have abused the agency’s powers to harass and intimidate perceived political opponents.

But the IRS is not the only entity to abuse the tax code, which provides a legal way for the crafty to shield earnings and expenses from taxation. While many of the nearly 1.6 million nonprofit organizations in the country serve as indispensable nongovernmental mechanisms for strengthening society, some are multi-million dollar operations that are akin to for-profit businesses, but pay virtually no federal taxes. These are nearly indistinguishable from taxpaying businesses, such as credit unions, social clubs, huge hospital chains, lobbying groups, and sports leagues. Several tax-free celebrity charities ultimately gave little or nothing to charitable causes. Lady Gaga’s Born This Way Foundation, raised \$2.6 million in 2012, but only gave away \$5,000 for “grants to organizations or individuals.”¹⁶ Similarly, the Kanye West Foundation spent a total of \$553,826 in 2009—but only \$583 went to charity. The rest was eaten up by expenses such as salaries, travel, overhead, and “professional fees.” In 2010, the foundation did even worse, spending \$572,383 without a single penny going charity.¹⁷

Meanwhile, the U.S. corporate tax rate is one of the highest in the developed world, making it far more difficult for American companies to compete in the global marketplace. As a result, companies continue to

relocate overseas, taking jobs—and the tax revenues they generate—with them. Each of the special tax breaks within the code is an admission by Congress that the current tax rates are too high for American businesses, yet they are only selectively provided for favored industries.

The complicated mess is not just unfair, it is a burden on working families and businesses. The tax preparation and accounting services industries take in a combined \$100 billion annually, a cost that is paid by families and companies^{18, 19}. Instead of using capital for investments to grow the U.S. economy through the creation of new jobs, American businesses are spending millions of dollars to comply with IRS paperwork requirements. Similarly, families are paying tax preparers money which could be better spent purchasing goods, paying for their children's college education, and starting businesses of their own.

Further, because the tax code is so complicated, the IRS will be unable to even collect nearly \$500 billion in taxes owed in 2014, more than enough to balance the federal budget this year. This is despite the IRS employing over 40,000 staff members and spending over \$10 billion to enforce tax compliance. A simpler tax code could significantly reduce this cost to all sectors and make the job of filing and collecting taxes easier for all.

Congress should not attempt to manipulate or distort investment decisions through the code, but should create the most economically neutral tax system possible. This will allow the free market to determine the most efficient allocation of capital, and is the optimal tax policy to maximize wealth creation.

The companies that benefit from the tax breaks listed in TAX DECODER will assuredly defend their provisions as vital policies whose absence would inflict undue harm on the economy. Savings and investment in the American economy should be predicated on risk and return – not lobbyists and politicians. The acute impacts that striking a special interest carve out will have on a specific business should not be prioritized over the massive benefits that fixing our broken tax system will have on the American people.

WHILE WEEDING OUT THE TAX CODE MAY CAUSE SOME SHORT TERM UNCERTAINTY FOR THOSE WHO HAVE BECOME RELIANT ON TAX HANDOUTS, THE U.S. ECONOMY AND INDIVIDUAL TAXPAYERS WOULD GREATLY BENEFIT FROM A SIMPLER, FAIRER CODE AND LOWER TAX RATES.

Nearly every politician on both sides of the aisle claims to want to make the tax code simpler and fairer but each time Congress takes up so-called tax reform, the result is the exact opposite. There were over 4,600 changes to the tax code made between 2001 and 2012.²⁰ These changes have only made the tax code more complicated and less fair.

This month Congress will likely approve a “tax extenders” bill, reauthorizing dozens of expired tax perks for select companies and industries. The legislation will cost more than \$40 billion and will include many tax breaks discussed in the report, including the wind production tax credit, the New Markets Tax Credit, and tax breaks for NASCAR, Hollywood, and tuna manufacturers.

This has become an annual ritual for Congress to rubber stamp the continuation of expiring tax earmarks and loopholes with little debate or discussion. Most members of Congress refuse to name even one specific tax break they would support eliminating. My office approached more than a dozen other Senate offices about sponsoring a bill to eliminate the tax free status for professional sports leagues and associations with annual gross receipts in excess of \$10 million. To date, only one other senator, Independent Angus King of Maine, has agreed to co-sponsor. When the office of a Democrat senator was asked to choose a tax credit we could target together, the senator's staffer likened killing tax giveaways to “clubbing baby seals.”

Despite assertions from some on the Right that eliminating tax earmarks violates campaign pledges to not raise taxes, ending many of these preferences would not negatively impact most taxpayers, if rates were simultaneously lowered. Many are not even tax cuts, but rather tax spending giveaways. Doing away with many of these would provide the means to reduce taxes on everyone who does not benefit from these tax code carve outs. After all, true tax cuts leave money entirely in the hands of those who earned it to begin with and allow them to spend or save it as they wish. Tax preferences, by contrast, might leave some money in the hands of the taxpayer, but only if the individual behaves as the government dictates. This is just another form of nanny state overreach that limits freedom by attempting to control markets and individuals.

TAX DECODER is not a comprehensive tax reform plan. It is an educational reference guide designed to equip taxpayers and lawmakers with the details needed to thoughtfully reconsider many aspects of the existing tax code. Ideally Congress would throw out the entire tax code and start over. But at the very least, Congress should make the code simpler, fairer and flatter. This report provides a list of options for Congress to streamline and simplify the tax code to achieve that goal. While many of the tax breaks identified throughout this report should be phased out or eliminated, others could also be reformed to better achieve their intended purpose.

Simplification and fairness are two of the primary considerations throughout this report. For every tax benefit, several questions should be asked: Does this give an unfair advantage to a select group at the expense of the many? Does this make the U.S. more competitive or does it help just one industry? Is this outdated? Does it duplicate another form of federal aid or assistance? Is there measurable data that provides evidence it is achieving the intended goals? Is the cost worth the outcome, including higher taxes levied elsewhere to pay for its costs? Is it highly susceptible to waste, fraud and abuse? Are the true beneficiaries the intended recipients? Should it be simplified, phased out or eliminated? Is it even necessary? Is this tax provision Washington's way of telling you what to do by coercing the behavior of American citizens or businesses?

These questions should not only be asked of provisions currently in the tax code but also of those proposed in the future.

While weeding out the tax code may cause some short term uncertainty for those who have become reliant on tax handouts, the U.S. economy and individual taxpayers would greatly benefit from a simpler, fairer code and lower tax rates.

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