Reforming Tax Expenditures & Ending Special Interest Giveaways

From teens with summer jobs to multi-billion dollar corporations, taxpayers across the country sent $2.16 trillion to Washington last year.[1] Most Americans agree the tax code is confusing and unfair, making it even more frustrating to hand Uncle Sam nearly twenty-five percent of their monthly paycheck.

The tax code is long overdue for comprehensive restructuring. Yet, instead of considering broad reform to simplify the code and lower rates, Washington continues to make the problem worse—doling out new tax breaks and subsidies in the form of tax credits to well-connected companies and special interests with powerful lobbyists who seem to have more influence than most members of Congress. The result is a complex tax structure that benefits only a few, hinders economic growth and drives up costs and taxes for many working families and businesses across the country.[2]

In part, the complexity of the tax code arises from the countless spending programs hidden within it. Masquerading as tax cuts, many of these programs are no different from any other federal program that spends taxpayer money. Many of the preferences repealed in this plan are costly and unproven tax provisions which were contained in the stimulus bill and earmarked for specific politically favored agendas. Cleaning up the code by eliminating the most egregious tax giveaways will pave the way for reducing tax rates for all Americans and small businesses.

The need for fundamental tax reform is clear: as government has grown so has the tax code. It was designed to collect from citizens only those resources truly needed to fund basic federal functions, but has become the latest playground for Washington politicians to hand out benefits to their favorite special interests. At more than 3,800 pages, the code is a labyrinth of exclusions, deductions, exemptions, and credits, making it nearly incomprehensible. By most estimates, these special preferences add up to more than $1 trillion in annual spending, [3] all administered by a Treasury Department that receives little oversight from Congress, leaving virtually no way to stop runaway costs.

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[1] "Budget and Economic Outlook: Fiscal Years 2011 to 2021," p. 14, Congressional Budget Office, January 2011, http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.

[2] Taxpayers spend more than $160 billion annually to comply with the tax code, a sum equal to 11 percent of all the revenue the federal government collects. Written Statement of Nina Olson, National Taxpayer Advocate, Internal Revenue Service, page 12, hearing before the United States Senate Committee on Finance, "Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due," June 28, 2011.

[3] National Commission on Fiscal Responsibility and Reform, "Moment of Truth, Report of the National Commission on Fiscal Responsibility and Reform," December 1, 2010, http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform., p. 25.

In his recent *National Affairs* analysis of the tax code, "Spending in Disguise," former member of President Bush's Council of Economic Advisers Donald Marron explains how the code has become a tool for secret spending programs, stating "[t]ax preferences are social safety-net programs. They are middle- and upper-income entitlements." Marron concludes, "The federal government is therefore bigger than we typically think it is. Conventional budget measures miss hundreds of billions of dollars that are implicitly collected and spent each year through spending-like tax preferences."[4]

The nonpartisan Congressional Research Service agrees, explaining how tax expenditures are, "in many ways equivalent to entitlement spending.[5] That is, tax expenditures are available to everyone who qualifies and federal budgetary costs depend on program rules (the tax code), economic conditions, and behavioral responses. Furthermore, they often remain in the tax code until changed or eliminated by congressional action."[6]

> "They [tax expenditures] represent a major exercise of government power, but face less oversight than many activities on the spending side of the budget. They conceal the true size of government, and they confer enormous power upon the tax-writing committees in Congress — which have the ability to simultaneously raise revenue and spend it inside the tax code."
> *Marron, Spending in Disguise*

Congress' tax code spending spree has created an unfair system in which taxpayers with similar incomes and businesses with similar profits often do not pay similar rates. For example, a recent report found eleven major U.S. corporations with $163 billion in profits from 2008-2010 had effective federal tax liabilities averaging only 3.3 percent—far below the corporate rate of 35 percent. In the case of General Electric, the company had a *negative* income tax liability of 61.3 percent, receiving $4.7 billion from the federal Treasury over the last three years.[7]

Many tax preferences are little more than corporate welfare, designed to compensate for our country's high tax rate. Inevitably, these exceptions tend to favor those companies and groups with close ties to lawmakers and access to the most experienced lobbyists. Without such access, small businesses and the middle class often bear the burden of the high standard tax rates while the wealthy and powerful receive a vast array of deductions, credits, and other preferences created by Congress.

Loose requirements for various tax write-offs allow clever taxpayers to reduce their taxable income for bizarre and dubious expenditures. One family was allowed to deduct the cost of cat food as a business expense, claiming cats were needed to keep animals out of their junkyard.[8] Meanwhile others have been allowed deductions including elective abortion services, toupees for some balding men and breast augmentations for exotic dancers.[9]

[4] Marron, Donald J., "Spending in Disguise*," National Affairs*, Summer 2011, http://www.urban.org/uploadedpdf/1001542-Spending-In-Disguise-Marron.pdf.
[5] Congressional Research Service Definition: Tax expenditures—special deductions, exclusions, exemptions, and credits in the tax code—are often used instead of direct expenditures (mandatory and discretionary spending) to achieve policy goals.
[6] CRS R41369, "Empowerment Zones, Enterprise Communities, and Renewal Communities: Comparative Overview and Analysis," Congressional Research Service, February 14, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41639&Source=search#fn29.
[7] Citizens for Tax Justice, "Twelve Corporations Pay Effective Tax Rate of Negative 1.5% on $171 Billion in Profits; Reap $62.4 Billion in Tax Subsidies," June 1, 2011, http://ctj.org/ctjreports/2011/06/twelve_corporations_pay_effective_tax_rate_of_negative_15_on_171_billion_in_profits_reap_624_billion.php.
[8] Blank, Peter, Kiplinger, "Extraordinary Tax Deductions," March 2010, http://kiplinger.com/features/archives/extraordinary-tax-deductions.html.

Some of the most expensive provisions in the code are wrought with waste or are poorly targeted, often benefiting upper income tax filers instead of those most in need. For example, individuals with over a million dollars in income benefited from more than $7 billion in tax relief through the mortgage interest deduction in one year alone.[10] In fact, the IRS recently found that in 2008, more than 18,000 individuals earning at least $200,000 used these tax credits, deductions, and other preferences to reduce their personal income tax liability to zero. This resulted in the highest percentage of high-income taxpayers who avoided paying taxes since this data collection began in 1977.[11]

Worse still, the government does not even collect all of the taxes it is legally owed. The IRS loses billions of dollars every year to erroneous payments and poor oversight of spending programs found in the tax code. Consider, the Earned Income Tax Credit Program was identified as having nearly $17 billion in improper payments in 2010,[12] while the IRS Inspector General found that more than 1,200 prisoners, 241 of whom are serving life sentences, mistakenly received $9.1 million in first-time homebuyer tax credits just one year.[13] Simply requiring beneficiaries to provide a valid Social Security number to receive the Additional Child Tax Credit could save another $17 billion annually.[14]

By allowing deductions for everything from clown wigs to basketball jerseys[15], the tax code not only misdirects federal funding, but it imposes a significant drag on the overall economy, hindering growth and slowing the recovery. As wages continue to stagnate and many Americans remain unemployed, the sluggish economy has produced below-average levels of federal revenue in recent years. Combined with Washington spending at an all time high, we have seen record deficits of more than $1.65 trillion. We simply can no longer afford a tax code that loses hundreds of billions of dollars in revenue every year as result of special-interest giveaways, fraud, and economic distortions. .

Ultimately, attempting to force all taxpayers, both corporate and individual, to pay the full standard rates is futile—there are simply too many escape hatches to avoid taxation. More importantly, our economy simply cannot grow under such a burdensome level of taxation. The only way to fix the tax code is to eliminate most preferences, eliminate the Alternative Minimum Tax, and sharply lower standard rates for businesses and individuals. In addition, the corporate code should be moved from a worldwide system to a competitive territorial system, like nearly all major industrial countries. While some favor a temporary repatriation holiday, transition to a territorial system would create a permanent incentive for companies to bring their foreign earnings home.

At a time of divided government and record deficits, it is unrealistic to believe we can put the federal budget back in black without looking at both spending and revenue. This plan eliminates waste and

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[9] Congressional Research Service, Response to Office of Senator Coburn, "Deductibility of Certain Expenses and Exemption for Certain Gambling Winnings," July 11, 2011.
[10] IRS, Statistics of Income Division, April 2011.
[11] Rubin, Richard and Zajac, Andrew, Bloomberg News, "High-Income Returns Reporting No Taxes Almost Doubled in 2008, IRS Says," June 14, 2011, http://www.bloomberg.com/news/2011-06-14/high-income-no-tax-returns-almost-doubled-in-2008-irs-says.html.
[12] "Improper Payments in the Administration of Refundable Tax Credits," written statement of Nina E. Olson, May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/Olsen_Testimony.pdf .
[13] Block, Sandra, "Home buyer tax credit fraud includes 1,295 prison inmates," *USA Today,* June 24, 2010, http://www.usatoday.com/money/economy/housing/2010-06-23-home-buyers-credit-inmates_N.htm.
[14] Estimate made by staff of Senator Coburn.
[15] Congressional Research Service, Response to Office of Senator Coburn, "Deductibility of Certain Expenses and Exemption for Certain Gambling Winnings," July 11, 2011.

duplication in every corner of the federal budget, including the tax code. By a ratio of 8 to 1, the report focuses heavily on reducing mandatory and discretionary spending, but also calls for ending wasteful spending in the tax code. Ending special interest giveaways, selling unused federal assets, and eliminating spending through the tax code will bring in more revenue, but without increasing tax rates.

Sweeping tax reform that creates a level playing field, eliminates tax subsidies, and dramatically reduces both personal and corporate income tax rates is clearly needed. Congress can act now to remove some of the most egregiously unfair, unwarranted tax preferences in the code. Preferences like many included in this report cost the government billions of dollars and do little for the economy. Meanwhile, other reforms proposed in this plan could be considered with rate reductions to promote a flatter, simpler code. These reforms will also begin to make the tax code fairer for those who cannot afford to hire a lobbyist to represent them in Washington. Immediately ending dozens of special interest giveaways and reforming other major tax provisions will help remove these distortions generating nearly $1 trillion over the next ten years.

TEN YEAR SAVINGS
Tax Expenditure: $962.02 billion
Other Revenue: $30.34 billion
Total: $992.36 billion

END MISDIRECTED ECONOMIC DEVELOPMENT TAX BREAKS

In addition to the more than 180 federal programs doling out federal dollars for local economic development initiatives across the country, a handful of tax subsidies spend billions of dollars through the tax code for the very same purpose. These tax breaks are duplicative of countless other federal programs and benefits, often poorly targeted, and difficult to measure in terms of success and effectiveness.

Congress should eliminate these tax expenditures and focus on ensuring a smaller subset of the hundreds of economic development programs work as intended. Ending the New Markets Tax Credit along with the Empowerment Zone, Renewal Community, and District of Columbia Tax Incentives, would result in savings of more than $15 billion over ten years.[16]

New Markets Tax Credit

Individuals investing in businesses that provide capital to low-income residents in low-income communities can apply for the New Markets Tax Credit.[17] New Market Tax Credits reduce an individual's taxes by a portion of their investment over several years, creating an incentive for investment. Rather than working this way, the program rewards past behavior, but does little to incentivize new development.

In addition, some of the "community development entities" benefiting from this special tax break are actually multi-million dollar companies. Recipients of the tax break are often subsidiaries of major banks, like two divisions of Chase Bank, which were awarded $204 million worth of tax credits through this program in only three years (2007-2009); or the Merrill Lynch Community Development Company, which received $174 million in the same period; or Wachovia Community Development Enterprises, which received $521 million in awards from 2004-2009.[18]

These credits have been used to subsidize expensive construction projects like the $116 million renovation of the landmark Blackstone Hotel in downtown Chicago, a Marriott hotel. This project's main beneficiary was Prudential Financial Inc., the second-largest U.S. life insurer, which received $15.6 million in New Market Tax Credits.[19]

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[16] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.

[17] Internal Revenue Code, Section 45D, http://www.taxalmanac.org/index.php/Internal_Revenue_Code:Sec._45D._New_markets_tax_credit.

[18] Website of the Community Development Financial Institutions Fund, "Spreadsheet from Community Development Financial *Institutions* Fund website," http://www.cdfifund.gov/docs/nmtc/NMTC_Public_Data_09-17-10.xls, accessed June 29, 2011.

[19] Dietz, David, "Rich Take From Poor as U.S. Subsidy Law Funds Luxury Hotels," *Bloomberg News*, February 8, 2011, http://www.bloomberg.com/news/2011-02-08/rich-taking-from-poor-as-10-billion-u-s-subsidy-law-funds-luxury-hotels.html, accessed June 29, 2011.

In 2009 alone, over $3.5 billion in federal funding was directed via this tax break for projects not seemingly intended to benefit low-income regions:

- $19.9 million for a multiplex movie cinema and retail development;
- $8 million for a hockey arena;
- $5 million for 3D digital products and software application sales;
- $1.1 million for a cable television station;
- $15.7 million for a performing arts venue and school;
- $2.2 million for the "development of enhanced streetscapes;"
- $4.9 million for an 86 Room Fairfield Inn & Suites;
- $3.75 million for the historic rehabilitation of a "vacant hotel;"
- $9.8 million for a movie studio and entertainment venue;
- $4.5 million for architecture studios;
- $10.7 million for a historic rehabilitation of the headquarters of a global entertainment and convention venue management company; and
- $31 million for two "historic theater rehabilitations."[20]

These credits are disbursed to a recipient for at least eight years. The Congressional Research Service estimates roughly $705 million will be spent on these credits in fiscal year 2011.

Empowerment Zone, Renewal Community, and District of Columbia Tax Incentives

Similarly, Empowerment Zones (EZs) and Renewal Communities (RCs) are federally designated geographic areas characterized by high levels of poverty and economic distress, where businesses and local governments are often eligible to receive federal grants and tax incentives.

Since 1993, Congress has authorized three rounds of EZs and one round of RCs with the objective of revitalizing federally selected economically distressed communities. These designations unlock a combination of federal tax incentives and grants.

Nearly $1.8 billion in grant incentives provided to EZs and ECs have been allocated since 1993 and have mostly been expended. The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010[21] enacted on December 17, 2010 extended EZ tax benefits, but not RCs, until the end of 2011.

There are several Empowerment Zone (EZ) tax incentives[22] intended to help "economic development" in areas that are struggling economically.[23] One of these provisions allows businesses to receive a credit equal to 20 percent of the first $15,000 in wages paid to an employee who is a resident of the empowerment zone and who performs most of their work within the empowerment zone. The idea is to make it easier for companies to hire individuals in these poor areas. RC tax incentives, which have not been extended since they expired in 2009,[24] are similarly

[20] Website of the Community Development Financial Institutions Fund, "Spreadsheet from Community Development Financial *Institutions* Fund website," http://www.cdfifund.gov/docs/nmtc/NMTC_Public_Data_09-17-10.xls, accessed June 29, 2011.
[21] Public Law 111-312.
[22] Internal Revenue Code, Sections 1396, 179.
[23] Website of the Department of Housing and Urban Development, "Tax Tips," http://www.hud.gov/offices/cpd/economicdevelopment/library/taxincentivesez.pdf, accessed June 29, 2011.
[24] Website of the Department of Housing and Urban Development, "Welcome to the Community Renewal Initiative," February 25, 2011, http://www.hud.gov/offices/cpd/economicdevelopment/programs/rc/index.cfm, accessed June 29, 2011.

allowed for businesses to collect an employment tax credit equal to 15 percent of the first $10,000 in wages paid to an employee who is a resident of the renewal community and who performs most of their work within the renewal community.

Other investment incentives apply to both the EZ and RC programs with the goal of fostering economic development through an increase in the capital stock within the designated geographic areas. Firms may expense up to $35,000 of the cost of new and used qualified property/assets they acquire when the assets are placed in service, for a total of $285,000 if they are located in an EZ. Empowerment zone tax-exempt bonds can be issued for economic development projects in EZs. Capital gain deferral options are also available for investments within EZs and 50-75 percent of the gain from the sale of EZ small business stock held for more than five years is excluded from gross income.

There is also a special carve out for the District of Columbia (DC) Enterprise Zone, which includes census tracts in the District of Columbia with a poverty rate of at least 20 percent. Businesses in the DC Zone are eligible for the following tax benefits: (1) a wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who resided within the District of Columbia; (2) $35,000 in increased Section 179 expensing; and (3) tax-exempt bond financing. Additionally, a capital gains exclusion is allowed for certain investments in small business stock held more than five years and made within the affected areas. These incentives were extended through 2011 after expiring in 2009.[25]

Since federal grant programs also exist to assist these economic development zones/communities, it is unclear why these tax incentives should be extended. For entities applying for government funding, additional points are awarded on grant applications for the Department of Housing and Urban Development, Treasury, and Health and Human Services, and Department of Education programs.

Government-sponsored studies by the Government Accountability Office (GAO) and the Department of Housing and Urban Development (HUD) have failed to demonstrate EZ designation generating improvement in community outcomes.

In 2001, HUD published a progress report examining the first five years of the Empowerment Zone and Enterprise Communities programs.[26] HUD investigators found little evidence that the EZ program resulted in community improvement. The small growth that did occur within these communities, given the low take-up rate of the tax incentives, may have been attributable to activities not related to EZ activities.

In 2006, GAO also released a report on the EZ program.[27] This study found “none of the federal agencies that were responsible for program oversight—including HHS and the Departments of Housing and Urban Development (HUD) and Agriculture (USDA)—collected data on the amount of program grant funds used to implement specific program activities. This lack of data limited both federal oversight and GAO’s ability to assess the effect of the program.”

[25] Section 754 of P.L. 111-312.
[26] Website of the Department of Housing and Urban Development, “Interim Assessment of the Empowerment Zones and Enterprise Communities (EZ/EC) Program: A Progress Report and Appendices,” October 31, 2011, “http://www.huduser.org/portal/publications/econdev/ezec_rpt.html , accessed June 29, 2011.
[27]Website of the Government Accountability Office, “Empowerment Zone and Enterprise Community Program, Improvements Occurred in Communities, but the Effect of the Program is Unclear,”GAO-06-727, September 22, 2006, http://www.gao.gov/new.items/d06727.pdf, accessed June 29, 2011.

Despite a previous request by GAO as part of a 2004 study for these federal agencies to address this deficiency, GAO found this issue had not been addressed two years later. Based on the limited data GAO had, it could not determine that the EZ program was effective.[28]

Tribal Economic Development Bond Program

Established in the 2009 stimulus legislation, the Tribal Economic Development Bonds (TEDB) program authorizes tribes to issue up to $2 billion in bonds for economic development purposes, with each tribe selected for participation eligible to issue as much as $30 million.

Unlike previous tribal bonds, this provision does not require bonded projects to fulfill an "essential government function," and thus can be used for a wide variety of initiatives including tourism development, convention facilities, golf course, and marinas. Tribes contend the provision brings them into parity with state and local government bond provisions.

The bonds are not always put to the best use. Thanks in part to the new tax free bond provision, the Salt River Pima-Maricopa Indian Community in Arizona constructed the new spring training facility for Major League Baseball's Colorado Rockies and the Arizona Diamondbacks. With twelve baseball fields, including an 11,000 seat central stadium, two soccer fields, clubhouses, separate workout facilities for both teams, and a theater, the Salt River Fields complex is conveniently located near the tribes' Talking Stick Resort, casino, and golf course.[29]

The New York Times describes the new facility this way: "Simply put, it's the nicest spring training facility in the majors." Legendary former Yankees manager Joe Torre gushed, "This is amazing. I've never seen anything like this in a major league place, much less a spring training facility. It's incredible. It's enormously impressive, it really is."[30]

[28] Congressional Research Service R41639, "Empowerment Zones, Enterprise Communities, and Renewal Communities: Comparative Overview and Analysis," February 14, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41639&Source=search#_Toc286402530.
[29] Website at Salt River Fields at Talking Stick, "Tribes, Teams Dedicate Grand Opening of Salt River Fields, http://www.saltriverfields.com/media/news-archive/11-02-11/Tribes_Teams_Dedicate_Grand_Opening_of_Salt_River_Fields.aspx, accessed June 27, 2011.
[30] Kepner, Tyler, "Salt River Fields, the New Spring Sensation," New York Times, February 26, 2011, http://bats.blogs.nytimes.com/2011/02/26/salt-river-fields-the-new-spring-sensation/, accessed June 27, 2011.

Also, these bonds are provided for the development of certain facilities associated with casinos. Although Congress in the Recovery Act excluded gaming as a permitted use of TED Bonds, the IRS opened a very large loophole, as the prohibition does not explicitly extend to ancillary facilities, such as a hotel, if they are structurally independent. As such, a hotel built on top of the casino would be ineligible, but a hotel built next to the casino would qualify – even though they serve exactly the same function.

This proposal would prohibit the further issuance of any new bonds under the program. Eliminating this provision could save $400 million over the next ten years.[31]

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[31] Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718. A significant portion of the money could be saved by shutting this program down immediately and stopping the issuance of any new bonds. According to the IRS, there have been significant forfeitures in the bond program.

END SPECIAL INTEREST CORPORATE TAX BREAKS

The Historic Preservation Tax Credit and the Preservation Credit for Rehabilitation of Non-Historic Structures

Millions of dollars in tax benefits were recently used to fund the $27 million development of a beer garden and microbrewery at a former Coca-Cola syrup plant in St. Louis.[32] This included $14.4 million of financing for the project provided through a HUD-insured mortgage. The project also benefited from $1.25 million in state brownfields credits, $2.8 million in tax-increment financing, and a $5.3 million federal historic preservation tax credit.[33]

The brewery, a beer tasting room and a beer garden were developed in a 12,000 square feet building. In addition to the brewery there are 77 apartment units along with 16,000 square feet of commercial space available.

The $18-$20 million conversion of Milwaukee's historic Loyalty Building into a Hilton Garden Inn is also expected to be financed in part with federal historic preservation tax credits. The 6-story building was purchased for $1.7 million in March – an amount less than half of the tax credit the developer would receive if the final project cost is $20 million.[34]

A similar $40 million project is expected to utilize these tax credits in Buffalo to renovate the Lafayette Hotel, after it was added to the National Register of Historic Places in August. The redevelopment project will see the upper floors converted into 115 one and two-bedroom apartments and a 34-room boutique hotel will occupy the second floor.[35] Prior to the renovation, the building was home to a number of social services organizations that used the rooms for "short-term emergency housing clients."[36]

Current law provides for two separate tax credits for historic preservation of structures.[37] One of them is applied to structures certified by the National Park Service as historic structures on the National Register of Historic Places or by the Secretary of Interior. This subsidy is expected to total $500 million in federal funds for fiscal year 2011 (including $400 million for corporations) and $600 million in fiscal year 2012.[38] There is no upper limit on the amount of rehabilitation expenditures that can be claimed.

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[32] Kelly Robert, "Beer garden, microbrewery set to open at old Coke plant," *Post-Dispatch* (St. Louis, MO), May 27, 2011, http://www.stltoday.com/business/local/article_14056c5f-5086-5fef-a26f-e4e0d98ff791.html, accessed June 29, 2011.
[33] Information verified by the Office of Sen. Tom Coburn in phone call to Steins Broaday, June 24, 2011.
[34] Daykin, Tom, "Developer hopes to begin downtown Hilton project by September, Journal-Sentinel (Milwaukee WI), June 13, 2011, http://www.jsonline.com/business/123789464.html, accessed June 29, 2011.
[35] Website of Buffalo Rising, "Termini Purchases Lafayette Hotel," May 21, 2011, http://www.buffalorising.com/2011/05/termini-purchases-lafayette-hotel.html, accessed June 29, 2011.
[36] Meyer, Brian, "First steps taken to aid Termini plans," *Buffalo News*, August 10, 2010, http://www.buffalonews.com/city/article20023.ece.
[37] Internal Revenue Code, Section 47.
[38] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

Additionally, there is a historic preservation tax credit for other structures not certified as historic. The credit provides up to 10 percent of renovation and rehabilitation costs for individuals and corporations for non-residential buildings built before 1936.[39] This subsidy is expected to total $200 million in federal funds for fiscal year 2011 (including $100 million for corporations) and $300 million in fiscal year 2012.[40] There is no upper limit on the amount of rehabilitation expenditures that can be claimed.

These tax credits are highly duplicative of numerous other federal grant programs allowing federal funds to be used for promotion of historic preservation, such as the Community Development Block Grant, the National Community Development Initiative, and USDA's Rural Development program.

Many states have a similar state tax credit in place, including:

- Minnesota, which has a 20 percent tax credit in addition to the federal tax credit;[41]
- Wisconsin, which has a 5 percent tax credit in addition to the federal tax credit;[42]
- Rhode Island had one that has been at least temporarily discontinued because of fraud and budget concerns;[43] and
- Michigan had one that was recently eliminated.[44]

These tax credits are duplicative and subsidize projects eligible for other government funding or that can be supported through private sources. Eliminating these two tax credits would result in savings of more than $7.6 billion over the next ten years.[45]

NASCAR Tax Break

The cost of NASCAR tracks or "motorsports entertainment complexes" can be written off over seven years.[46] One of the main beneficiaries of this tax subsidy is the International Speedway Corp, owners of the Daytona Speedway and 11 other NASCAR tracks.[47] Estimates have put the company's benefit from this provision at approximately $38 million.[48]

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39 Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

40 Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

41 Bjorhus, Jennifer, "Developers line up for historic tax credit," *Star-Tribune* (Minneapolis, MN), June 15, 2011, http://www.startribune.com/business/123642889.html, accessed June 29, 2011.

42 Website of the Wisconsin Historical Society, "Historic Preservation Tax Credits for Income-Producing Historic Buildings," http://www.wisconsinhistory.org/hp/architecture/iptax_credit.asp, accessed June 29, 2011.

43 Mackay, Scott, "Reinstate the Historic Preservation Tax Credit," *WRNI*, June 13, 2011, http://www.publicbroadcasting.net/wrni/news.newsmain/article/0/13/1814624/Top.Stories/Reinstate.the.historic.preservation.tax.credit, accessed June 29, 2011.

44 Website of National Public Radio, "Coltrane House, Chicago Hospital Called Endangered," June 15, 2011, http://www.npr.org/templates/story/story.php?storyId=137189590, accessed June 29, 2011.

45 Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718.

46 McMurray, Jeffrey, "Lawmakers Aim to Protect NASCAR Tax Break," *Associated Press*, May 11, 2004.

47 Park, Clayton, "Fan loyalty to sponsors' products fuels NASCAR success," February 20, 2011, http://www.news-journalonline.com/business/local-business/2011/02/20/fan-loyalty-to-sponsors-products-fuels-nascar-success.html, accessed June 23, 2011.

48 Website of the Center for American Progress, "Congressman Join Chorus for Calling for Tax Expenditure Scrutiny," June 18, 2010, http://www.americanprogress.org/issues/2010/06/tax_expenditure_scrutiny.html, accessed June 23, 2011.

In order to qualify for the special seven-year recovery period, the racing track facility must be permanently situated on land and host a racing event within thirty-six months of its completion.[49] These businesses can also use a 15 year depreciation schedule for "land improvements" if the venue hosts an event within thirty-six months of its completion.[50] The provision encompasses all facilities including grandstands, and food and beverage concession stands.[51] Local track owners have received plenty of other tax breaks from states and other local authorities eager to keep the speedway in their community.[52] The depreciation schedule in the tax code for similar non-residential real property is typically 15 to 39 years.[53]

The IRS previously questioned whether these types of racetracks belong in the same tax category as amusement parks until Congress interceded on NASCAR and other track owners' behalf.[54] Since 2004, this provision has been extended several times, and would cost $400 million over the next decade.[55]

Dog and Pony Show Tax Breaks

Foreigners who gamble at horse and dog tracks in the United States were once subject to a withholding tax on their winnings, though no longer.[56] In 2004, Congress eliminated the tax for bets placed by foreign bettors on live horse or dog races in the United States through certain wagering pools if the wager was initiated from outside the United States.[57] Supporters and detractors contend this provision assists these tracks with their Internet betting operations.

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[49] Website of the Joint Committee on Taxation, "Technical Explanation Of The Revenue Provisions Contained In The Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010, December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3716, June 23, 2011.

[50] Website of the Joint Committee on Taxation, "Technical Explanation Of The Revenue Provisions Contained In The Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010, December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3716, June 23, 2011.

[51] Website of the Joint Committee on Taxation, "Technical Explanation Of The Revenue Provisions Contained In The Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010, December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3716, June 23, 2011.

[52] Graves, Will, "Kentucky Speedway to get tax breaks with Cup race," Associated Press, February 17, 2009, http://www.usatoday.com/sports/motor/2009-02-17-4071969232_x.htm, accessed June 23, 2011.

[53] Website of Taxpayers for Common Sense, "Holiday Honey Baked Hams – Special Interest Carveouts at the End of the Year," http://www.taxpayer.net/user_uploads/file/FederalBudget/TaxPolicy/Top_Special_Interest_Carveouts_EndofYear2010.pdf, accessed June 23, 2011.

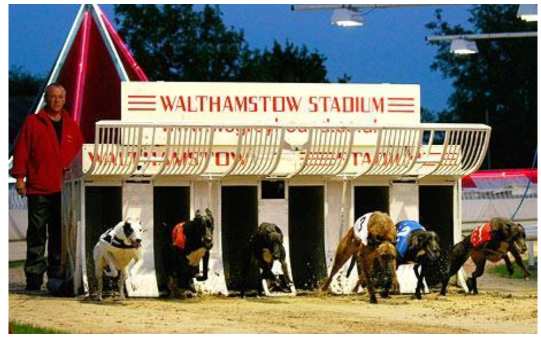
[54] McMurrary, Jeffrey, "Lawmakers Aim to Protect NASCAR Tax Break," *Associated Press*, May 11, 2004.

[55] Website for Joint Committee on Taxation, "Estimated Budget Effects Of The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3715, accessed June 23, 2011; Estimate by staff of Senator Tom Coburn.

[56] Norris, Floyd, "Multinational Companies Get a Tax Break, as Do Foreign Gamblers," New York Times, October 15, 2004, http://www.nytimes.com/2004/10/15/business/15norris.html?_r=1&scp=2&sq=Multinational%20Companies%20Get%20a%20Tax%20Break&st=cse, June 21, 2011.

[57] Website of IRS.gov, "Gambling winnings from Dog and Horse racing," http://www.irs.gov/publications/p519/ch03.html#en_US_publink1000222289, accessed June 20, 2011.

The provision exempts a certain type of betting known as as pari-mutuel. Rather than placing a bet against the track, pari-mutuel betting allows horse racing bettors to wager against each other. This type of betting system allows payouts to range from less than the amount wagered "to astronomical amounts."[58] A horse or dog racing track then takes a minimal commission from all wagers as a handling fee.[59]



Some have raised concerns that the consumer behavior promoted by this type of tax subsidy may be harmful to the economy. According to the *Federal Communications Law Journal*, "Internet gambling deprives state and local governments of valuable tax revenues required to maintain services. Internet gambling also forces consumers to pay higher fees and interest rates as a result of uncollectable gambling debts."[60]

Some news reports from 2003 claim this tax earmark was inserted in a key tax bill at the behest of powerful lawmakers for parochial interests. [61] Ending this provision would save $30 million dollars over the next ten years.[62]

Hollywood Tax Breaks

Designed as an incentive to encourage Hollywood to produce feature films and television programs in the United States, entertainment companies may currently elect to deduct up to $15 million in certain costs associated with the production of television episodes and movies where at least 75 percent of the compensation costs are for work performed on U.S. soil.[63] [64] Allowing Hollywood to benefit from this accelerated cost recovery results in federal revenue losses of at least $30 million a year.

While benefitting from special tax treatment, the entertainment industry is not lacking in privately generated revenue. The year's top grossing film, Hangover Part II, brought in more than $232 million less than one month after hitting theaters. With a production budget of $80 million, the film netted a profit in its first weekend, as moviegoers spent more than $85 million to catch the latest installment of this series.[65] Likewise setting new records was *Harry Potter and the Deathly Hallows, Part 2*, which set an opening day record of $92.1 million and $168.6 in its first weekend.[66] Despite a tough economy, taxpayers are still choosing to spend their own money at the

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[58] Website of the Sports Geek, "Pari-Mutuel Horse Racing Betting Explained," http://www.thesportsgeek.com/sports-betting/horse-racing/pari-mutuel-betting/, accessed June 20, 2011.
[59] Website of the Sports Geek, "Pari-Mutuel Horse Racing Betting Explained," http://www.thesportsgeek.com/sports-betting/horse-racing/pari-mutuel-betting/, accessed June 20, 2011.
[60] Hammer, Ryan D., "Does Internet gambling strengthen the U.S. economy? Don't bet on it," *Federal Communications Law Journal*, December, 2001.
[61] McKinney, Joan, "Louisianians and tax cuts," *Sunday Advocate (Baton Rouge, LA)*, May 25, 2003.
[62] Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement For H.R. 4520, Fiscal Years 2005 – 2014," October 7, 2004, http://www.jct.gov/publications.html?func=startdown&id=1618, accessed June 20, 2011; Staff estimate from the Office of Senator Coburn (Provision phases out in 2014.)
[63] Joint Committee on Taxation, "General Explanation of Tax Legislation Enacted in the 111th Congress," March 2011.
[64] The deduction jumps to $20 million if production took place in areas eligible for designation as a low-income community.
[65] BoxOfficeMoJo, The Hangover Part 11, accessed June 19, 2011, http://boxofficemojo.com/movies/?id=hangover2.htm.
[66] Bowles, Scott, "'Harry Potter' finale shatters weekend record," *USA Today*, July 17, 2011, http://www.usatoday.com/life/movies/news/2011-07-18-box-office-july-18_n.htm.

box office. They should not be forced to pay for Hollywood flicks twice – once at the box office and once with a federal subsidy program for a multi-billion dollar a year industry.

Hollywood film production is also being subsidized through state tax incentives in nearly 40 states—to the tune of $1.5 billion in 2010, according to the Center on Budget and Policy Priorities (CBPP), which suggests states consider scaling back their Hollywood tax breaks.[67] According to the Motion Picture Association, only 11 states do not provide "significant tax incentive for [entertainment] production."[68] However, in light of chronic budget shortfalls, many states are now considering eliminating these tax subsidies altogether.[69]

It is unclear if these incentives, whether at the state or federal level, actually pay for themselves by bringing in enough revenue during production to offset the cost of the multi-million dollar write offs and tax breaks. An independent commission in the state of Missouri recommended eliminating the credit in 2011, stating "This tax credit serves too narrow of an industry and fails to provide a positive return on investment to the state. There is currently no long term opportunity for the location of production facilities for films in Missouri."[70] CBPP echoes this sentiment, saying, "The revenue generated by economic activity induced by film subsidies falls far short of the subsidies' direct costs to the state. To balance its budget, the state must therefore cut spending or raise revenues elsewhere, dampening the subsidies' positive economic impact."

Unlike Washington, many states are forced to live within their means and cannot run large deficits to fund low-priority spending during an economic downturn. Congress should follow their lead and eliminate this tax break for a highly profitable industry in little need of taxpayer support—other than their purchase of popcorn and movie tickets on a Friday night. Eliminating this provision could save more than $1 billion over ten years.[71]

Indian Employer Tax Credit

When businesses locate on Indian reservations they can qualify for enhanced accelerated depreciation rules for property and an employment tax credit when they hire tribal members. The original intent was to spur economic development on reservations, among the most isolated and depressed economies in the nation.[72]

The tax credit is available to employers for up to $20,000 of qualified wages and health insurance costs paid by the employer for tribal members. The credit is worth 20 percent of the excess of eligible

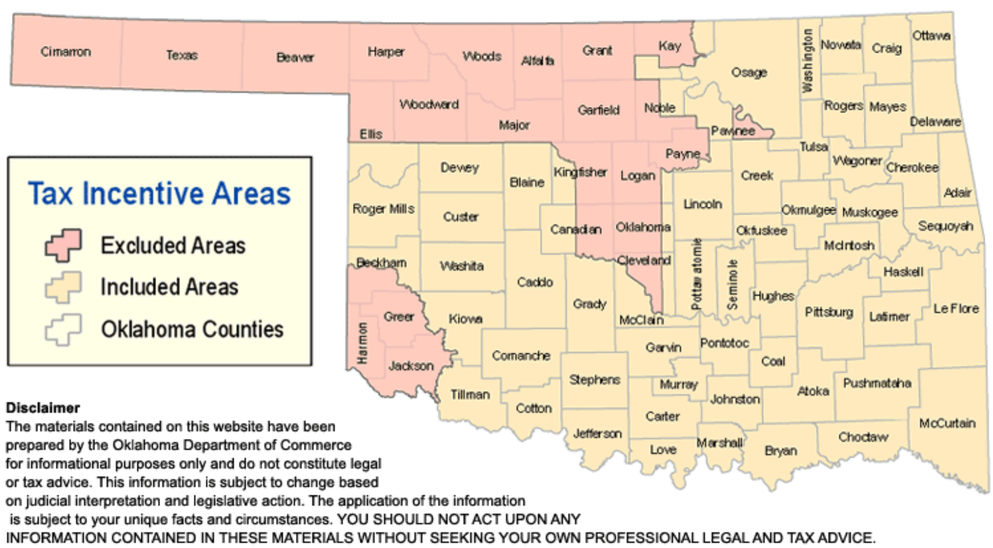
[67] Center on Budget and Policy Priorities, "State Film Subsidies: Not Much Bang For Too Many Bucks," Accessed June 19, 2011, http://www.cbpp.org/cms/index.cfm?fa=view&id=3326.
[68] Website of the Motion Picture Association of America, State by State Statistics, accessed June 19, 2011, http://www.mpaa.org/policy/state-by-state.
[69] Patton, Zach, "The Value of Movie Tax Incentives: States spend billions on incentives to lure film productions away from Hollywood. Some say it's gone too far," *Governing*, June 2010, http://www.governing.com/topics/economic-dev/The-Value-of-Movie-Tax-Incentives.html.
[70] Report of the Missouri Tax Credit Review Commission, November 30, 2010, accessed June 15, 2011, http://tcrc.mo.gov/pdf/TCRCFinalReport113010.pdf.
[71] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.
[72] Website of the Senate Committee on Indian Affairs, "Testimony of Donald Laverdure, Deputy Assistant Secretary, Office of the Assistant Secretary-Indian Affairs, Department of the Interior," January 28, 2010, http://www.indian.senate.gov/public/_files/DonaldLaverduretestimony.pdf, accessed July 1, 2011.

employee wages and health insurance costs this year over the amount of such wages and costs incurred by the employer during 1993.[73]

The law had been amended to include all former Indian reservation lands in Oklahoma, which represents the vast majority of land in the state. However, Oklahoma stands in stark contrast to the reservation economies that prompted the original incentive. Though it is home to 39 tribes, no reservations existed after statehood in 1907. American Indians make up 8.6 percent of the Oklahoma population and the percent of former Indian land in private ownership, 97 percent, is among the highest in the nation.[74] Unemployment, conversely, is among the lowest in the nation at 5.3 percent.[75] Yet, because much of Oklahoma had reservation status prior to statehood, two-thirds of Oklahoma lands qualify for this special tax status—regardless of proximity to tribal communities

Oklahoma Chamber of Commerce and business development officials remain strong proponents of the incentive and believe it to be an important recruiting tool.[76] However, it is unclear whether these types of tax subsidies are successful or not. In describing the Indian Lands Tax Credit and other similar credits, the Congressional Research Service finds, "if the main target of these provisions is an improvement in the economic status of individuals currently living in these geographic areas, it is not clear to what extent these tax subsidies will succeed in that objective."[77]

While supporters may be able to point to a benefit on occasion, the reservation economy still remains in third-world conditions and has generally not seen discernable improvement since this provision was enacted. Ending this provision could save $1 billion over the next 10 years.[78]



[79]

[73] Website of the Joint Committee on Taxation, "Technical Explanation of the Revenue Provisions Contained in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3716, accessed July 1, 2011.
[74] Website of the Oklahoma Department of Wildlife Conservation, "Partners for Fish and Wildlife Program," "http://www.wildlifedepartment.com/landowner/partners.pdf , accessed July 1, 2011.
[75]Website of the Bureau of Labor Statistics, "Local Area Unemployment Statistics, http://www.bls.gov/lau/ , accessed July 1, 2011.
[76] Website of the Oklahoma Department of Commerce, "American Indian Land Tax Credits," http://www.okcommerce.gov/Site-Selection/Incentives/Indian-Land-Tax-Credit, accessed July 1, 2011.
[77] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.
[78] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.

Tree Planting Tax Subsidies

The federal tax code has several breaks for tree planting in the timber industry, including annual expensing and deductions that can provide significant benefits to the industry.

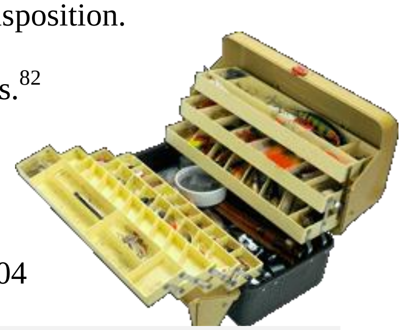
While taxes are deferred until a company harvests its timber, deductions for timber growing expenses can be made at the time of expenditure. Maintenance costs, such as thinning, disease and pest management, and fire costs can be deducted as they occur.[80]

Up to $10,000 in reforestation expenses may also be deducted per taxpayer per unit of property, with amounts over that being amortized over seven years.[81] This allows multiple individuals to claim the same benefit for the same unit of property, which by regulation, only has to be one acre or more in size.

Reforestation expenditures include costs associated with forestation or reforestation by planting, artificial seeding, or natural seeding.

The current expensing provision allows for immediate expensing (especially in light of deferred tax assessment) while other industries may be required to capitalize these costs and amortize them over a longer periods of time or, alternatively, only recover them upon a future disposition.

Eliminating these provisions could save $4.8 billion over the next ten years.[82]



Tackle Box Tax Break

Manufacturers, producers and importers of fishing tackle boxes were required to pay a 10 percent excise tax on all equipment they sold until 2004 when the law was changed, reducing the amount of the tax to only three percent.[83]

The tax code allows multiple individuals to claim the same benefit for the same unit of property

Yet, other sport fishing equipment is still subject to the full excise tax, including manufacturing of fishing rods and poles (capped at $10), fishing reels, lures and hooks. The revenue produced from the tackle boxes and other fishing equipment pays for federal and state sport-fishing programs.[84]

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[79] Website of the Oklahoma Department of Commerce, American Indian Lands Tax Credits, accessed July 5, 2011, http://www.okcommerce.gov/Site-Selection/Incentives/Indian-Land-Tax-Credit.

[80] Website of the Lewis and Clark Law School, "Reflections on the Environmental Impacts of the Federal Tax Subsidies for Oil, Gas and Timber Production," http://www.lclark.edu/live/files/8324-lcb152art2bogdanski, accessed June 27, 2011.

[81] Website of the Lewis and Clark Law School, "Reflections on the Environmental Impacts of the Federal Tax Subsidies for Oil, Gas and Timber Production," http://www.lclark.edu/live/files/8324-lcb152art2bogdanski, accessed June 27, 2011.

[82] Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718.

[83] Website of the Joint Committee on Taxation, "General Explanation Of Tax Legislation Enacted in the 108th Congress," Mary 31, 2005, http://www.jct.gov/publications.html?func=startdown&id=2314, accessed June 24, 2011.

Sports-fishing businesses have paid a federal excise tax on their products for more than 60 years. These funds were initially deposited in the general treasury until 1950. But in that year, sportsmen and businesses teamed with lawmakers to redirect the revenue to the sport-fishing programs. They hoped the program would encourage more people to fish and that the sale of fishing equipment would therefore increase.[85]

In 2009, taxes and duties on the sport-fishing industry totaled $123 million.[86] Over the next ten years, the cost is estimated to be $11 million dollars.[87] Ending this specialty tax break would once again treat tackle boxes the same as other sport fishing equipment.

Eliminate IRS Tax Exemptions for Bailout Recipients

As part of the effort to stabilize the economy the Treasury Department used its authority under the Troubled Asset Relief Program ("TARP")[88] to become a major shareholder in several companies. Through a series of subsequent agency-issued "Notices," the IRS excluded major bailout recipients and their other owners, perhaps improperly, from certain tax obligations for potentially the next 20 years.

Generally, when one company buys another's assets, it does not also acquire its tax losses. In order to limit "trafficking" in tax losses, the tax code limits a buyer's ability to use the Net Operating Losses ("NOLs") of a loss corporation it buys. The limits apply whenever the stock owned by shareholders holding 5 percent or more in the loss corporation increase by 50 percentage points within a three-year period. These limits then restrict the amount of the NOLs the firm can use to an amount equal to "(A) the value of the old loss corporation, multiplied by (B) the long-term tax-exempt rate."[89]

From 2008 to 2010, the Treasury Department issued a series of "Notices"[90] exempting firms in specified industries from the statutory restrictions under section 382:

- Notice 2008-100 declared that an acquisition by Treasury of acquired stock in a loss corporation would not trigger 382 limitations.[91]
- Notice 2009-14 purported to "amplify" 2008-100, and explicitly covered the auto industry.[92]

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[84] Website of the Joint Committee on Taxation, "General Explanation Of Tax Legislation Enacted in the 108th Congress," Mary 31, 2005, http://www.jct.gov/publications.html?func=startdown&id=2314, accessed June 24, 2011.
[85] Website of the Association of Fish and Wildlife Agencies, "Financial Returns to Businesses from the Federal Aid in Sport Fish Restoration Program," March 3, 2011, http://www.fishwildlife.org/files/SportFish-Restoration-ROI-Report_2011.pdf, accessed June 24, 2011.
[86] Website of the Association of Fish and Wildlife Agencies, "Financial Returns to Businesses from the Federal Aid in Sport Fish Restoration Program," March 3, 2011, http://www.fishwildlife.org/files/SportFish-Restoration-ROI-Report_2011.pdf, accessed June 24, 2011.
[87] Website of the Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 4520 The 'AMERICAN JOBS CREATION ACT OF 2004,' Fiscal Years 2005 – 2014," October 7, 2004, http://jct.gov/publications.html?func=startdown&id=1618, accessed June 24, 2011.
[88] Emergency Economic Stabilization Act of 2008, P.L. 110-343, 122 STAT. 3765, Sec. 101(c)(5)
[89] 26 U.S.C. § 382(b)(1)
[90] In Revenue Ruling #90-91, the IRS announced that pursuant to the Revenue Reconciliation Act of 1989, all notices and announcements issued by the Service and published in the Internal Revenue Bulletin are considered authority and may be relied upon to the same extent as a revenue ruling or revenue procedure.
[91] Internal Revenue Bulletin 2008-44. November 3, 2008.
[92] Internal Revenue Bulletin 2009-7. February 17, 2009. Subsequently amplified and superseded by Notice 2009-38, May 4, 2009.

- Notice 2010-2 declared that for purposes of the 5 percent rule above, (1) stock previously held by treasury should be treated as if it had never been outstanding; and (2) Treasury selling stock to a new public group would not be considered to have increased the Group's ownership.[93]

CFO.com reported the final notice as Treasury anticipating the situation that would arise with a GM IPO and "fixing a snag" in advance.[94]

As a response to Notice 2010-2, legislation was introduced, which would have deemed that Internal Revenue Service Notice 2010-2 shall have no force and effect of tax law. It would have also amended the Internal Revenue Code of 1986 to restrict the authority of the Secretary of the Treasury to prescribe regulations under section 382 of such Code. This legislation did not become law.

These carve-outs provide special benefits to just three companies: General Motors, AIG and Citigroup—all major recipients of TARP funding. Although some argue the carve-outs will result in additional above the line revenue for the Treasury upon the sale of these assets, there is no guarantee of this. Instead, repealing these notices immediately would prevent any further significant revenue loss from these TARP recipients, which could avoid paying more than $90 billion combined in taxes because of this special tax treatment.[95]

3 Major Recipients

General Motors: ("Old GM") was a publicly traded auto manufacturer that reported losses of $88 billion between 2005 and 2009. Over the course of 2008, the Treasury loaned "Old GM" $49.5 billion. When "Old GM" declared bankruptcy in June, 2009, the Treasury took a 61 percent stake in the assets of "New GM." GM's re-organization was conducted as a "363-sale" under the bankruptcy code,[96] limiting creditors' rights and allowing it to reform as a "G reorganization," which allowed "New GM" to absorb many of "Old GM's" assets and liabilities tax-free, most notably the NOL carry-forwards and other credit carryovers.[97] "New GM" stands to avoid as much as $45.4 billion in taxes because of the Treasury Department's exemptions.[98]

American International Group ("AIG"): AIG is a publicly traded insurance company that received $85 Billion from the Federal Reserve in September, 2008, giving the U.S. Government a 79.9 percent stake in the company. AIG received an additional $37.8 billion securities agreement later that month, followed by a $40 Billion share purchase with TARP funds in November. At its peak, the U.S. Government owned 92 percent of AIG. Following a recent share sale, the U.S. Treasury's stake has now been reduced to 77 percent. AIG officials have touted the tax benefits as "a source of funds," and accumulated over $25.6 billion in NOL carry-forwards and other tax-deferred assets.[99] A slideshow prepared for the company's first quarter earnings call indicates some of the accumulated tax assets do

[93] Internal Revenue Bulletin 2010-2. January 11, 2010.
[94] Willens, Robert, "Treasury Fixed Snag Prior to GM IPO", CFO.com website. September 27, 2010.
[95] This plan assumes $45 billion in prevented revenue loss from this recommendation.
[96] 11 U.S.C. § 363
[97] 26 U.S.C. § 382(g)
[98] Smith, Randall and Sharon Terlep, "GM Could Be Free of Taxes for Years." *The Wall Street Journal*, November 3, 2010.
[99] Buhayar, Noah. "AIG Joins Citigroup, GM in Deferred Tax Asset Hall of Fame." *Bloomberg News*. July 8, 2011.

not need to be used until 2030.[100] Chief Financial Officer David Herzog said on a recent AIG earnings call ,"We're really not going to pay much income tax to the U.S."[101]

Citigroup ("Citi"): Citi is a publicly traded bank that received $25 billion from the original TARP lending program in October, 2008. In November, it received an additional $20 billion, through Treasury's Capital Purchase Program ("CPP"), along with a loss sharing agreement with Treasury, the Federal Reserve, and the FDIC. The Treasury received $27 billion in preferred stock and warrants in exchange, giving it a 34 percent stake in Citi. University of Cincinnati Tax Law Professor Paul Caron called the issuance of Notice 2010-2 a $38 billion tax break for Citi in exchange for a partial repayment of TARP funds.[102] Although Citi has now repaid much of its TARP money and the Treasury has sold its remaining stake in the bank, Citi has expressed an intention to use $23.2 billion in NOL carry-forwards and other credit carryovers this year.[103]

Railroad Tax Credit

In 2003, Congress passed legislation to temporarily offer a tax credit to certain railroad companies for railroad track maintenance expenses incurred in 2005, 2006, and 2007. The purpose of this credit was to encourage the rehabilitation, rather than the abandonment, of short-line railroads (Class II or Class III), which were spun off in the deregulation of railroads. Qualified railroad track maintenance expenditures were eligible for a 50-percent business tax credit up to a limit of $3,500 times the number of miles of railroad track owned by an eligible taxpayer.

While the credit expired at the end of 2009, it was retroactively extended to cover both 2010 and 2011 last December.[104] As a result of the extension, total revenue loss is expected to be $232 million in 2011 and $99 million 2012.[105]

This provision substantially lowers the cost of track maintenance for the qualifying short-line railroads, with tax credits covering half the costs for those firms and individuals. For example, with the recent extension of the credit, Iowa Interstate Railroad (IAIS) announced an increase of $4.5 million in the infrastructure portion of its capital spending program for 2011 from $9.5 million to $14 million.[106] The American Short Line and Regional Railroad Association compiled a document detailing projects that utilized the tax credit. The document shows many of the projects were finished, but also that their benefits should have been funded by the projects' beneficiaries. As an example, one completed project reduced "operating costs and transit times." Another project "will support streamlined operations, as

[100] American International Group 1st Quarter 2011 Results Conference Call. Available at http://www.aigcorporate.com/investors/May_2011/1Q11%20Earnings%20Release%2005-05-2011_Final.pdf
[101] Ovide, Shira. "AIG: We're Practically Tax Free!" *The Wall Street Journal*, May 6, 2011.
[102] "IRS Eased NOL Rules for Citigroup in Exchange for Repayment of TARP Funds." Taxprofblog. December 16, 2009. Available at: http://taxprof.typepad.com/taxprof_blog/2009/12/irs-eased-nol.html
[103] Buhayar, Noah. "AIG Joins Citigroup, GM in Deferred Tax Asset Hall of Fame." *Bloomberg News.* July 8, 2011.
[104] Public Law 111-312.
[105] Website of the Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," December 10, 2010, http://jct.gov/publications.html?func=startdown&id=3715, accessed June 29, 2011.
[106] Website of Rail Resource, "Tax Credit Extension Gives Boost to Iowa Interstate Railroad's Capital Projects, January 31, 2011, http://www.railresource.com/content/?p=1148, accessed June 29, 2011.

well as an increase in rail traffic resulting from the opening of a new Archer Daniels Midland dry mill ethanol facility … that will employ 80 people and generate an additional 30,000 carloads per year."[107]

Proponents argue this tax credit is necessary to ensure short railroad lines, many of which were previously abandoned, are kept in good repair. The increase in functional short lines is said to provide more transportation options for manufacturers and farmers.

Unfortunately, such tax credits also substitute the judgment of Congress for that of the market by favoring certain modes of transportation, such as short-line railroad, over other transportation methods. If improving a rail line will lower operating costs for a railroad, this should provide an ample incentive for the railroad to pay for these improvements. If a nearby ethanol plant wants to increase the amount of ethanol it transports, it should decide how best to accomplish this goal. As the Congressional Research Service finds, "In general, special subsidies to industries and activities tend to lead to inefficient investment allocation since in a competitive economy businesses should earn enough to maintain their capital."[108]

Any government involvement should be through local citizens who are concerned with the economic well-being of their community and elect to pay their state or local taxes to fund these specific capital improvements. Repealing this tax credit would enable more efficient allocation of private funds to address transportation needs and result in savings of $2.3 billion over ten years to taxpayers.[109]

<u>Tax Break for Eskimo Whaling Captains</u>

Eskimo whaling captains have braved the frigid arctic waters for decades to hunt the bowhead whale. They are also given significant support for this from U.S. taxpayers.

Traditionally, the captains of the boats are paid in whale meat and "muktuk – blubber and skin – and, by custom, donate most of the meat to [the] community."[110] But as modern times have made whale hunting more expensive, out-of-pocket costs for weapons and whale boat upkeep for the whaling captains increased.[111]

Despite the fact that commercial whaling is banned in U.S. territorial waters,[112] after seven years of lobbying by elected officials from Alaska, Congress decided to provide a tax benefit to whaling captains, effective in 2005. Specifically, the tax code now allows Native Alaskan whaling captains to claim up to a $10,000 per year charitable tax deduction to offset their equipment and fuel and certain

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[107] Website of the American Short Line and Regional Railroad Association, "Section 45G," 2011 Edition, "http://www.aslrra.org/45Gsuccess.pdf, accessed June 29, 2011.
[108] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.
[109] Website of the Joint Committee on Taxation, "Estimated Budget Effects of the 'Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," December 10, 2010, http://jct.gov/publications.html?func=startdown&id=3715, accessed June 29, 2011.
[110] Morgan, Dan, "Engineering a Tax Break for Eskimo," *Washington Post*, July 25, 2009, http://juneauempire.com/stories/072599/Loc_taxbreak.html, accessed June 25, 2011
[111] Morgan, Dan, "Engineering a Tax Break for Eskimo," *Washington Post*, July 25, 2009, http://juneauempire.com/stories/072599/Loc_taxbreak.html, accessed June 25, 2011
[112] Congressional Research Service, Response to Office of Senator Coburn, "Deductibility of Certain Expenses and Exemption for Certain Gambling Winnings," July 11, 2011.

other costs for the annual subsistence whale hunts generally in the Beaufort Sea. The charitable deduction is offered even though the hunting activities are not otherwise charitable within the meaning of the tax code, and donations of whale meat are not required to be made to a charitable organization.[113]

The provision was first proposed in 1997 because of an IRS ruling that prevented whaling captains from deducting their hunting costs from their taxes.[114] However, only certain individuals who are recognized as whaling captains by the Alaska Eskimo Whaling Commission get the break.[115] This year, tax preparation officials in Alaska with Jackson Hewitt, have seen "out of the norm returns" for the deduction.[116] Ending this tax break could save taxpayers $4 million over the next ten years.[117]

Brownfields Tax Break

Non-profit organizations are subject to taxes under the unrelated business income tax (UBIT) for activities that are not part of their original tax-exempt purpose. Gains from the sale of assets that were debt-financed in part are subject to the UBIT in proportion to the debt. Currently, qualifying brownfield properties[118] remediated and sold to another party are exempt from this tax.

The exclusion from the tax reduces the cost of remediating and reselling brownfields by tax exempt organizations using debt finance. The savings would typically be 35 percent of the gain in value. The provision targets areas in distressed urban and rural communities that can attract the capital and enterprises needed to rebuild and redevelop polluted sites. This provision was added by the American Jobs Creation Act of 2004 (P.L. 108-357) to address what was considered by some to be an unintentional effect of UBIT on tax exempt entities' ability to invest and redevelop environmentally contaminated real estate.

This expensing provision for businesses enables companies to deduct brownfield remediation costs against income in the year incurred, instead of capitalizing them over several years.[119] The deduction applies to both the regular and the alternative minimum tax. This subsidy is intended to encourage investment and redevelopment of brownfields. According to the Congressional Research Service, this tax subsidy is primarily viewed as an instrument of community development.

[113] Website of Alaska Digest, "Sen. Murkowski Says Eskimo Whaling Captains Tax Credit Will Help Protect Historic Whaling, Subsistence In Alaska," October, 2004, http://www.alaska-sites.com/akdigestemailnews102004o.htm, accessed June 25, 2011.
[114] Website of Alaska Digest, "Sen. Murkowski Says Eskimo Whaling Captains Tax Credit Will Help Protect Historic Whaling, Subsistence In Alaska," October, 2004, http://www.alaska-sites.com/akdigestemailnews102004o.htm, accessed June 25, 2011.
[115] Collins, Margaret, "Whaling or Hosting Exchange Student Lets U.S. Taxpayers Claim Deductions," *Bloomberg News*, April 18th, 2011, http://www.bloomberg.com/news/2011-04-18/whaling-or-hosting-exchange-student-lets-u-s-taxpayers-claim-deductions.html, accessed June 25, 2011.
[116] Collins, Margaret, "Whaling or Hosting Exchange Student Lets U.S. Taxpayers Claim Deductions," *Bloomberg News*, April 18th, 2011, http://www.bloomberg.com/news/2011-04-18/whaling-or-hosting-exchange-student-lets-u-s-taxpayers-claim-deductions.html, accessed June 25, 2011.
[117] Website of the Joint Committee on Taxation, "Estimated Budget Effects of the Conference Agreement for H.R. 4520 The 'American Jobs Creation Act of 2004,' Fiscal Years 2005 – 2014," October 7, 2004, http://jct.gov/publications.html?func=startdown&id=1618, accessed June 24, 2011.
[118] Brownfield Properties include any property that is held for use in a trade or business and on which there has been an actual or threatened release or disposal of certain hazardous substances.
[119] Internal Revenue code Section 198.

While this provision was set to expire in 2000, Congress has instead increased program eligibility and repeatedly extended it, most recently in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.[120]

Because only companies with more than $10 million in annual revenue must file an additional tax form to claim environmental remediation costs on their tax returns (other businesses just combine these costs with other expenses they can write off), the funding data in the past is incomplete. However, according to the IRS, 184 companies filed the separate tax form and claimed $574 million in tax benefits for the last available tax year, 2008.[121]

The Congressional Research Service has echoed concerns that this "expensing is inefficient because it makes investment decisions based on tax considerations rather than inherent economic considerations."

CRS also noted some question the effectiveness of the provision: "The effectiveness of that tax subsidy has been questioned, as … the main barrier to development appears to be regulatory rather than financial… Barring such regulatory disincentives, the market system ordinarily creates its own incentives to develop depressed areas, as part of the normal economic cycle of growth, decay, and redevelopment. As an environmental policy, this type of capital subsidy is also questionable on efficiency grounds."[122]

These concerns should be further considered, given the numerous other federal programs intended to aid cleanup and redevelopment efforts of brownfields. Congress should eliminate these duplicative initiatives and focus on ensuring the remaining federal programs do not overlap. Additionally, Congress should revisit current federal regulations of brownfields to ensure federal law does not penalize good-faith attempts to remediate such areas of blight. Ending these tax breaks will save at least $3.2 billion over the next ten years.[123]

Low Income Housing Tax Credit

As one of the purest examples of a direct spending assistance program run through the tax code, the Low Income Housing Tax Credit (LIHTC) provides more than $5 billion annually in tax credits for the development of affordable housing. Recipients of the credit often sell the credit to investors who in turn develop housing for upper low-income tenants. Over a period of ten years, the nonrefundable credit compensates companies for roughly 70 percent of their investment, [124] and this reimbursement can reach nearly 90 percent of the private companies' costs.

Using the tax code to promote affordable housing is both inefficient and duplicative of countless programs at the Department of Housing and Urban Development, which provides other forms of federal assistance to help those in need of housing. As a tax credit, the money is funneled first to the companies taking advantage of the tax break, and much of the federal funds are lost to administrative

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[120] Consolidated Appropriations Act, 2001 (P.L. 106-170).

[121] E-mail from the Internal Revenue Service, June 30, 2011.

[122] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

[123] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.

[124] CRS RS22389, "An Introduction to the Design of the Low-Income Housing Tax Credit," Congressional Research Service, September 17, 2010, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL34591&Source=search#fn23.

costs and payouts to private companies instead of being applied directly to the housing projects. An audit by the state of Missouri, which provides an additional state tax credit with the LIHTC, found that "For every $1 in LIHTC authorized and issued, the current tax credit model provides only about $.35 towards the development of housing. The remaining $.65 goes to investors, syndication firms, and to the federal government in the form of increased taxes resulting from the use of state tax credits."[125]

The same audit found that a portion of funding for the housing projects even came from other federal sources, including federal loans and even more tax credits—the historic preservation credit and the affordable housing credit.[126] In these cases the LIHTC is also driving up the cost of other federal programs.

In addition, the LIHTC does not necessarily help meet the needs of those who are very poor and most in need of housing assistance. Specifically, recipients of the credit are required to ensure their rents can be paid by those earning 50 to 60 percent of local median incomes. As a result, these subsidized properties are often available mostly to the higher end of those living in affordable housing who are most likely to make the rental payments every month to the private companies receiving the federal benefit.[127]

Despite decades of federal funding to combat homelessness, many are still without a place to call home. Unfortunately, it is unclear if this expensive tax spending program increases the net supply of available affordable housing, or merely replaces already existing housing structures starting to age. The Congressional Budget Office explains, "the low-income housing credit, like other supply subsidy mechanisms, is unlikely to increase substantially the supply of affordable housing. Subsidized housing largely replaces other housing that would have been available through the private, unsubsidized housing market."[128] Ending this duplicative and inefficient tax program is estimated to save at least $57 billion over the next ten years.[129]

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[125] Susan Montee, Missouri State Auditor, Report No. 2008-23, "Analysis of Low Income Housing Tax Credit Program," April 2008, http://www.auditor.mo.gov/press/2008-23.pdf.
[126] Susan Montee, Missouri State Auditor, Report No. 2008-23, "Analysis of Low Income Housing Tax Credit Program," April 2008, http://www.auditor.mo.gov/press/2008-23.pdf.
[127] Joint Center for Housing Studies of Harvard University, "Long-Term Low Income Housing Tax Credit Policy Questions," November 2010, http://www.jchs.harvard.edu/publications/governmentprograms/long-term_low_income_housing_tax_credit_policy_questions.pdf.
[128] Congressional Research Service Staff Memorandum, "The Cost-Effectiveness of the Low-Income Housing Tax Credit Compared with Housing Vouchers," April 1992, http://www.cbo.gov/ftpdocs/62xx/doc6216/doc09b.pdf.
[129] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.

Reforming Expensive Exemptions and Deductions

Reform the Home Mortgage Interest Deduction & End the Deduction for Vacation Homes

One of the most popular provisions in the tax code is the home mortgage interest deduction, even though it is claimed by only about a quarter of all tax filers.[130] For the millions of Americans who claim the deduction every year, though, it helps offset the cost of owning a home. Under current law, homeowners can deduct the interest paid on home mortgages for primary residences and vacation homes loans of up to $1 million, and also on an additional $100,000 home equity line of credit. This is one of the most expensive tax breaks in current law, resulting in lost federal revenue of nearly $88 billion in fiscal year 2011.[131]

While most assume the mortgage interest deduction largely benefits middle and lower income earners, economist Martin Sullivan points out this is actually not the case. Sullivan asserts, "The tax benefit provided by the mortgage interest deduction flows overwhelmingly to rich families like those portrayed in the hit television series Beverly Hills, 90210."[132] Data from the Internal Revenue Service further emphasizes this discrepancy. In 2008 alone, millionaires[133] across the country took advantage of more than $7 billion in mortgage interest deduction tax breaks.[134] Sullivan explains the disparity, "First, the rich have larger houses and larger mortgages than the poor. Second, the deduction is available only to itemizers. While almost all high-income taxpayers itemize deductions on their returns, very few of the poor do. Finally, the rich have much higher marginal income tax rates than the poor."[135]

The provision of the mortgage interest deduction relating to second homes further highlights that those benefitting from this tax break are among the most well off. Even a yacht can be considered a second residence—as long as the luxury boat has a "sleeping, cooking, and toilet facility" and an individual lives in it for at least two weeks a year.[136]

The *Seattle Post-Intelligencer* exposed numerous examples of vacationers wrongly taking advantage of this deduction, also noting the IRS does little to verify boat-owners actually meet the requirements to consider these floating vacation getaways a second home. In one case, the newspaper found a Seattle businessman who was able to "declare his yacht a second home for tax purposes … allowing him to reduce his income by $19,200, the amount he pays in interest on the loan. "According to the paper, he also deducted the

[130] Fleenor, Patrick, "Tax Savings from Mortgage Interest Deduction Vary Significantly from State to State," Fiscal Facts, Tax Foundation, May 25, 2010, http://www.taxfoundation.org/publications/show/26341.html.
[131] Office of Management and Budget, FY 2012 Budget Submission, Supplemental Materials, Tax Expenditure Spreadsheet: Tables 17-1 to 17-4, accessed June 25, 2011, http://www.whitehouse.gov/omb/budget/Supplemental.
[132] Sullivan, Martin, TaxProf Blog, "The Rich Get 100 Times More Mortgage Subsidy Than the Poor," March 7, 2011, http://taxprof.typepad.com/files/130tn1110.pdf.
[133] Those with an adjusted gross income of over $1 million, as claimed on their tax return.
[134] IRS, Statistics of Income Division, April 2011.
[135] Sullivan, Martin, TaxProf Blog, "The Rich Get 100 Times More Mortgage Subsidy Than the Poor," March 7, 2011, http://taxprof.typepad.com/files/130tn1110.pdf.
[136] Website of the Internal Revenue Service, Publication 936, Part 1, accessed June 25, 2011, http://www.irs.gov/publications/p936/ar02.html.

annual $3,600 state registration fee, and between the two tax breaks, was able to lower his tax bracket from 36 to 32 percent, greatly reducing his annual tax bill.[137]

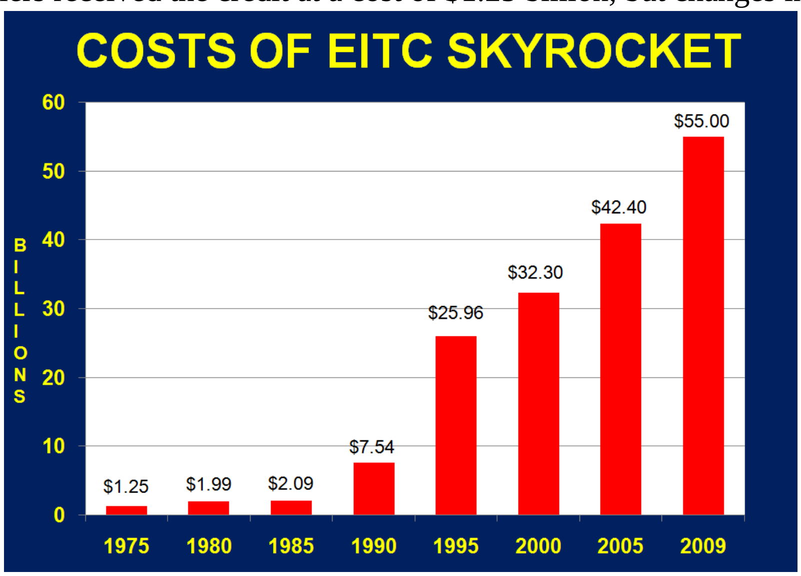
Reforms are needed to ensure this deduction is not abused to provide tax breaks for vacation homes, yachts, and mansions. Instead, this deduction should be directed to help those in the middle own their home. As proposed by the President's National Commission on Fiscal Responsibility and Reform,[138] eliminating the deduction for second homes and equity lines of credit, combined with lowering the cap for the primary deduction to homes worth $500,000, will better target the mortgage deduction to those with the most need, while resulting in significant savings.

Enacting these reforms could save more than $187 billion over the next ten years.[139]

Earned Income Tax Credit: Allow Up To Five Years of Benefits for Recipients

Congress created the Earned Income Tax Credit (EITC) in 1975 as a small temporary program designed to reduce the tax burden on working low-income families and "to encourage them to seek employment rather than welfare."[140] Three years later, Congress made the program a permanent welfare program.

When the EITC started, 6.2 million filers received the credit at a cost of $1.25 billion, but changes in the 1990s caused the cost of the program to skyrocket. One study found "between 1990 and 1996 the program more than doubled in real terms" and "much of this increase in costs is driven by the increase in the number of recipients — in 1995, 19 million filers received the EITC, 160 percent more than 10 years earlier."[141]



The program is now one of the largest federal welfare programs with 24 million people filing to receive a total of $55 billion worth of tax credits during tax year 2009.[142]

[137] Nalder, Eric, "Declaring your boat a second home can bring big tax relief," *The Seattle Post-Intelligencer*, November 10, 2004, http://www.seattlepi.com/local/article/Declaring-your-boat-a-second-home-can-bring-big-1159212.php#ixzz1QJsx1UUY.
[138] National Commission on Fiscal Responsibility and Reform, "Moment of Truth, Report of the National Commission on Fiscal Responsibility and Reform," December 1, 2010, http://www.fiscalcommission.gov/news/moment-truth-report-national-commission-fiscal-responsibility-and-reform. The Commission plan included this recommendation as part of the illustrative comprehensive tax reform proposal detailed on page 31 of the report.
[139] Estimate provided by the Joint Committee on Taxation.
[140] "Improper Payments in the Administration of Refundable Tax Credits," Testimony of the Honorable J. Russell George Treasury Inspector General for Tax Administration before the Committee on Ways and Means Subcommittee on Oversight U.S. House of Representatives, May 25, 2011.
[141] "Redistribution and Tax Expenditures: The Earned Income Tax Credit," Eissa, Nada & Hoynes, Hilary, National Tax Journal, June 2011, http://www.econ.ucdavis.edu/faculty/hoynes/publications/Eissa-Hoynes-NTJ-2011.pdf .

Since the tax credit is refundable, an EITC recipient does not need to owe taxes to receive the benefits. If an individual's income does not exceed a certain level, he or she can receive a credit in the form of a direct payment. As a result of credits like EITC, "30 percent of tax-filing units received more from the federal government in tax credits than the amount of their income tax liability."[143] When an individual receives the EITC as a refund payment it is scored as an outlay, meaning money leaves the federal Treasury, just as with a discretionary spending program. This portion of the program EITC resulting in spending through the tax code of more than $54 billion in 2010.[144]

It is also possible for individuals receiving a tax rebate check to obtain other federal assistance. In addition to the refundable portion of the EITC, hundreds of billions of dollars in federal assistance is directed toward these same low-income individuals through programs such as Medicaid, Supplemental Nutrition Assistance Program, Supplemental Security Income, Pell Grants, Temporary Assistance for Needy Families, the additional (refundable) Child Tax Credit, and Section 8 Housing Choice Vouchers. Many individuals can qualify for most or all of these programs at the same time. According to the Congressional Research Service (CRS), "The federal government spent almost $708 billion in fiscal year 2009 on programs for the low-income, and nearly $578 billion the previous year."[145]

The following CRS chart (Figure 1) shows the percentage of filers eligible for EITC who also reported receiving federal assistance from other welfare programs such as SNAP and WIC benefits. The diagram shows that a significant proportion of EITC recipients are likely receiving other welfare benefits. CRS also explains "EITC is generally not counted as income, nor as a resource, in determining eligibility or benefits in federal need-tested programs."[146] This proposal recommends a change in this policy, requiring EITC benefits be considered as income for such purposes.

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[142] "Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year," Treasury Inspector General for Tax Administration, February 7, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf .

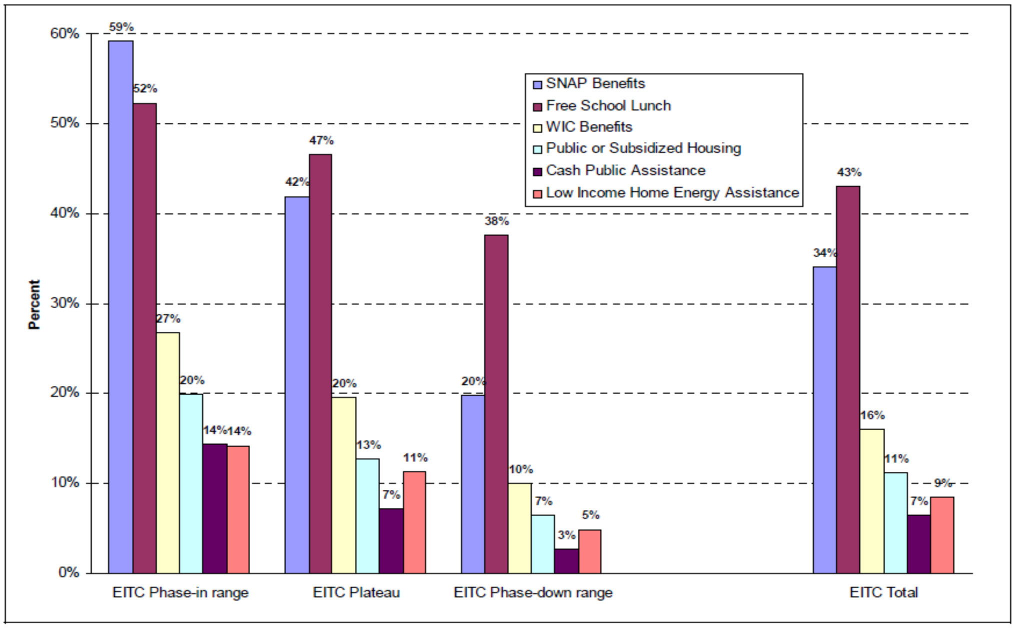
[143] "Obamacare Tax Subsidies: Bigger Deficit, Few Taxpayers, Damaged Economy," The Heritage Foundation, Winfree, Paul, May 24, 2011, http://www.heritage.org/research/reports/2011/05/obamacare-tax-subsidies-bigger-deficit-fewer-taxpayers-damaged-economy.

[144] OMB Data Table 32-1: http://www.whitehouse.gov/omb/budget/Analytical_Perspectives.

[145] "Federal Benefits and Services for People with Low Income: Programs, Policy, and Spending, FY2008-FY2009," Congressional Research Service, Spar, Karen, January 31, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41625&Source=search.

[146] EITC Recipient Receipt of Selected Need-Tested Benefits, Congressional Research Service June 30, 2011.

Figure 1. Head of Household Tax Filers, with One or More Children, Qualifying for the EITC, by Household Receipt of Selected Need-Tested Benefits in 2009



Source: Estimates prepared by the Congressional Research Service (CRS) based on analysis of data from the U.S. Census Bureau's 2010 Annual Social and Economic Supplement to the Current Population Survey (CPS/ASEC).

In part, EITC was designed to help those at the lower end of the economic scale by effectively re-paying their payroll taxes and thus providing an incentive to keep working even at low paying jobs as they transitioned into the working world to eventually become self-reliant. However, as the program grew, the general purpose started to change from an anti-poverty program to an entitlement welfare program. Studies have found the program is not completely transitional, but is being used for long-term support. Up to 20 percent of EITC claimants receive the credit for over five years.[147]

Unfortunately, the EITC program has also become a target of abuse and scams, which only further take away from those it was meant to serve while draining taxpayer resources. According to the Treasury Inspector General for Tax Administration (TIGTA), "the Government Accountability Office (GAO) has listed the Earned Income Tax Credit (EITC) Program as having the second highest dollar amount of improper payments of all federal programs."[148] Little if any progress has been made in fixing the problem in the last decade since agencies were required to report improper payments to the Congress.[149] The IG estimates between 23 and 28 percent of EITC payments are improper each year. GAO recently reported $16.9 billion in improper payments were made through EITC program in 2010. This represents a massive increase "from approximately $12 billion in 2009."[150]

[147] "Income Mobility and the Earned Income Tax Credit: Short-term Safety Net or Long-term Income Support," Dowd, Tim & Horowitiz, John, April 11, 2011, pg: 2 http://pfr.sagepub.com/content/early/2011/04/06/1091142111401008.

[148] "Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year," Treasury Inspector General For Tax Administration, February 7, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

[149] "Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year," Treasury Inspector General For Tax Administration, February 7, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

[150] "Improper Payments in the Administration of Refundable Tax Credits," written statement of Nina E. Olson, May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/Olsen_Testimony.pdf

The Treasury IG also stated, "While the IRS has implemented some of our recommendations, it has not taken actions to address key recommendations aimed at preventing/reducing EITC improper payments."[151] One instance of fraud in Wisconsin involved an individual who filed multiple fraudulent tax returns and claimed earned income tax credits over many years. It is estimated he received about $3.2 million in federal earned income tax credit refunds.[152]

Limiting the time an individual can claim the EITC will help ensure the program acts primarily "as a safety net for workers experiencing temporary income and employment shocks,"[153] not a permanent entitlement program. Limiting this tax benefit to no more than five years may also reduce the amount of improper payments made by the government and prevent some fraud and abuse. This proposal assumes savings of $65 billion over the next ten years. Specifically, the plan recommends EITC be reformed to phase in allowing recipients to receive the benefit for a maximum of five years and directs the IRS to implement reforms proposed by the TIGTA to reduce improper payments in this program.[154]

Additional Child Tax Credit: Require Proper Beneficiary Identification

The Additional Child Tax Credit (ACTC) is the refundable portion of the child tax credit and is directed to individuals with very little or no other tax liabilities.[155] Millions of individuals are able to obtain the tax credit without a valid Social Security Number (SSN). Instead they use an Individual Taxpayer Identification Number (ITIN), which is available even to those that are "not authorized" to work in the United States.[156] In 2000, a total of 62,000 ITIN filers with claims totaling $62 million in the additional child tax credit. By 2010 the number grew to 2.3 million ITIN filers claiming a total of $4.2 billion[157] in tax credits.[158] In total, $22.7 billion in ACTC credits were distributed in 2010.[159]

ITIN number fraud is a growing concern. The Treasury IG explained, "Billions of dollars in ACTC are being provided to ITIN filers without verification of eligibility, and IRS employees have raised concerns about the lack of an adequate process for identifying and addressing improper claims."[160]

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[151] Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year," Treasury Inspector General For Tax Administration, February 7, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201140023fr.pdf

[152] "Tax Credits often benefit wrong people," Werner, Mary Jo, June 6, 2011, http://lacrossetribune.com/news/opinion/article_cd9657c0-8ec7-11e0-a5d7-001cc4c03286.html

[153] "Distinguishing Between Short-Term and Long-term Recipients of the Earned Income Tax Credit," Dowd, Timothy, National Tax Journal December 2005.

[154] Estimate by Staff of Senator Coburn.

[155] Website of the Internal Revenue Service, "Ten Facts about the Child Tax Credit," http://www.irs.gov/newsroom/article/0,,id=106182,00.html, accessed June 14, 2011.

[156] Treasury Inspector General for Tax Administration, "Testimony before the House Ways and Means Subcommittee on Oversight-Improper Payments in the Administration of Refundable Tax Credits," May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/George_Testimony.pdf, accessed June 14, 2011.

[157] Changes made to the ACTC in the Stimulus bill are in place through 2012. It is unclear whether those loosened requirements will be extended into 2013. That would increase the total estimated cost above the staff estimate.

[158] Treasury Inspector General for Tax Administration, "Testimony before the House Ways and Means Subcommittee on Oversight-Improper Payments in the Administration of Refundable Tax Credits," May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/George_Testimony.pdf, accessed June 14, 2011.

[159] Treasury Inspector General for Tax Administration, "Testimony before the House Ways and Means Subcommittee on Oversight-Improper Payments in the Administration of Refundable Tax Credits," May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/George_Testimony.pdf, accessed June 14, 2011.

[160] Treasury Inspector General for Tax Administration, "Testimony before the House Ways and Means Subcommittee on Oversight-Improper Payments in the Administration of Refundable Tax Credits," May 25, 2011, http://waysandmeans.house.gov/UploadedFiles/George_Testimony.pdf, accessed June 14, 2011.

Over 60,000 ITINs were assigned and used on multiple tax returns processed in 2008.[161] Seventy percent of these ITIN numbers should never been issued due to shady documentation provided by the applicants.[162] Just like Social Security numbers, ITIN numbers are supposed to be "specific to individuals and should be issued to and used only by that individual."[163]

The use of the ITIN numbers has been controversial for some time because of its susceptibility to fraud. In 2003, a number of states decided to allow ITIN numbers for use on driver's licenses, instead of Social Security numbers. In response, Henry O. Lamar, Jr., IRS Wage and Investment Division Commissioner, wrote a letter to each state motor vehicle department discouraging this practice stating that the IRS does not "subject ITIN applicants to the same rigorous document verification standards as Social Security number or visa/passport applicants."[164]

Ending the ACTC for individuals without a valid SSN would save at least $8.9 billion over five years,[165] with potential savings of $17.8 billion over ten years.[166] The IRS should also be given more authority by Congress to deny fraudulent claimants.

Reform the Tax Treatment of Employer-Provided Health Insurance

Tax benefits have played an important part in providing health care to millions of Americans for over 60 years. However, excesses in the current benefit structure have actually increased the cost of health care for many, especially the uninsured. Currently, those with the most generous employment benefits gain the most from the existing tax structure. This can be addressed with simple reforms to the employer-provided health exclusion to provide a more balanced benefit to everyone and greater fairness.

Americans receiving health insurance from their employer also benefit from preferential treatment under the tax system, compared with individuals who purchase health insurance on their own. Under current federal law, health insurance coverage provided to individuals by their employers does not count toward employees' income for purposes of determining their federal income taxes. This tax treatment of health coverage is referred to as the "employee exclusion" for employer-sponsored insurance (ESI), since the employer's payment of the health coverage is excluded for tax calculation purposes. Considering the average cost of ESI in 2010 was approximately $13,770 for family coverage, this exclusion results in significant tax savings for many employees while reducing government tax revenues by more than $150 billion annually.[167]

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161 Website of the Treasury Inspector General for Tax Administration, "Individual Taxpayer Identification Numbers Are Being Issued Without Sufficient Supporting Documentation" (Report No: 2010-40-005), December 8, 2009, http://www.treasury.gov/tigta/auditreports/2010reports/201040005fr.pdf, accessed June 14, 2011.

162 Website of the Treasury Inspector General for Tax Administration, "Individual Taxpayer Identification Numbers Are Being Issued Without Sufficient Supporting Documentation" (Report No: 2010-40-005), December 8, 2009, http://www.treasury.gov/tigta/auditreports/2010reports/201040005fr.pdf, accessed June 14, 2011.

163 Website of the Treasury Inspector General for Tax Administration, "Individual Taxpayer Identification Numbers Are Being Issued Without Sufficient Supporting Documentation" (Report No: 2010-40-005), December 8, 2009, http://www.treasury.gov/tigta/auditreports/2010reports/201040005fr.pdf, accessed June 14, 2011.

164 Website of the National Immigration Law Center, "The IRS Individual Taxpayer Identification Number: An Operational Guide to the ITIN Program," 2004, http://www.nilc.org/immsemplymnt/ITINs/ITIN_Paper_2004-web.pdf, accessed July 5, 2011.

165 Website of the Treasury Inspector General for Tax Administration, "Semi-annual Report to Congress, October 1, 2008 – March 30, 2009," http://www.treasury.gov/tigta/semiannual/semiannual_mar2009.pdf, accessed June 14, 2011.

166 Estimate made by the staff of Senator Coburn.

167 Kaiser Family Foundation, "Family Health Premiums Rise 3 %" http://www.kff.org/insurance/090210nr.cfm , June 2010.

While the employer-based tax health benefit initially helped encourage and expand the number of individuals with health coverage, economists from across the political spectrum argue the current tax treatment of health benefits is one key driver of rapidly rising health care costs. The unlimited tax exclusion for employer-provided health coverage hides the true cost of insurance from those covered by it, undermines the health care market, and contributes to more expensive care and more costly insurance for many. Respected economist Roger Feldman explains:

> "Currently, [employer-sponsored insurance] ESI premiums are exempt from income and payroll taxes, while insurance purchased by individuals and self-employed workers lacks some or all of these tax privileges. ESI has many advantages… but these advantages are supported by an inefficient and unfair tax subsidy. These conclusions are not controversial among health economists, who agree, virtually unanimously, that excluding ESI premiums from taxable compensation causes workers to demand more insurance than they would in the absence of that exclusion. There is also general agreement that this higher level of coverage leads to inefficiently high levels of health care spending, and finally, that the tax subsidy is 'upside-down' with the largest subsidies going to high-income taxpayers. I believe there is also general agreement that the tax subsidy should be reformed so that it does not encourage consumption of more insurance on the margin, and so it should not disproportionately benefit high-income taxpayers."[168]

Careful reforms to the tax treatment of health coverage are long overdue. Targeted reform addressing three significant problems with the current ESI employee exclusion could lower costs, and improve health care, while also generating revenue.

Current Tax Treatment Contributes to Increasing Costs

From the president's economists to Nobel Laureate Milton Freidman, many policy experts and academics agree the tax treatment of health coverage contributes to inefficiency, increased levels of insurance and increased utilization, and rising health care spending.

The nonpartisan Congressional Research Service explains, "One criticism of the exclusion for employer-provided health insurance is that it reduces the after-tax cost of insurance to workers in ways that are not transparent, likely resulting in their obtaining more coverage than they otherwise would. Not being explicitly capped or limited in some other manner, it does little to restrict the generosity of the insurance or annual premium increases. The exclusion thus contributes to what some economists consider an excess of insurance coverage and a significant welfare (or efficiency) loss for insured individuals and society as a whole."[169]

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[168] House Ways and Means Committee Website, "Hearing Video",http://waysandmeans.house.gov/hearings.asp?formmode=view&id=7416 , June 2010.

[169] CRS Report: RL 34767, "The Tax Exclusion for Employer-Provided Health Insurance: Issues for Congress", Congressional Research Service, January 4th 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL34767&Source=search.

These tax subsidies increase consumer demand and encourage certain behaviors or decisions that would otherwise be realized without the subsidy. The director of the Congressional Budget Office, Doug Elmendorf, said, "many analysts would agree that the current tax exclusion for employment-based health insurance—which exempts most payments for such insurance from both income and payroll taxes—dampens incentives for cost control because it is open-ended."[170]

The Tax Policy Foundation likewise concludes, "Insulation from the full costs of health care—and the lack of transparency in the trade-off between wages and benefits—may drive up overall health care costs by spurring greater demand for health insurance that combines benefits, networks, and management features in more expensive ways than employers and employees might otherwise demand. This can drive up overall health care costs."[171]

A similar critique was offered by Nobel prize winning economist, Milton Freidman, who said: "The high cost and inequitable character of our medical care system are the direct result of our steady movement toward reliance on third-party payment…. The ideal way to do [reverse course] would be to reverse past actions: repeal the tax exemption of employer-provided medical care."[172] The tax code effectively subsidizes the purchase of health insurance by making it artificially inexpensive for a consumer related to what they pay out of pocket for other goods or services. The critique is not an ideological one, however, as one liberal economist also acknowledged, saying "no health expert today would ever set up a health system with such an enormous tax subsidy to a particular form of insurance coverage."[173]

The distorting impact of the employee tax exclusion for health coverage can be quantified. According to estimates from the Tax Policy Center, "even when we adjust for medical price inflation as recorded by increases in medical insurance premiums — which has far outstripped overall price growth — the employer exclusion still grows in real terms between 1988 and 2002 (a 36 percent rise)."[174] The gross size of the employee exclusion makes it effectively one of the largest tax subsidies in federal law.

Current Tax Treatment Is Inequitable, Regressive

There is a second reason to reform ESI, related to how it treats lower-income individuals, compared to top income-earners. As one economist explained, "the tax exclusion of employer expenditures from individual taxation ….is a regressive entitlement, since higher income families with higher tax rates get a bigger tax break; about three-quarters of these dollars go to the top half of the income distribution."[175] In other words, the current tax treatment of ESI is inequitable, generally yielding a larger tax benefit for higher-income Americans who receive more generous benefits, compared with lower-income Americans who receive less. The Tax Policy Foundation further details this shortfall of the health exclusion:

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[170] Senator Coburn Website, "What Experts Have Said About the Tax Treatment of Health Insurance," http://coburn.senate.gov/public/index.cfm/files/serve?File_id=2cedd12f-36dd-4c15-b63e-c6963654c55a , Page 1, June 2010.
[171] "Changes to the Tax Exclusion of Employer-Sponsored Health Insurance Premiums", Tax Policy Center, June 2010, http://www.taxpolicycenter.org/uploadedpdf/411916_tax_exclusion_insurance.pdf.
[172] Hoover Institute Stanford University, "How to Cure Health Care", http://www.hoover.org/publications/digest/3459466.html , June 2010.
[173] Senate Finance Committee Website, "Hearing Testimony", http://finance.senate.gov/hearings/testimony/2008test/073108jgtest.pdf , June 2010.
[174] "Growth in the Exclusion of Employer Health Premiums", Tax Policy Center, June 2005, http://www.taxpolicycenter.org/UploadedPDF/1000794_Tax_Fact_6-27-05.pdf .
[175] Senate Finance Committee Website, "Hearing Video", http://finance.senate.gov/hearings/testimony/2008test/073108jgtest.pdf, June 2010.

> "The current tax exclusion is regressive. Because it reduces taxable income, the exclusion is worth more to taxpayers in higher tax brackets than to those facing lower tax rates. Not taxing a $10,000 premium, for example, saves a taxpayer in the 35 percent top tax bracket $3,500 but reduces the tax bill for someone in the 15 percent tax bracket by just $1,500. In addition, the value of the tax exclusion is greater for those with higher incomes, who tend to have jobs with richer benefits, and smaller for lower-income employees, who are much less likely to have ESI coverage. Thus, the current tax exclusion disproportionately subsidizes those with higher incomes."

This is another area where analysts of all political stripes find significant agreemnt. Len Nichols, director of the health policy program at the New America Foundation has said the current tax treatment of employer-sponsored health insurance "is highly regressive (because this particular tax break is worth more to people who make more and have higher income tax rates and because high-income Americans are more likely to have employer-sponsored health insurance than those with lower incomes.). Eliminating or capping the employer tax exclusion is one option that could play a substantial role in financing comprehensive reform."[176] Meanwhile, Robert Helms of the American Enterprise Institute agrees: "The tax subsidy is regressive, offering more benefits to those with higher incomes… This distribution also helps to explain the political popularity of the tax exclusion. The policy gives more to those who have higher incomes and who work for firms that offer health insurance – a powerful bloc of voters."[177]

Current Tax Treatment Depresses Wages

The current tax treatment of ESI also effectively depresses wages. Employee compensation includes not only an employee's salary, but any additional benefit contributions from their employer (life insurance, health insurance, parking benefits, etc.). As has been shown, employees benefitting from ESI currently receive disproportionate compensation through the employer share of their health care. The diversion of employer dollars from salaries to benefits effectively depresses net wages. CRS explains: "There is general understanding about these matters—it is reasonable to assume that much of the employer contribution is actually borne by workers through reduced wages."[178] In fact, one significant reason wages have stagnated in real dollars in recent decades is due to employers shifting compensation dollars toward health care coverage under ESI, which in turn feeds the disconnect between employees and their health care choices.

Policy Reform Realizes Savings, Realigns Incentives

Because the current tax treatment of health insurance inflates costs, depresses wages, and is regressive, this proposal caps the tax benefit of the individual employee exclusion at $7,500 for individual premiums and $15,000 for premiums for families. The policy would start in 2013 and the cap would remain frozen through 2017, growing with a mix of health inflation and consumer inflation thereafter. This cap is well above the average premium levels for employer-sponsored health insurance in 2010 of $5,050 for an individual and $13,770 for families.

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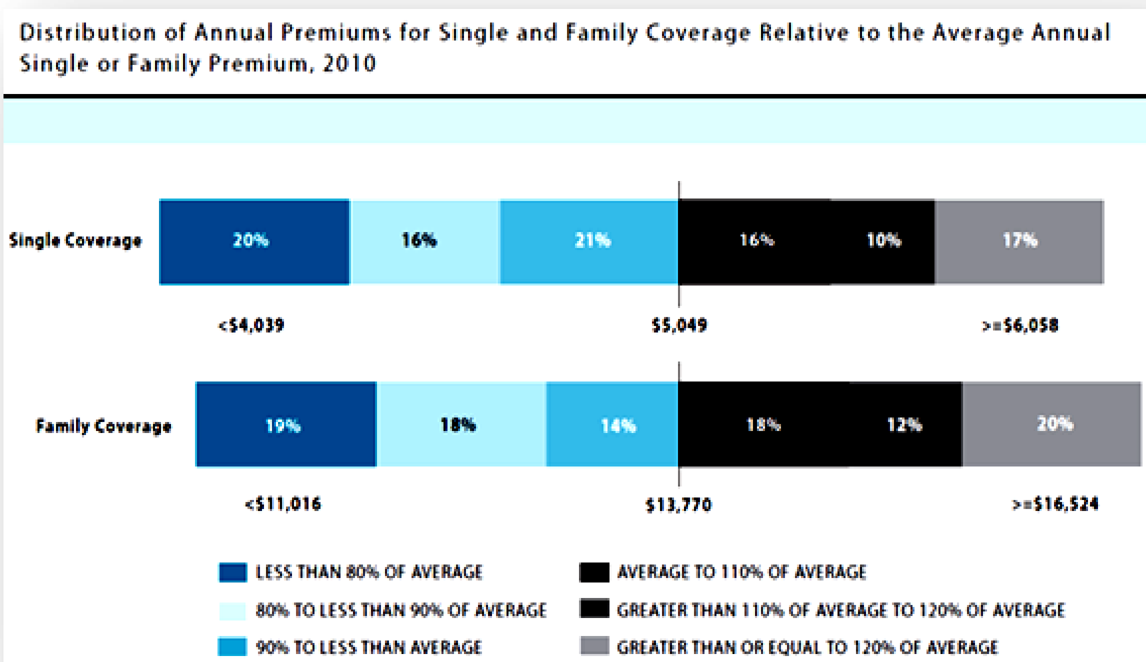
[176] "Health Politics: Continuing the Employer Tax Exclusion Debate", New America Foundation, June 2010, http://www.newamerica.net/blog/new-health-dialogue/2008/health-politics-getting-whole-story-employer-sponsored-insurance-6098/ .
[177] "Tax Reform and Health Insurance", American Enterprise Institute, June 2005, http://www.aei.org/publications/filter.all,pubID.21921/pub_detail.asp.
[178] CRS Report: RL 34767, "The Tax Exclusion for Employer-Provided Health Insurance: Issues for Congress", Congressional Research Service, January 4th 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL34767&Source=search

This proposal is similar to the one put forward by the bipartisan National Commission on Fiscal Responsibility and Reform, which recommended capping the exclusion at the 75th percentile of premium levels in 2014, with cap frozen in nominal terms through 2018 – though unlike the Commission plan, this plan does *not* phase out the tax exclusion.[179] As the Commission noted, "reducing … the exclusion for employer-provided health insurance will help decrease growth in health care spending, according to virtually all health economists."[180]

Implementing this reform to the health tax exclusion could save more than $200 billion over the next decade.[181] The cap grows with a blend of health and consumer inflation, providing a long-term approach to helping reduce the distortion in the tax code. This approach is balanced, maintaining the majority of the tax preference from the current ESI exclusion, but also putting downward pressure on health spending. Over the longer term, this reform has the effect of encouraging some individuals and families to choose lower cost plans.



The Kaiser Family Foundation and Health Education Research and Trust, "Employer Provided Benefits, 2010."[182]

Implement Chained CPI

Many provisions throughout the tax code are automatically adjusted each year based on inflation, including the size of the standard deduction to income bracket thresholds and exemption amounts.[183]

[179] The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, page 31. *http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf*
[180] The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth*, December 2010, page 36. *http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf*
[181] Staff estimate.
[182] Page 29, http://ehbs.kff.org/pdf/2010/8085.pdf

As with other government programs also adjusted for inflation, the consumer price index (CPI) is applied to some in the tax code. For more than 15 years, many budget experts have agreed the current CPI mechanism outpaces actual inflationary growth, causing the cost of government programs to rise rapidly, needlessly adding to the deficit.[184] As the CBO Director Doug Elmendorf explained last year, "According to many analysts…the CPI overstates increases in the cost of living because it does not fully account for the fact that consumers generally adjust their spending patterns as some prices change relative to other prices."[185]

The Bureau of Labor Statistics developed a more accurate measure of inflation, known as Chained CPI, which over the last ten years has grown at a slightly slower rate than the current measure for CPI.[186] As a more accurate measure of inflation, it is only appropriate it be applied government-wide, even throughout the tax code. The nonpartisan Congressional Budget Office explains, "Indexing allows those tax parameters to grow over time in nominal terms but keeps them relatively stable in real (inflation-adjusted terms). …Indexing with that lower measure would increase the amount of income subject to taxation over time and thus result in higher tax revenues."[187]

The *Washington Post* editorial board points out in their support of a government-wide transition to Chained CPI, noting academics and economists across the political spectrum agree this is an area of government spending and automatic growth that can and should be addressed. The *Post* says, "Among the organizations that have endorsed a switch to the Chained CPI are the president's fiscal responsibility commission (better known as Simpson-Bowles), the Bipartisan Policy Center's Deficit Reduction Task Force, the conservative Heritage Foundation and the liberal Center for American Progress."[188]

Applying Chained CPI to the tax code would save $59.6 billion over the next ten years.[189]

The Foreign Earned-Income Exclusion

Citizens who live and work in other countries are permitted to exclude from U.S. federal income tax up to $92,900 of their foreign earned income.[190] They may also exclude approximately $13,000 in employer-provided housing costs.[191] The combined exclusion of over $100,000 is available even to U.S. citizens who pay no taxes in the country where they are currently working.

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[183] Congressional Budget Office, "Budget Options 2007," Revenue Option 6, page 266, http://www.cbo.gov/ftpdocs/78xx/doc7821/02-23-BudgetOptions.pdf.
[184] Goldwein, Marc and Rosenberg, Adam, Moment of Truth Project, "Measuring Up: The Case for Chained CPI," May 11, 2011, http://crfb.org/sites/default/files/MeasuringUp5_11_2011.pdf.
[185] Congressional Budget Office, Director's Blog, "Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code," accessed July 5, 2011, http://cboblog.cbo.gov/?p=477.
[186] Congressional Budget Office, Director's Blog, "Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code," accessed July 5, 2011, http://cboblog.cbo.gov/?p=477.
[187] Congressional Budget Office, "Budget Options 2007," Revenue Option 6, page 266, http://www.cbo.gov/ftpdocs/78xx/doc7821/02-23-BudgetOptions.pdf.
[188] Editorial, "The Chained CPI, an easy way to save money," *The Washington Post,* May 26, 2011, http://www.washingtonpost.com/opinions/the-chained-cpi-an-easy-way-to-save-money/2011/05/23/AGaYsLCH_story.html.
[189] Estimate provided by the Joint Committee on Taxation.
[190] Internal Revenue Code ("Code") section 911(a)(1), (b)(2); The amount of the foreign earned income exclusion is adjusted annually for inflation. The 2011 inflation adjustment is provided in IRS Revenue Procedure 2010-40, 2010-2 C.B. 663.
[191] Code section 911(a)(2), (c). The amount of the housing-cost exclusion is based on the amount of the foreign earned income exclusion and therefore automatically adjusts for inflation.

A form of the foreign earned income exclusion has existed for decades and long been seen as a way to make American companies overseas more competitive in the global economy by increasing exports and equalizing the tax treatment of employees regardless of where they worked (as most American citizens overseas are taxed by their resident country). However, it is not clear this goal is being met through this tax exemption.

In 2006, more than 300,000 taxpayers lived overseas and reported approximately $36.7 billion in income. About half of this amount was not taxed as a result of this provision. Nearly 60 percent of taxpayers who took advantage of this provision paid no taxes to the United States in 2006.[192]

Regardless of where they live, U.S. citizens with identical incomes should have similar tax liabilities.[193] The Congressional Research Service also found this provision is potentially a subsidy for business because it "subsidizes employers sending employees overseas" and it "may work against U.S. domestic interests by encouraging highly compensated U.S. citizens to work overseas…expatriating U.S. intellectual capital and reducing U.S. tax revenue."[194]

Also of note, citizens working overseas are not just working for American companies. In the 21st century global economy, many Americans are working overseas for non-U.S. companies, yet taking advantage of this tax break. The tax exemption is provided for these employees, but is not necessarily encouraging U.S. competitiveness. In fact, depending on the country, some employees working for non-U.S. companies may not be subject to Medicare and Social Security taxes, in addition to enjoying the income tax exclusion.[195]

Beneficiaries argue they should not be required to pay taxes because they receive limited government services. However, a majority of the discretionary budget of the U.S. government funds the Departments of Defense, State, and Veterans Affairs, as well as interest on the national debt. Clearly American citizens benefit from our embassies and consulates. This includes the significant protection from the United States military through treaties and other international agreements. The U.S. military's global presence with the worldwide deployment of ground troops and constant patrol of naval warships along commercial shipping lanes ought to be paid for by all citizens who benefit from this protection.

U.S. citizens should be allowed to retain the tax credit for the taxes they pay to other governments while overseas, but should be required to include all of the earnings in what they report to the IRS as part of their taxable income. According to the Congressional Budget Office, ending the exclusion would save at least $71.3 billion over ten years.[196]

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[192] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

[193] Website of the Congressional Budget Office, "CBO Budget Options, Vol 2," August, 2009, http://cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf, June 25, 2011, 202.

[194] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

[195] Website of the IRS, "Publication 54: Tax Guide for U.S. Citizens and Resident Aliens Abroad," Department of the Treasury, http://www.irs.gov/pub/irs-pdf/p54.pdf.

[196] Website of the Congressional Budget Office, "CBO Budget Options, Vol 2," August, 2009, http://cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf, June 25, 2011, 202.

The Health Coverage Tax Credit

The Health Coverage Tax Credit (HCTC) is a federal income tax credit that covers most of the cost of qualified health insurance for eligible Americans and their family members. Individuals eligible to claim the credit include those receiving income support or wage subsidies under the federally funded Trade Adjustment Assistance program and individuals between the ages of 55 and 64 receiving payments from the U.S. Pension Benefit Guaranty Corporation, because the government took over their company's failed pension system.

The credit's well-intended purpose is to help offset the cost of health coverage for Americans who may be in unique need due to job loss. However, there is little interest in taking advantage of the credit among the eligible population, eligible participants have other similar federal health benefits to select from, and the credit has extremely costly overhead for an under-utilized program. Meanwhile, the credit is poorly targeted, as some participants earn more than the median income, yet siphon funding from those who need it most.

Despite its high cost to taxpayers, the tax credit is largely underutilized by those who could receive the benefit. For each year the credit has been available, less than 30,000 individuals have participated, out of hundreds of thousands of individuals who potentially are eligible for the credit. For example, in tax year 2008—the most recent year data is available—the program had only 24,790 participants.[197] One reason for low participation is the offer of the credit might be duplicative for individuals already enrolled in other government-funded health programs, such as Medicare, Medicaid, Children's Health Insurance Program, and Federal Employees Health Benefits Program. The law states individuals who receive the credit cannot be *enrolled* in most other federal health programs, but this does not preclude otherwise eligible individuals from being eligible to participate in another federal health program.

Nonpartisan experts note the widespread lack of participation in the Health Coverage Tax Credit program. According to the Congressional Research Service, "data for the HCTC indicate[s] that it is not widely used, raising questions about its effectiveness. At this time it is not clear whether changes to the HCTC program will lead to more taxpayers using the credit, or if participation will always be low."[198]

Even recent changes in the credit program have not boosted enrollment. The stimulus bill directed $150 million be spent through the Department of Labor's Employment and Training Administration (ETA) on "National Emergency Grants." The grants were designed to cover the cost of health insurance coverage for eligible Americans until they could be enrolled in the Health Coverage Tax Credit program. A 2010 report by the Labor Department's Office of Inspector General found as of December 2009, only "3 grants totaling $8 million of the appropriated $150 million had been awarded to 6 states."[199] The Inspector General's office found that "while ETA conducted various outreach activities, these outreach efforts were not completely effective," and noted that their "primary concern was ETA has not determined the need for the full $150 million given the low participation in the program." If participation in the program is low during both a strong economy and during a recession, it certainly highlights the fundamental question of whether or not the program is even needed. In fact,

[197] IRS publication, 2010 Report to the Congress Health Coverage Tax Credit.
[198] Fernandez, Bernadette. The Health Coverage Tax Credit, Congressional Research Service, January 5, 2011 (RL32620). http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL32620&Source=search
[199] http://www.oig.dol.gov/public/reports/oa/2010/18-10-003-03-390.pdf

prior to the stimulus bill, only about 14,000 individuals per month received the tax credit as advance payments.[200]

Canceling the credit will also save in administrative costs, which are significant given the program's low participation. From 2003-2008 the administrative costs for the program were a steep $161 million.[201] In fiscal year 2009 alone, taxpayers paid $28 million to run the program.[202] CRS notes high administrative costs are not limited to just the start-up of the credit program. "Observers of the HCTC have voiced concerns regarding the efficiency with which the program is run," CRS states. Specifically, CRS found that "administrative costs remain high even after a few years of operation," and cited a GAO estimate program administrative costs at nearly one-fifth of total program costs during a five-year period.[203] CRS notes another study "estimated that of the federal funding going towards advance payments in 2007, a full third would be spent on administration," which would leave "only 66 cents for every federal dollar spent on the advance payment component for purchasing health coverage."[204] Additionally, from 2009 through this year, the IRS will spend about $40 million to implement changes to the credit program from the stimulus bill and update its computer systems for the program.[205]

Because the health coverage tax credit is a refundable credit, there is also a question of equity under the law. As a refundable credit, Americans may claim the full credit amount even if they have little or no federal income tax liability. This allows individuals who have not paid any federal income taxes to benefit directly from the subsidy of other Americans whose income taxes fund the program through general revenues. Most participants in the credit program had a bachelor's degree with household income between $35,000 and $74,000.[206] According to the 2010 Census, the national median income is over $50,000. As such, families receiving subsidies could have had income well within—or above—the national average.

Additionally, this special tax break is poorly targeted. The credit currently covers 80 percent of the premium for qualified health insurance purchased by an enrollee, with the enrolled individual responsible for covering the remaining 20 percent of the premium. This level of subsidization exceeds the customary cost-sharing most Americans experience in their employer-based insurance. Additionally, while individuals who benefit from the credit may be enrolled in COBRA insurance, individuals on COBRA who are ineligible for the credit usually pay about 102 percent of the premium cost of their former employer-sponsored health insurance plan. The Congressional Research Service highlights that the current 80 percent subsidy rate is available to all enrollees regardless of income, even though wealthy enrollees can more readily pay for their insurance. "For example," CRS notes, "in the case of a $3,000 self-only policy, the HCTC would provide $2,400 in tax savings to taxpayers with incomes of $50,000, as well as those with incomes of $5,000."

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[200] Fernandez, Bernadette. The Health Coverage Tax Credit, Congressional Research Service, January 5, 2011 (RL32620). http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL32620&Source=search

[201] "Health Care Coverage Tax Credit: Participation and Administrative Costs", Government Accountability Office, April 30 2010, http://www.gao.gov/new.items/d10521r.pdf

[202] IRS publication, 2010 Report to the Congress Health Coverage Tax Credit, page 7.

[203] U.S. Government Accountability Office, *Trade Adjustment Assistance: Most Workers in Five Layoffs Received Services, but Better Outreach Needed on New Benefits*, GAO-06-43, January 2006.

[204] S. Dorn, "Administrative Costs for Advance Payment of Health Coverage Tax Credits: An Initial Analysis," The Urban Institute, March 2007, at http://www.cmwf.org/usr_doc/1017_Dorn_admin_costs_advance_payment_HCTC.pdf.

[205] Government Accountability Office, "Health Coverage Tax Credit: Participation and Administrative Costs," April 30, 2010, available at http://www.gao.gov/new.items/d10521r.pdf.

[206] IRS' 2010 report to the Congress, Health Coverage Tax Credit Survey, page 2.

Unfortunately, more inequities abound. As CRS pointed out, "Unemployed workers who do not receive TAA allowances may question why they are denied the credit, particularly if they too have lost their jobs because of trade competition. Similarly, early retirees whose pensions are not paid in part by the PBGC may question not being eligible for the credit, as may those who receive no pension at all."

While most Americans benefitting from the credit certainly have experienced the true hardship of job loss, taxpayers can do better than to pay for a program with few users, high administrative costs, and entrenched inequities for individuals not enrolled in the program. Eliminating the tax credit would save $1.8 billion over the next ten years.[207]

Exclusion of Certain Allowances for Federal Employees Abroad

Federal government civilian employees who work abroad and pay federal income taxes, but no taxes to a foreign government, are allowed to exclude from income taxes certain cost-of-living special allowances such as housing, travel, and food. The rationale is that costs of living, such as food, fuel, and living expenses for those living abroad are generally higher.[208] However, incomes for federal civilian workers overseas are generally higher than average incomes in the United States, in part because of this discrepancy. As a result, this tax expenditure is not addressing a true need and largely benefits higher-income earners.

There is no similar tax exclusion for federal workers employed in high cost-of-living areas in the United States such as metropolitan areas or other high-cost areas like Hawaii and Alaska. In addition, some federal workers, such as Department of State employees, even earn Washington, D.C. 'locality' pay while serving overseas to compensate for the higher cost of living. It is unclear why federal employees receive both additional salary for a higher cost of living and tax-free benefits for the same reason.

As a result of the hidden costs of this tax provision, federal agencies may not make the most prudent decisions on where to base their personnel. Agency budgets do not include the amount of money lost to the Treasury through these allowances and exemptions. As such, what may appear to be a better deal to taxpayers may actually cost more than another option when the cost of this tax benefit is taken into consideration.

Part of the underlying assumption for this special tax break is that federal employees are driven primarily by financial considerations when looking at overseas employment. But foreign federal jobs also provide the opportunity to live and work in a foreign country with a steady paycheck and benefits. With a nine percent unemployment rate in the United States, it is unlikely federal workers will leave the federal workforce if this tax provision were repealed. However, it is also clear should any federal employees choose to leave such a desirable overseas post, there would likely be plenty of qualified applicants for any such job openings.

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[207] Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718.

[208] Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions," Prepared by the Congressional Research Service, December 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4.

Repealing the exclusion from income taxes certain cost-of-living special allowances such as housing, travel, and food for federal employees is also part of a bipartisan proposal and is included in tax reform legislation sponsored by Senators Ron Wyden (D-Oregon) and Dan Coats (R-Indiana).[209]

In fiscal year 2010 these exclusions cost the federal government $1.6 billion.[210] Eliminating this provision would save $18 billion over the next 10 years.[211]

Transit and Parking Tax Subsidy

Businesses can provide their employees up to a $230 per month in monthly tax-free benefits to commute to work via transit, vanpool, or park their vehicle at work. For bike commuting, employers can provide employees $20 each month.[212]

For parking alone, this perk is expected to cost taxpayers $4.2 billion in fiscal year 2011, and more than $22 billion over five years. For mass transit and van pools, the cost is nearly $800 million in fiscal year 2011 and more than $4 billion over five years.[213]

In 1978, Congress temporarily eliminated this provision but brought it back in 1981. Three years later during the 1984 debate over the Deficit Reduction Act, Congress rewrote tax rules on employee fringe benefits. At the time, the lawmaker remained concerned "that without clear boundaries on the use of these fringe benefits, new approaches could emerge that would further erode the tax base and increase inequities among employees in different businesses and industries."[214]

Federal employees enjoy a similar subsidy for mass transit and parking, but they are directly subsidized to the tune of about $470 million, according to numbers from the Transit Benefit Program. Recently costs have increased significantly because of the upper limit increase for transit benefits.[215]

In 1993, Congress authorized selected federal agencies to elect to pay all or a portion of employees' public transportation costs.[216] In fiscal year 2000, the subsidy program was expanded by Executive Order to all other government agencies.[217] To be eligible to receive the transportation subsidy, employees must use public transportation to commute to and from their offices. DOT manages this program and takes a cut of almost five percent out of the total amount disbursed in subsidies. Most federal workers do not actually pay for parking, but are provided free parking spots—a very valuable perk in cities like Washington D.C. where parking is always at a premium.

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[209] S. 727, "Bipartisan Tax Fairness and Simplification Act of 2011," Introduced in the Senate on April 5, 2011.
[210] Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions," Prepared by the Congressional Research Service, December 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4
[211] Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718.
[212] Website for the National Center for Transit Research, "Commuter Tax Benefits Summary Table," April 22, 2011, http://www.nctr.usf.edu/programs/clearinghouse/commutebenefits/, accessed June 29, 2011.
[213] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011. Total benefit is $25.9 billion over the next five years.
[214] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.
[215] Personal Memo to Senator Tom Coburn, Congressional Research Service, June 14, 2011.
[216] 5 U.S.C. § 7905.
[217] Executive Order 13150, dated April 21, 2000.

In 2006, the Treasury Inspector General for Tax Administration (TIGTA) found the IRS did not adequately verify whether or not employees receiving subsidies were actually eligible for the subsidy or the amount awarded.[218]

With generous benefits such as these, one recipient concluded, "Where can you go for that price, drive all month and have all your maintenance, safety sticker, registration, insurance and not have to pay for it?"[219]

Other states have also instituted similar tax credits. New Jersey has the Urban Transit Hub Tax Credit, which recently incentivized Panasonic to move its headquarters closer to a rail station and reap $102 million in tax credit benefits.[220] New Jersey is currently considering expanding this tax credit to residential buildings as well.[221]

Maryland has a tax credit of up to $50 per month per person for mass transit and van pools.[222] Washington State has a similar tax credit of up to $60 per month,[223] and so does the state of Minnesota.[224]

While employers and employees alike enjoy having their travel subsidized by others, such programs are not national priorities – especially when numerous states have enacted their own subsidies for similar costs in order to encourage certain types of transportation and/or economic development. Given the fact that the tax expenditures alone total more than $5 billion annually rescinding this tax subsidy would result in substantial savings over ten years of more than $51.6 billion. [225]

Ending Misdirected Energy Tax Preferences

Clean Coal Investment and Gasification Tax Credits

Two tax credits are available for certain advanced clean coal and gasification technologies. Created in 2005, these credits cost taxpayers more than $1.6 billion initially, and in 2008, Congress allocated an

[218] Website for the Treasury Inspector General for Tax Administration, "The Administration of the Public Transportation Subsidy Can Be Improved," March 23, 2006, http://www.treasury.gov/tigta/auditreports/2006reports/200610062fr.html, accessed June 29, 2011.

[219] Fujimori, Leila, "Vanpool Seeks Federal Funds After Rate Hike," *Star-Advertiser* (Honolulu, HI), June 23, 2011, http://www.staradvertiser.com/news/hawaiinews/20110623__Vanpool_seeks_federal_funds_after_rate_hike.html, accessed June 29, 2011.

[220] Spodek, Yaffi, "In N.J., Tax Credit Sparks Development," *Wall Street Journal*, June 13, 2011, http://online.wsj.com/article/SB10001424052702303848104576382081750787932.html, accessed June 29, 2011.

[221] Whiten, Jon, "Gov. Christie Vetoes Transit Hub Tax Credit Bill, Saying it Requires Too Much Affordable Housing, Jersey City Independent, February 23, 2011, http://www.jerseycityindependent.com/2011/02/23/gov-christie-vetoes-transit-hub-tax-credit-bill-because-it-requires-too-much-affordable-housing/, accessed June 29, 2011.

[222] Website of the Comptroller of Maryland, "Commuter Tax Credit," http://business.marylandtaxes.com/taxinfo/taxcredit/commuter/default.asp , accessed June 29, 2011.

[223] Website of King County, Washington, "Washington State Tax Credit," http://www.kingcounty.gov/transportation/CommuteSolutions/EmployerTaxBenefits/StateTaxCredit.aspx, accessed June 29, 2011.

[224] Website of the Minnesota Department of Revenue, "Employer Transit Pass Credit," http://taxes.state.mn.us/individ/pages/other_supporting_content_transit_pass_credit.aspx, accessed June 29, 2011.

[225] Staff estimate based on Joint Committee on Taxation JCS-3-10, "Estimates Of Federal Tax Expenditures For Fiscal Years 2010-2014," http://www.jct.gov/publications.html?func=startdown&id=3718.

additional $1.5 billion in sum for both credits.[226] Of this, $1.25 billion was authorized for investments using "integrated gasification combined cycle (IGCC) or other advanced coal-based electricity generation technologies." Investments that are approved may be eligible for a 30 percent tax credit. These tax breaks are only available for specific projects approved by the Secretary of the Treasury, together with officials at the Department of Energy,[227] and are distributed similar to direct grants more typically found in discretionary spending programs.

Last year, a $417 million clean coal investment tax credit was awarded to a 602-megawatt facility in Taylorville, Illinois. The company that received the award believed the credit "to be the largest ever granted to a single project." The same facility had already received a $2.579 billion loan guarantee, which brought the federal support for this one facility to $3 billion out of its $3.6 billion total cost.[228] Despite the significant federal investment, the project has been held up by delays. Opponents also remain concerned the electricity from the facility will be more expensive and "drive up their energy costs and lead to job losses."[229]

Close to 45 percent of the U.S. electric market is coal-based and supporting the industry should remain an important priority. However, there is still "uncertainty surrounding the economic feasibility and commercial viability" of these type of facilities. While these incentives may feel appropriate to some, the Congress is still supporting an industry with "economically unproven technologies in the sense that none may have become commercial without significant subsidies" and may be incapable of standing on its own.[230]

More than $1 billion in the clean coal credit has been allocated to three specific projects, while $250 million in the gasification credit has been directed to two other initiatives. According to the IRS, roughly $240 million in credits have yet to be directed to any recipients.[231] These tax credits, which provide direct federal aid through the tax code should be ended, all unallocated funds should be returned to the Treasury, and any unused funding from projects already in receipt of the credit should be directed to the Treasury for debt reduction. It is important to end this special interest break now or taxpayers will be liable for technology that likely cannot exist without significant federal subsidies. This proposal would rescind the remaining $240 million and end the tax credit immediately.

Renewable Energy Tax Credits

Federal Funding for Renewable Energy

Basic Renewable Energy Research and Development (wind, solar, geothermal, hydro, biofuels) is the focus of the U.S. Department of Energy's Office of Energy Efficiency and Renewable Energy. The

[226] Joint Tax Committee, Present Law Energy-Related Tax Provisions and Proposed Modifications Contained in the President's Fiscal Year 2011 Budget, April 14, 2010, http://www.jct.gov/publications.html?func=startdown&id=3678.

[227] Website of the Congressional Budget Office, "CBO Budget Options, Vol 2," August, 2009, http://cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf, June 25, 2011, 223.

[228] DiSavino, Scott, "US gives tax credit to Illinois clean coal project," Reuters, July 28, 2010, http://www.reuters.com/article/2010/07/28/utilities-tenaska-taylorville-idUSN2821308620100728, accessed June 27, 2011.

[229] Finke, Doug and Landis, Tim, "Taylorville officials willing to wait a little longer on Tenaska, " *State Journal-Register* (Springfield, IL), June 1, 2011, http://www.sj-r.com/state/x724665090/Taylorville-officials-willing-to-wait-a-little-longer-on-Tenaska, accessed June 27, 2011.

[230] Website of the Congressional Budget Office, "CBO Budget Options, Vol 2," August, 2009, http://cbo.gov/ftpdocs/102xx/doc10294/08-06-BudgetOptions.pdf, June 25, 2011, 223.

[231] Website of the Internal Revenue Service, Announcement 2010-56, September 27, 2010, accessed July 5, 2011, http://www.irs.gov/irb/2010-39_IRB/ar09.html.

DOE has made significant progress by partnering with industry to develop more cost-competitive alternative energy technologies.[232]

The Department of Energy plays an important role to furthering fledgling technology. In recent years though, private investment has started to increase commensurate with the maturity and profitability of the technology itself. Combined global public and private renewable energy financing reached $243 billion in 2010, up from $186.5 billion in 2009.[233]

The United States began funding research and development for renewable energy nearly 40 years ago.[234] The American Recovery and Reinvestment Act (stimulus bill) provided an infusion of over $90 billion in tax cuts and spending in 2009 alone.[235] In 2010, the federal government provided $34 billion.[236]

While federal renewable energy research and development is a worthy goal, it is no longer essential as the technology and scale of renewable energy generation are reaching a point where industry and private investors can best provide this funding.

The Role of Markets

The role of federal research should not be overlooked. Federal research has brought about spectacular technological advancements in past decades, the development of the atom bomb in the 1940s and the Internet and GPS in more recent years. Indeed, critical research initiatives have an important place in the federal budget.

Alternative energy technology is a growing market, with billion-dollar industries that have many applications already available on a commercial scale. Energy security, as it relates to DOE's purview, should *not* mean investing in projects the private sector is already very interested in supporting or deploying non-competitive technology.

Before continuing to spend taxpayer dollars in this way, policymakers should first ask, "Are we addressing a market failure or unmet need?" The fact that renewable energy technologies are not being applied on a cost-competitive, commercial scale is not necessarily a market failure. It may simply mean that a given product is not a good investment.

"Ray Lane, venture capital backer of Google, Amazon.com, and other Internet groundbreakers says the alternative energy investment boom 'is bigger than the Internet by an order of magnitude. Maybe

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[232] Website of U.S. Department of Energy, Energy Blog, 50 Years After the MoonShot Speech, Critical Advancements in Clean Energy Technology, G. Simmons, May 25, 2011, accessed June 29, 2011, http://blog.energy.gov/blog/2011/05/25/50-years-after-moonshot-speech-critical-advancements-clean-energy-technology; Website of CNN Politics, State of the Union Coverage, "Obama Touts Clean Energy a Day After State of the Union Speech, CNN Wire Staff, January 26, 2011, accessed June 29, 2011, http://www.cnn.com/2011/POLITICS/01/26/white.house.tour/index.html

[233] Website of RenewableEnergyWorld.com, "2010 Clean Energy Investment Hits a New Record," January 11, 2011 http://www.renewableenergyworld.com/rea/news/article/2011/01/2010-clean-energy-investment-hits-a-new-record, accessed June 28, 2011.

[234] Sissine, Fred, "Renewable Energy R&D Funding History: A Comparison with Funding for Nuclear Energy, Fossil Energy, and Energy Efficiency R&D," *Congressional Research Service*, January 26, 2011, http://www.crs.gov/Products/RS/PDF/RS22858.pdf, accessed June 28, 2011.

[235] Weiss, Daniel J., "Clean Energy Progress Without Congress, *Center for American Progress*, January 20, 2011,http://www.americanprogress.org/issues/2011/01/energy_sotu.html, accessed June 28, 2011.

[236] Website of RenewableEnergFocus.com, "2010: Clean energy investment up to US $243 billion," April 27, 2011, http://www.renewableenergyfocus.com/view/17600/2010-clean-energy-investment-up-to-us243-billion/, accessed June 28, 2011.

two.'"[237] Even initiatives considered too risky for private investment eventually catch on if determined to have potential.[238] There is a desire among multiple levels in supply chains to produce efficient, cost-effective technology that consumers will demand.

Renewable energy development is not without its risks. These risks, however, are a cornerstone to a working market, because they force entrepreneurs to address glitches in technology and delivery systems, ultimately providing the highest quality good or service in response to consumer demand rather than the political whims of Congress. Misguided subsidies foster an attitude of apathy by removing the natural link revenues share with performance and merit. They also neutralize the competitive advantage investors and companies have earned by risking capital on cutting edge innovation. Providing subsidies allows others to catch up without true risk and potentially discourages risks essential to innovation.

The Injection of Private Capital

Decades of research and federal funding have laid the foundation for renewable energy. Now venture capital, private equity, philanthropists, and dedicated renewable energy businesses are taking the lead in developing technologies on a commercial scale that are cost-competitive and can pave the way for a future generation of technology.

Billions of private sector dollars and venture capital[239] are already dedicated to next generation energy technologies. The U.S. led the world in venture capital and private equity investments in renewable energy by a long shot in 2010 with over $4 billion.[240] In the same year, global venture capital reached $8.8 billion, up 28 percent from 2009.[241]

Philanthropists are now playing a significant role as well. Richard Branson pledged $3 billion for renewable energy technologies,[242] Warren Buffet invested $5.4 billion for wind energy developments,[243] and Bill Gates invested in algae biofuels[244] and energy-tech startups.[245][246]

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[237] Website of New Energy Technologies Inc., "Investing in renewable and alternative energy," http://www.newenergytechnologiesinc.com/investing_renewable, accessed June 28, 2011.

[238] Wald, Mathew L, "Energy Firms Aided by U.S. Find Backers," *New York Times*, February 2, 2011, http://www.nytimes.com/2011/02/03/business/energy-environment/03energy.html?_r=1, accessed June 2

[239] Podkul, Cezary, "Private Equity is Bullish on Clean Energy," *New York Times*, http://green.blogs.nytimes.com/2010/01/29/private-equity-is-bullish-on-clean-energy/, accessed June 28, 2011; Website of Pipeline Clean Energy, "Project financing stalls in 1Q11 while venture capital and private equity accelerate," April 19, 2011, http://cleanenergypipeline.com/Press.aspx?id=15, accessed June 28, 2011; and Website in LiveScience.com, "Investment in Green Energy Quadruples in 4 years," June 3, 2009, http://www.livescience.com/5497-investment-green-energy-quadruples-4-years.html, accessed June 28, 2011.

[240] Bloomberg New Energy Finance, BCSE Meeting, March 15, 2011, Slide 11; Website of Deloitte & Touche LLP in conjunction with The Cleantech Group, "Global Clean Technology Venture Investment Increases 65 Percent in 1H 2010 to March the Record 1H 2008," July 1, 2010, accessed June 29, 2011, http://www.deloitte.com/view/en_US/us/press/Press-Releases/83fef471f40f9210VgnVCM100000ba42f00aRCRD.htm

[241] Website of RenewableEnergyWorld.com, "2010 Clean Energy Investment Hits a New Record," January 11, 2011 http://www.renewableenergyworld.com/rea/news/article/2011/01/2010-clean-energy-investment-hits-a-new-record, accessed June 28, 2011.

[242] Website of the U.S. Department of Energy, "Richard Branson Pledges $3 Billion in Renewable Energy Technology Development," September 26, 2006, http://www1.eere.energy.gov/inventions/energytechnet/news_detail.html?news_id=10304, accessed June 28, 2011.

[243] Dodrill, Tara, "Warren Buffett Boosts Wind Power Financials," *Yahoo News*, March 2, 2011, http://news.yahoo.com/s/ac/20110302/tc_ac/7979838_warren_buffett_boosts_wind_power_financials, accessed June 28, 2011.

[244] LaMonica, Martin, "Bill Gates Invests in Algae Fuel," *CNet News*, September 17, 2008, http://news.cnet.com/8301-11128_3-10043996-54.html, accessed June 28, 2011.

[245] Website of Renewable Energy World, "Bill Gates backs battery built for clean energy," May 23, 2011, http://www.renewableenergyworld.com/rea/partner/buy-battery/news/article/2011/05/bill-gates-backs-battery-built-for-clean-energy, accessed June 28, 2011.

[246] LaMonica, Martin, "Bill Gates investing in Vinod Khosla green-tech fund," CNet News, January 25, 2010, http://news.cnet.com/8301-11128_3-10439785-54.html?tag=mncol;title, accessed June 28, 2011.

American companies are also being proactive. Started in 2005, GE's Ecomagination program is on pace to invest $10 billion between 2010 and 2015 in renewable energy and energy efficiency technologies, such as buildings and appliances.[247] GE recently marked a milestone in thin-film solar and will construct what will likely be the largest manufacturing plant for solar panels in the country, estimated to cost $600 million.[248] To date, Google has totaled $780 million in renewable energy investments, including solar, wind, and transmission.[249] The company does not seem to be slowing down either as it recently announced a $280 million contribution to a solar energy fund, its largest renewable energy investment to date.[250] With Citi, it is investing $102 million in a wind energy project.[251] Goldman Sachs went beyond its original commitment to invest $1 billion in renewable energy and energy efficiency projects and has now invested over $2 billion.[252]

Downfalls of Excessive Subsidies

Subsidizing market success or potential is not the highest and best use of taxpayer dollars. Over-subsidizing fledgling technologies brings with it potential problems.

Some countries subsidize the renewable energy industry more heavily than ours and have created a tax environment unrealistically favorable to renewable energy. These efforts can be attributed, in part, to why some American renewable energy manufacturing moved overseas in recent years. For example, Spain subsidized its renewable energy industry so heavily that when it scaled back subsidies (particularly for solar), the bubble it had created for renewable energy production burst, resulting in thousands of lost jobs and plummeting prices for solar panels.[253]

States with similar provisions also experienced similar consequences in recent years. In Pennsylvania, a swath of tax credits from various levels of government depressed market prices for solar by 75 percent to the point it could not be made profitable. Now state legislators are seeking corrective measures requiring utilities to buy solar power—essentially increasing the state's clean energy standard—that will initially increase prices for them but ultimately be passed on to consumers.[254]

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[247] Website of Environment and Energy Management News, "GE's Ecomagination Spent $1.8bn, Launched 22 Products in 2010,"June 21, 2011, http://www.environmentalleader.com/2011/06/21/ges-ecomagination-spent-1-8bn-launched-22-products-in-2010/, accessed June 28, 2011.

[248] Anderson, Eric, "GE hits milestone with thin-film solar, will build plant," *Times-Union* (Albany, NY), April 7, 2011. http://blog.timesunion.com/business/ge-hits-milestone-with-thin-film-solar-will-build-plant/23346/, accessed June 28, 2011.

[249] Website of Google Green, "Are there innovative ways to support innovation," http://www.google.com/green/collaborations/support-innovations.html, accessed June 28, 2011.

[250] The Official Google Blog website, "Helping homeowners harness the sun," June 16, 2011, http://googleblog.blogspot.com/2011/06/helping-homeowners-harness-sun.html, accessed June 28, 2011; Website of the Financial Times Tech Hug, "Google launches $280 million solar fund," June 15, 2011 http://blogs.ft.com/fttechhub/2011/06/google-launches-280-million-solar-fund/, accessed June 28, 2011.

[251] Website of BusinessWire, "Citi, Google to Invest in Additional Phase of Terra-Gen Power's Alta Wind Energy," June 22, 2011, http://www.businesswire.com/news/home/20110622006208/en/Citi-Google-Invest-Additional-Phase-Terra-Gen-Power%E2%80%99s, accessed June 29, 2011; Website of Austin Business Journal, by Silicon Valley/San Jose Business Journal, "Google puts another $102M in wind energy," June 22, 2011, http://www.bizjournals.com/austin/news/2011/06/22/google-puts-another-102m-into-mojave.html, accessed June 28, 2011.

[252] Website of Goldman Sachs, "Environmental Stewardship and Sustainability," http://www2.goldmansachs.com/citizenship/environment/business-initiatives.html, accessed June 28, 2011.

[253] Faiola, Anthony, "Spain's Answer to unemployment: Go Greener," *Washington Post*, September 24, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/09/23/AR2009092302152.html, accessed June 28, 2011.

[254] Maykuth, Andrew, "Pennsylvania's solar-energy industry suffering from success," Philadelphia Inquirer (PA), May 24, 2011, http://articles.philly.com/2011-05-24/business/29578002_1_solar-projects-green-energy-capital-partners-solar-power, accessed June 28, 2011.

While there may be a limited role for DOE research where market investments do not reach, this is done most efficiently at the Office of Science where the Department is already at work in these areas.

Tax Credit Basics

The cornerstones of commercial renewable energy tax credits are the Production Tax Credit and Investment Tax Credit. Because the developers claiming these two credits do not typically have the tax liability to profit from a credit, they often team with banks or other capital partners to utilize the tax credit. During the economic crisis, banks lost their ability to maintain a strong partnership. As a result, Congress provided through the American Recovery and Reinvestment Act a program offering grants in lieu of tax credit, effectively monetizing the tax credit in the form of a cash grant up front to bridge the gap in the financial industry.

Business Energy Investment Tax Credit

The Business Energy Investment Tax Credit (ITC) provides a 30 percent credit to owners or long-term lessees for constructing both commercial and individual renewable energy properties. It is scheduled to expire at the end of 2016.

The ITC is primarily used for solar projects. Large wind has not been eligible since the 1980s.[255] According to the Solar Energy Industries Association (SEIA), the U.S. solar market is becoming more attractive both domestically and abroad and international markets for solar, particularly as Italy and Germany, have slowed. According to Solarbuzz, a market research and analysis provider for solar power, the U.S. will account for 9 percent of global solar photovoltaic demand through 2011 and 14 percent by 2015.[256] SEIA attributes this growth in the U.S. in part to declines in infrastructure costs, better business models, and state-based incentives.[257]

The ITC is structured to reward capital investment rather than electricity generation itself, which can be problematic. For example, a company could construct a wind turbine that does not spin, yet the project would be eligible for the tax credit. Eliminating this credit would save $5 billion over ten years.[258]

Renewable Electricity Production Tax Credit

The Renewable Electricity Production Tax Credit provides a per kilowatt hour (kWh) tax credit for electricity generated from renewable energy sources. The credit began at 1.5 cents per kWh in 1992 and is annually adjusted for inflation. By 2005, $2.1 billion (23 percent) of energy tax expenditures were associated with the PTC, which was largely claimed by large wind projects. Between 2009 and 2013, approximately 75 percent of funding is expected to go towards wind projects. Biomass facilities are expected to take the second largest share followed by closed-loop biomass, geothermal, hydropower, solar, small irrigation, and municipal solid waste facilities. Refined coal producers also benefit from this credit. Around 60 facilities around the country have been approved by the IRS to receive a $6.27 per ton credit for coal they produce.

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[255] Small wind projects can receive the credit.
[256] ADP News Renewable Energy Track, "US solar industry shines through in Q1 2011," June 27, 2011, http://www.forconstructionpros.com/article/article.jsp?siteSection=25&id=20696&pageNum=3, accessed June 29, 2011.
[257] ADP News Renewable Energy Track, US solar industry shines through in Q1 2011, June 27, 2011, http://www.forconstructionpros.com/article/article.jsp?siteSection=25&id=20696&pageNum=3, accessed June 29, 2011
[258] Sherlock, Molly, "Energy Related Tax Provisions," *Congressional Research Service* memo, May 11, 2011.

The PTC is available for ten years and is provided at a reduced amount if a project is also receiving federal assistance through other means. Unlike the ITC, the production tax credit rewards actual generation of electricity rather than just the investment in renewable energy infrastructure.

The structure of the PTC may lend itself to excessive subsidy values, though, because the credit is not considered taxable income. A 2006 analysis described the true value of the PTC using as an example a normal investment in a qualifying wind energy project with totals of approximately $1.5 million and 1 megawatt of capacity. If such an investment is made in an area with high wind potential, harnessing 35 percent of capacity in a given area, annual production would reach three million kilowatts per hour (kWh), generating $58,000 from the PTC. This amount, however, would be the equivalent to $90,000 of corporate revenue taxed at the 35 percent corporate tax rate. When examined over a ten-year time period at an 8 percent discount rate, the value of the PTC in this scenario would reach $625,000 for a total of $1.5 million investment over its lifetime. This is the equivalent to a 42 percent ITC.[259]

Such credits may not be necessary, however. Wind power accounted for 26 percent of all new U.S. electric capacity in 2010 with 15 percent growth in the same year. There were over 400 wind-related manufacturing facilities in the U.S. in 2010 with over 38 states operating utility-scale facilities.[260]

Ending this provision would save $14 billion over ten years.[261]

Sec. 1603 Grants in Lieu of Tax Credits

The Grants in Lieu of Tax Credits program was created as an option by the stimulus bill to allow for the monetization of the Production Tax Credit or Investment Tax Credit or 48C, effectively making each refundable by allowing recipients to receive grants instead of credits.

Under the program, renewable energy developers earn almost immediate grants of 30 percent of project costs. The program was originally intended to expire after one year but remains in existence today.[262] Investigative news stories found the program was subsidizing jobs overseas as eight out of ten stimulus dollars spent on wind energy farms went to foreign companies, creating approximately 4,500 jobs overseas.[263] Of the 11 American wind farms that received grants from the U.S. Treasury, 695 of the 982 turbines were imported.

Moreover, the investigation found the program funded projects already underway that would have continued regardless.[264] A total of 19 wind farms, which received $1.3 billion, were built before any

[259] Sullivan, Martin A. "Economic Analysis, Wind Credits and Clean Air," *Tax Notes*, October 30, 2006, 405-417.
[260] Website of the American Wind Energy Association, "2010 U.S. Wind Industry Market Update," http://www.awea.org/learnabout/publications/factsheets/upload/Market-Update-Factsheet-Final_April-2011.pdf, June 28, 2011.
[261] Sherlock, Molly, "Energy Related Tax Provisions," *Congressional Research Service* memo, May 11, 2011.
[262] Feldman, Stacy, "U.S. Solar Industry Fights to Save Controversial Clean Energy Grants" *Reuters*, November 16, 2010, http://www.reuters.com/article/idUS404294354320101116, accessed June 28, 2011.
[263] Website of the Financial Times, "US Energy Stimulus Dollars Go Overseas," October 29, 2009, http://www.ft.com/cms/s/0/b091007e-c4b3-11de-8d54-00144feab49a.html, accessed June 28, 2011.
[264] Feldman, Stacy, "U.S. Solar Industry Fights to Save Controversial Clean Energy Grants" *Reuters*, November 16, 2010, http://www.reuters.com/article/idUS404294354320101116, accessed June 28, 2011.

of the stimulus money was distributed. Fourteen were already sending electricity to the grid.[265] Ending this provision could save $29.86 billion over ten years.[266]

Qualifying Advanced Energy Manufacturing Investment Tax Credit

The Qualifying Advanced Energy Manufacturing Investment Tax Credit provided $2.3 billion in the form of 30 percent tax credits for investments by manufacturers into new, expanded, or re-equipped domestic renewable energy facilities.[267] While this provision has not yet expired, it has been fully exhausted of funding. This proposal would repeal the authorization for the provision.

Under this program there was no cap on the number of projects an individual investor could apply for the credit, and applicants were not disqualified if they already received a federal grant or loan for similar purposes.[268] A large portion of the tax subsidy benefits went to foreign entities. Of the $2.3 billion made available, solar received $1 billion.[269] REC Silicon, a subsidiary of a Norwegian company, received the largest credit of $155 million.[270] A German subsidiary also received $128.4 million for a project in Tennessee.[271] Not allowing this provision to be extended could save $2.3 billion.[272]

The Residential Renewable Energy Tax Credit

The Residential Renewable Energy Tax Credit provides a 30 percent credit to homeowners for renewable electricity generating property.

There are two components to this tax credit. The first is the Non-Business Energy Property Tax Credit (26 USC 25C), which originally provided a 10 percent credit up to $500 for appliance upgrades to existing homes. The stimulus bill expanded the credit to 30 percent up to $1,500. This has since returned to its original value and is extended through the end of 2011. This credit is discussed more thoroughly in the energy efficiency portion of this proposal.

The second component is the Residential Renewable Generation Tax Credit, which provides a 30 percent credit for renewable electricity generating property (26 USC 25D) for solar panels, small wind turbines, and geothermal systems. This component expired at the end of 2010.

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[265] Website of the Investigative Reporting Workshop, "Overseas firms collecting most green energy money,"October 29, 2009, http://investigativereportingworkshop.org/investigations/wind-energy-funds-going-overseas/story/overseas-firms-collecting-most-green-energy-money/, accessed June 28, 2011.

[266] Website of the Joint Committee on Taxation, "Estimated Budget Effects Of The 'Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010,'" December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3715, accessed June 28, 2011.

[267] Website of the White House, "Office of the Press Secretary, Fact Sheet: $2.3 Billion in New Clean Energy Manufacturing Tax Credits," January 8, 2010, accessed June 29, 2011, http://www.whitehouse.gov/the-press-office/fact-sheet-23-billion-new-clean-energy-manufacturing-tax-credits

[268] Website of the Department of Energy, "President Obama Awards $2.3 Billion for New Clean-Tech Manufacturing Jobs,"http://www.energy.gov/recovery/48C.htm, accessed June 28, 2011.

[269] Cheyney, Tom, "For the record: Manufacturing investment tax credit typo pushes REC Solar to the top of the list," *PV-Tech*, January 13, 2010,http://www.pv-tech.org/chip_shots_blog/for_the_record_manufacturing_investment_tax_credit_typo_pushes_rec_solar_to, accessed June 28, 2011.

[270] Website of Renewable Energy Corporation, REC ASA – REC Silicon to Receive US Federal Tax Credits for Job Creating Investments, January 12, 2010, accessed June 29, 2011, http://www.recgroup.com/view?feed=R/136555/PR/201001/1372439.xml

[271] Osborne, Mark, "Polysilicon producers top U.S. federal tax credits, *PV-Tech*, January 12, 2010, http://www.pv-tech.org/news/polysilicon_producers_top_u.s._federal_tax_credits, accessed June 28, 2011.

[272] Staff estimate.

The cost for this provision was $200 million in 2010, and ending it would save $2 billion over ten years.[273]

Clean Renewable Energy Bonds and Qualified Energy Conservation Bonds

Clean Renewable Energy Bonds (CREBs) are issued with a zero percent interest rate, allowing the borrower to repay only the principal of the bond and the bondholder to receive federal tax credits in lieu of the traditional bond interest. Effectively, it allows those who issue them to receive an interest-free loan, while the cost of the interest payments is shifted to the government.

In the CREBs program, the benefit is provided to finance renewable energy projects for state, local, and tribal governments, utilities, and rural electric cooperatives. Public sector utilities are the primary target of this provision. The American Recovery and Reinvestment Act provided $1.6 billion, which raised the previous $800 million cap and the maximum cap to $2.4 billion.[274]

Like CREBs, Qualified Energy Conservation Bonds (QECBs) are issued with a zero percent interest rate, allowing the borrower to repay only the principal of the bond and the bondholder to receive federal tax credits in lieu of the traditional bond interest. The credit's rate is set daily by the Treasury Department, and it can be claimed quarterly to offset the tax liability of the bondholder. Credits that exceed the bondholder's tax liability may be carried forward to the next year but cannot be refunded.

In contrast to CREBs, QECBs are not subject to the approval of the Department of Treasury. Instead, they are distributed to each state government based on population and are, in turn, allocated to local governments on the basis of population. Its broad definition of eligible projects allows for increased participation. The original provision was limited to $800 million but was expanded by the stimulus bill to $3.2 billion.[275] This plan would repeal these tax benefits, preventing any future federal expenditures for these conservation bonds.

Alternative Motor Vehicle Credit (26 USC 30B)

Providing a $1,300 tax credit for alternative vehicles, the Alternative Motor Vehicle Credit has experienced significant structural problems. According to the U.S. Treasury Inspector General for Tax Administration (TIGTA), approximately $33 million in tax credits claimed by 12,920 individuals were paid erroneously through this tax credit, out of $163.9 million in credits that were reviewed by the IG. Among the number of false claims were 29 prisoners who claimed the credit while incarcerated. Additionally, the report found IRS was not able to monitor credits that were claimed on paper-file tax returns.[276]

Others have raised concerns that federal tax credits for alternative motor vehicles are not the most effective way to encourage widespread purchases. A study published in the *Journal of Environmental*

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[273] Sherlock, Molly, "Energy Related Tax Provisions," *Congressional Research Service* memo, May 11, 2011.
[274] Website of the U.S. Department of Energy, "Tax Breaks for Businesses, Utilities, and Governments," http://www.energy.gov/additionaltaxbreaks.htm, accessed June 28, 2011.
[275] Cunningham, Lynn J. "Renewable Energy and Energy Efficiency Incentives: A Summary of Federal Programs," *Congressional Research Service*, R40913, March 22, 2009, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R40913&Source=search, accessed June 28, 2011.
[276] Website of the U.S. Treasury Inspector General for Tax Administration, "Individuals Received Millions of Dollars in Erroneous Plug-in Electric and Alternative Motor Vehicle Credits," January 21, 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201141011fr.pdf, accessed June 28, 2011.

Economics and Management found state-based tax incentives have a greater impact on purchases of hybrid vehicles than federal income tax incentives. The study demonstrated that only a small percentage of motorists attribute their purchase of hybrid vehicles to tax incentives while most purchase them for personal preferences or high fuel costs.[277] Eliminating these tax breaks will save $3.1 billion over ten years.[278]

Ethanol Tax Incentives

In the 1970s, Congress began providing federal assistance for the domestic production of ethanol, which included the establishment of the Renewable Fuels Standard (RFS) that created a permanent market for the industry. Since that time federal assistance has grown to include multiple tax incentives and federal grant programs. Most recently, EPA issued a decision to increase the current fuel blend wall from ten percent to fifteen percent (E15), effectively creating an even larger market for ethanol producers.

While born of good intentions, federal subsidies for ethanol now face sizeable roadblocks as consumers have protested the required use of ethanol in their fuel. Ethanol-blended fuel is nearly a third less efficient than gasoline (ethanol burns at 68 percent the energy content of gasoline), has contributed to the increased price of corn (as well as land, feed, and other input costs), and can cause engine damage.[279]

Overall, ethanol subsidies are outdated and have failed to achieve their goals of helping our nation to achieve energy independence. The Congressional Budget Office recently found consumers incur a cost of $1.78 per gallon as a result of federal subsidies before they even pay at the pump.[280] Meanwhile, U.S. biofuels consumption remains a small share (4.3 percent) of national transportation fuel use.

The original federal ethanol mandates stemmed from several events, foremost of which was the global energy crisis of the 1970s and a desire to achieve energy independence. Over four decades later, our nation seeks this goal more than ever, but ethanol has not helped achieve this target. It is time to give taxpayers a break and allow the ethanol industry a chance to stand on its own or fail.

Volumetric Ethanol Excise Tax Credit (VEETC)

While various forms of federal assistance continue to sustain the ethanol industry, foremost among them is the Volumetric Ethanol Excise Tax Credit (VEETC), which provides 45 cents per gallon to blenders of ethanol. This subsidy alone accounts for $6 billion in federal spending. It is available in unlimited quantities to blenders, including companies such as Exxon, Valero, BP, and Chevron, which has drawn the ire of some environmentalists. While it was intended to encourage the use of ethanol,

[277] Gallagher, Kelly Sims, and Muehlegger, Erich J, "Giving Green to Get Green: Incentives and Consumer Adoption of Hybrid Vehicle Technology." Harvard Kennedy School Faculty Research Working Paper Series RWP08-009, February 2008, http://web.hks.harvard.edu/publications/workingpapers/citation.aspx?PubId=5488, accessed June 28, 2011.
[278] Staff Estimate based on "Expiring Tax Provisions (xls)," available on website of the Congressional Research Service, The Budget and Economic Outlook: An Update, August 2010, http://www.cbo.gov/doc.cfm?index=11705.
[279] Schnepf, Randy. "Agriculture-Based Biofuels: Overview and Emerging Issues," *Congressional Research Service*, June 11, 2010
[280] Website of the Congressional Budget Office, Using Biofuel Tax Credits to Achieve Energy and Environmental Policy Goals, July 2010, http://www.cbo.gov/doc.cfm?index=11477, accessed June 28, 2011.

the Congressional Research Service determined the VEETC only duplicates what the Renewable Fuels Standard already requires. Now the VEETC only functions to incentivize the consumption of fuel.[281]

The U.S. Senate recently voted overwhelmingly on a bipartisan basis to repeal the VEETC by a margin of 73-27, clearly demonstrating that taxpayers are ready to end costly and redundant ethanol subsidies. When VEETC is eliminated, the import duty should be eliminated as well.

The cost for this provision is $4.8 billion in 2011. Ending this provision would save $2.4 billion for the rest of this year.[282]

Small Ethanol Producer Credit

The Small Ethanol Producer Tax Credit provides 10 cents per gallon for the first 15 million gallons of ethanol produced for any producer with capacity below 60 million gallons and has been valued at $440 million annually. It is estimated to cost nearly $500 million. It is scheduled to expire at the end of 2011. This tax credit is intended to target small businesses and farmer cooperatives.

The *Los Angeles Times* recently interviewed an ethanol producer about the efforts in Congress to end ethanol subsidies. When asked what impact ending this tax credit would have, one CEO of a longtime small ethanol production company expressed a widely held view, noting, “I don’t see a fatal effect.” The tax credit is valued at $1.5 million annually for his company. [283]

While ethanol fuel has yet to capitalize on the ample opportunity given it by taxpayers to achieve economic viability on its own merit, eliminating this tax credit would likely have minimal impacts, considering the Renewable Fuels Standard continues to mandate ethanol be blended with gasoline. Eliminating this provision would save $4 billion over the next decade.[284]

Biodiesel Tax Credit

Biofuels such as ethanol and biodiesel are renewable fuels made from organic sources such as crop wastes and animal fat. This biodiesel tax credit provides $1 per gallon, available in unlimited amount to all qualifying biodiesel producers. The credit was created in 2004 and briefly expired two different times and later extended retroactively. It is now scheduled to expire at the end of 2011.[285]

U.S. biodiesel production is much smaller than its ethanol counterpart but has also shown strong growth, rising from 0.5 million gallons in 1999 to an estimated 776 million gallons in 2008. Without the tax credit, biodiesel is more expensive than gasoline, demonstrating the fuel is not economical to produce without federal assistance. According to the Congressional Research Service, “Demand for biofuels [both ethanol and biodiesel] to fulfill a mandate is not based on price, but rather on

[281] Schepf, Randy, “Redundancy of ethanol blender’s tax credit when coupled with usage mandate,” *Congressional Research Service* Confidential memo, July 13, 2010.

[282] Website of the Joint Committee on Taxation, “Estimated Budget Effects Of The ‘Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010,’” December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3715, accessed June 28, 2011.

[283] Shaffer. David, “Midwest towns caught in middle of ethanol-subsidy fight,” Los Angeles Times, June 25, 2011, http://articles.latimes.com/2011/jun/25/business/la-fi-ethanol-subsidies-20110625, accessed June 28, 2011.

[284] Staff estimate.

[285] Ausick, Paul, “Biodiesel Makers Will Struggle After Tax Credit Expires, January 5, 2010, http://www.investorplace.com/4732/biodiesel-makers-struggle-after-biodiesel-tax-credit-expires/, accessed June 28, 2011.

government fiat. As long as the consumption of biofuels is less than the mandated volume, its use is obligatory."[286]

The cost for this provision was $500 million in 2010. Ending this tax subsidy would save $5 billion over ten years.[287]

Cellulosic Ethanol Production Tax Credit

The Cellulosic Ethanol Production Tax Credit provides $1.01 per gallon and expires at the end of 2012. While not yet being produced commercially, cellulosic ethanol holds great promise, and is included as a component of the Renewable Fuels Standard (RFS). The Environmental Protection Agency's recent draft of the RFS for 2012 projects a reduced production from the previous estimate of 500 million[288] down to 3.45 to 12.9 million of cellulosic ethanol.[289]

Still, industry stakeholders still claim this goal is too high.[290] While this should not be taken as a sign cellulosic has no future, it should give strong caution to policymakers not to artificially enhance the capital environment of cellulosic projects. Although the fuel appears to hold great promise, Congress would be wise to avoid another situation similar to its experience with corn-based ethanol and, instead, allow markets to direct the capital as the technology merits it. Already, venture capital, oil and natural gas companies, banks, and agricultural research and technology companies have teamed with industry experts to invest in cellulosic biofuels, and this will likely continue so long as the technology merits additional funding.[291]

This plan calls for the elimination of this tax credit. Currently, the costs associated with this giveaway are minimal under current conditions. However, if production increases to meet RFS requirements, its costs would be substantial. In fact, some estimates project it could cost $10 billion by 2015 and $20 billion by 2020 if cellulosic biofuels fulfill their expectations.[292]

Energy Efficiency Tax Credits

The Case for Energy Efficiency
Energy efficiency is an important goal for both industry and individuals, especially given our nation's current economic outlook and our dependence for foreign sources of energy. Energy efficiency measures have saved consumers over $200 billion, or $2,000 per household, since their inception and are projected to double in savings over the next twenty years.[293]

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[286] Schnepf, Randy, "Agriculture-Based Biofuels: Overview and Emerging Issues," Report: RN1282, *Congressional Research Service,* June 11, 2010, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41282&Source=search, accessed June 28, 2011.
[287] Sherlock, Molly, "Energy Related Tax Provisions," *Congressional Research Service* memo, May 11, 2011.
[288] Website of the Des Moines Register, EPA cuts non-corn ethanol targets," June 22, 2011, http://blogs.desmoinesregister.com/dmr/index.php/2011/06/22/epa-cuts-non-corn-ethanol-targets/, accessed June 28, 2011.
[289] Doggett, Tom, "US EPA proposes 2012 ethanol use at 13.2 bln gallons," Reuters, June 21, 2011, http://www.reuters.com/article/2011/06/21/usa-ethanol-epa-idUSWNA156820110621, accessed June 28, 2011.
[290]Mandel, Jenny, "Refiners Protest EPA's 'ridiculous' cellulosic targets," Greenwire, June 22, 2011, accessed June 29, 2011.
[291]Website of the Congressional Research Service, Cellulosic Biofuels: Analysis of Policy Issues for Congress, Kelsi Bracmort, Randy Schnepf, Megan Stuffs, Brent D. Yacobbuci, January 13, 2011, accessed on June 29, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL34738&Source=search
[292] Website of the Congressional Research Service, Renewable Fuel Standard (RFS): Overview and Issues, Randy Schnepf, Brent D. Yacobucci, February 1, 2011, accessed on June 29, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R40155&Source=search#_Toc284409516
[293] Website of the Natural Resources Defense Council, "Efficient Appliances Save Energy -- and Money, January 13, 2010, http://www.nrdc.org/air/energy/fappl.asp, accessed June 30, 2011.

Energy efficiency provides a way for consumers to be more knowledgeable, thoughtful, and responsible with household and commercial energy consumption. More generally, it provides a greater degree of conservation of our nation's natural resources.

Despite the benefits that energy efficient appliances and upgrades hold, the federal government offers a variety of tax credits to incentivize consumers to make these improvements.

Double the Benefits

However, federal assistance for these initiatives ignore a primary benefit of efficient products, which is that consumers can recoup the initial high costs of purchase within a reasonable payback period and realize considerable savings as the product(s) consume smaller amounts of energy on an annual basis.

The Department of Energy provides an economic justification for each product's efficiency based on life cycle costs and payback periods.[294] For example, when analyzing conservation standards for residential refrigerator-freezers, DOE found that certain efficient products can generally be more cost-effective in the long run.[295] In one scenario, the average number of years it takes to recoup the cost of consumers' investments for three versions of refrigerator-freezers are 5.8 years, 6.7 years, and 6.9 years.

In short, taxpayers are paying consumers in the short-term to save more money in the long-term. Federal tax credits for energy efficiency measures double the financial benefit of purchasing more efficient products or upgrading appliances or equipment and essentially pay individuals or companies to take steps a savvy consumer would likely take anyway.

Private Organizations are Assuming the Role of Assistance

Taxpayer assistance for energy efficiency measures should only be provided to those who cannot afford to do it themselves. This can actually be achieved most efficiently if led by community leaders that understand the needs of local residents and can deliver services more efficiently than a centralized government. The U.S. Senate Committee on Finance recently heard testimony on tax reform from the president of the Tax Foundation in Washington, DC, who stated:

> The relentless growth of credits and deductions over the past 20 years has made the IRS a super-agency, engaged in policies as unrelated as delivering welfare benefits to subsidizing the manufacture of energy efficient refrigerators…these [are] not the functions we would want a tax collection agency to perform.[296]

At the same time, private and nonprofit organizations are partnering on their own initiative to address the same issues in their respective communities. Partnerships like Michigan's Clean Energy Coalition, which was established in 2006, are leveraging private capital and corporate goodwill in local communities with the technical expertise and local wherewithal of the organization's staff in order to

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[294]Website of the U.S. Department of Energy, "Office of Energy Efficiency and Renewable Energy, Appliances & Commercial Equipment Standards," http://www1.eere.energy.gov/buildings/appliance_standards/, accessed June 30, 2011.

[295] Website of the U.S. Department of Energy, Office of Energy Efficiency and Renewable Energy, "Technical Report: Analysis of Amended Energy Conservation Standards for Residential Refrigerator-Freezers," October 2005. http://www1.eere.energy.gov/buildings/appliance_standards/pdfs/refrigerator_report_1.pdf, accessed June 30, 2011.

[296] Website of the Tax Foundation, "Is the Distribution of Tax Burdens and Tax Benefits Equitable? (Testimony of Scott A. Hodge before the U.S. Senate Committee on Finance)," May 3, 2011, http://www.taxfoundation.org/publications/show/27254.html, accessed June 30, 2011.

meet the needs and energy consumption problems for less fortunate residents in over 40 local communities.[297] The *Cities of Promise* initiative is targeting eight economically struggling cities in Michigan to enhance with cost-saving efficiency upgrades.[298] The Department of Energy recognized that municipalities themselves are the leaders in this area who can apply an entrepreneurial spirit to address the unique needs of struggling nearby communities.[299]

For other social classes, efficiency—and the cost savings that result from it—is a sufficient financial reward in itself. Double payment or otherwise further encouragement of consumers to take cost-savings efficiency steps (even ones that would not have otherwise) is an example of promoting political policy positions through the tax code.

Masking Bad Public Policy

It is worth recalling Congress' creation of national energy efficiency standards in the 1980s, which are still in existence today and continue to increase periodically. These standards require products meet certain levels of efficiency that, as previously discussed, increase the cost to manufacturers (or consumers, if they are passed on). These standards have continued to grow, draining resources, innovation, and increasing costs. According to a 2003 study by a non-profit research organization, these standards will cost consumers $46 billion to $56 billion through 2050.[300]

To counter the cost burden of these mandates, Congress provides tax credits to purchase the equipment it requires be built (and purchased), essentially serving as political cover for the burdens of federally mandated efficiency standards. Since these costs are often passed along to consumers, efficiency tax credits are provided both commercially and residentially.

This behavior is not new to Washington. Congress did the same thing when it mandated certain levels of corn-based ethanol by establishing the Renewable Fuels Standard, which requires a certain percentage of gasoline be blended with biofuels. This was, and continues to be, a burdensome policy, because it requires the consumption of inefficient and, in some cases, non viable (cellulosic) fuels. However, Congress masked some of the burden related to corn-based ethanol by creating the Volumetric Ethanol Excise Tax Credit (VEETC), which pays blenders of ethanol to follow the federal mandate, allowing companies to recoup their costs and Congress to achieve its public policy agenda.

Based on Flawed Measurements

Some efficiency tax credits are contingent upon the purchase of products with Energy Star's approval (varies by product).[301] As noted in this report's section on energy policy, the integrity of the Energy Star program has been lost as the program was found to be riddled with fraud and abuse, therefore,

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[297] Website of the Clean Energy Coalition, "Stakeholders," http://cec-mi.org/about/stakeholders/, accessed June 30, 2011; Website of the Clean Energy Coalition, "Communities," http://cec-mi.org/communities/, accessed June 30, 2011.

[298] Gilmer, Ellen M., "The Art of Luring 'Poor' Cities Into Energy-Saving Projects," ClimateWire via New York Times, June 27, 2011, http://www.nytimes.com/cwire/2011/06/27/27climatewire-the-art-of-luring-poor-cities-into-energy-sa-63497.html?pagewanted=print, accessed June 30, 2011.

[299] Gilmer, Ellen M., "The Art of Luring 'Poor' Cities Into Energy-Saving Projects," ClimateWire via New York Times, June 27, 2011, http://www.nytimes.com/cwire/2011/06/27/27climatewire-the-art-of-luring-poor-cities-into-energy-sa-63497.html?pagewanted=print, accessed June 30, 2011.

[300] Sutherland, Ronald, "The High Cost of Federal Energy Efficiency Standards for Residential Appliances," *CATO Institute,* December 23, 2003, http://www.cato.org/pubs/pas/pa504.pdf, accessed June 30, 2011.

[301] Website for the American Council for an Energy-Efficient Economy, "Energy Efficiency Tax Incentives: Changes in Store for 2011," January 10, 2011, http://www.aceee.org/press/2011/01/energy-efficiency-tax-incentives-changes-store-2011, accessed June 30, 2011; and email correspondence with the Congressional Research Service.

calling into question the true value of products approved by the program for their efficiency, which these credits encourage consumers to purchase.

Federal Investments

Finally, the U.S. led the world in energy efficiency measures at $3.3 billion in investments.[302] Despite such a high level of funding, there has not been a corresponding metric that the U.S. Department of Energy has to show for its investment. There has also been a lack of sufficient documentation as to whether efficiency tax credits are serving those who can least afford upgrading themselves or if they are subsidizing wealthy individuals.

Congress is essentially paying consumers to save—a practice many would pursue without federal incentives. It is the responsibility of consumers to decide whether the initial cost of an energy-efficient appliance can be recouped before the product's lifecycle ends.

The Residential Energy Efficient Tax Credit For Existing Homes

The Residential Energy Efficient Tax Credit provides up to $500 to homeowners (increased to $1,500 by ARRA and scheduled for termination at the end of 2011) for the purchase of high-efficiency improvements (appliances) to existing homes. Over $5.8 billion has been allocated to 6.8 million taxpayers through the end of 2010.[303]

The U.S. Treasury Investigator General (IG) recently exposed structural problems in the administration of this tax credit, revealing that it has led to abuse of taxpayer dollars. The IG's findings showed the tax credits were wrongly awarded to 262 prisoners and 100 underage individuals younger than 18, 216 of whom were under 14 years old, and at least one of whom was under 3 years old.[304] The IRS was not able to confirm whether the individuals who claimed the credit were qualified at the time their returns were processed.

The IRS also failed to require documentation from a third party showing that an individual did in fact make a qualified purchase. In a sample of 6.8 million people who claimed over $5.8 billion in energy-efficiency tax credits for 2009, the IG found 30 percent of taxpayers had no record of even owning a home.[305] Such insufficient safeguards leave taxpayers vulnerable to erroneous payments.[306]

The cost for this provision in 2011 is $1.2 billion. Over the next 10 years, the provision will cost $12 billion, and should be eliminated.[307]

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[302] Website of the Climate and Energy Project, "U.S. drops to 3rd in clean-energy investment," March 30, 2011, U.S. drops to 3rd in clean-energy investment, accessed June 30, 2011.

[303] Harney, Kenneth R., "Treasury inspector general highlights problems at IRS with homeowner tax credits, *Washington Post,* May 27, 2011, http://www.washingtonpost.com/realestate/treasury-inspector-general-highlights-problems-at-irs-with-homeowner-tax-credits/2011/05/23/AGm9qmCH_story.html, accessed June 29, 2011.

[304] Peterson, Kristina, "Treasury Audit Finds IRS Doesn't Adequately Track Energy Credits," *Dow Jones Newswires,* May 18, 2011,http://online.wsj.com/article/BT-CO-20110518-714482.html, accessed June 30, 2011.

[305] Peterson, Kristina, "Treasury Audit Finds IRS Doesn't Adequately Track Energy Credits," *Dow Jones Newswires,* May 18, 2011,http://online.wsj.com/article/BT-CO-20110518-714482.html, accessed June 30, 2011.

[306] Website of the Treasury Inspector General for Tax Administration, Processes Were Not Established to Verify Eligibility for Residential Energy Credits, 2011-41-038, April 19 2011, http://www.treasury.gov/tigta/auditreports/2011reports/201141038fr.pdf, accessed June 30, 2011.

[307] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service,* December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011

Energy Efficient New Homes Tax Credit for Homebuilders

This credit provides up to $2,000 for builders of new efficient homes and is scheduled to terminate at the end of 2011.

The Congressional Research Service describes this provision as the type of tax subsidy that, "promote(s) specific types of investment [that] are economically inefficient, as they direct resources away from what would generally be their most productive use."[308]

The cost for this provision in 2011 is $66 million.[309] Over the next 10 years, the provision is estimated to cost $620 million, and should be eliminated.[310]

Energy Efficient Appliance Tax Credit for Manufacturers

This credit provides a tax credit up to $25 million in value to industrial companies or appliance manufacturers for new clothes washers, dishwasher, or refrigerators that meet Energy Star 2007 requirements. Ending this provision would save $2 billion over 10 years.[311]

Residential Energy Conservation Subsidy Exclusions for Businesses and Individuals

This exclusion provides that conservation subsidies provided by public utilities either directly or indirectly are nontaxable. It does not have a scheduled expiration date. Residential and multi-family residential entities qualify.

Qualified installations include solar water heat, solar space heat, photovoltaics, or other energy efficiency technologies not identified on houses, apartments, condominiums, mobile homes, boats and similar properties. If a building or structure contains both dwelling units and other units, any subsidy must be properly allocated.[312]

The individual exclusion provides that conservation subsidies provided by public utilities either directly or indirectly are nontaxable. A residential energy conservation measure includes "installations or modifications primarily designed to reduce consumption of electricity or natural gas, or to improve the management of energy demand. Eligible dwelling units include houses, apartments, condominiums, mobile homes, boats and similar properties."[313]

These two exclusions should be eliminated.

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[308] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.
[309] Website of the Joint Committee on Taxation, "Estimated Budget Effects Of The 'Tax Relief, Unemployment Insurance Reauthorization, And Job Creation Act Of 2010,'" December 10, 2010, http://www.jct.gov/publications.html?func=startdown&id=3715, accessed June 28, 2011
[310] Staff of Senator Tom Coburn estimate.
[311] Sherlock, Molly, "Energy Related Tax Provisions," *Congressional Research Service* memo, May 11, 2011
[312] Cunningham, Lynn J. and Roberts, Beth A., "Renewable Energy and Energy Efficiency Incentives: A Summary of Federal Programs," Congressional Research Service, March 22, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R40913&Source=search, accessed June 30, 2011.
[313] Website for the Database of State Incentives for Renewables and Efficiency, "Residential Energy Conservation Subsidy Exclusion (Personal), http://www.dsireusa.org/incentives/incentive.cfm?Incentive_Code=US03F&re=1&ee=1, accessed June 30, 2011.

Oil and Gas Tax Credits

The U.S. tax code is riddled with tax credits and subsidies that distort energy markets. While deductions allow companies to keep more of their own money and allocate capital as they see fit, tax credits are more akin to a direct spending program. While there can be a benefits associated in certain economic conditions, it would benefit taxpayers to end the tax credits for production of low-producing wells—the Enhanced Oil Recovery Tax Credit in particular.

These tax credits are neither spending programs hidden in the tax code nor provisions intended to allow companies to manage more of their own capital. Rather, they are safety net programs that pay energy companies, typically smaller independent oil and natural gas producers, in times when it is not economical to produce oil from expensive, low-producing wells. It should be noted the enhanced oil recovery tax credit could have an initial economic impact in certain parts of the country. However, this volatility would likely be temporary as markets would adjust to reflect the true cost of energy.

Repeal of Enhanced Oil Recovery Credit

The Enhanced Oil Recovery (EOR) Credit provides a 15 percent credit for the costs of oil recovery technologies. Enhanced Oil Recovery costs include those paid for depreciable tangible property, intangible drilling and development expenses, tertiary injectant expenses (such as CO2, nitrogen, or steam to supplement natural well pressure leveraged to extract oil from underground), and construction costs for certain natural gas facilities in Alaska.[314]

The credit is available when crude prices dip below $28 per barrel with a $6 phase-out range that occurs once prices reach $34 per barrel. Price triggers are determined by the annual average price of domestic crude oil from the previous calendar year. This credit is currently inactive but has cost $2.4 billion since its inception in 1990.[315] Some believe eliminating this credit would not have a significant impact on production as prices are expected to remain high. Although the potential savings are unclear, this proposal repeals this tax credit, preventing future revenue losses associated with dispensing federal benefits to cover the costs of enhanced oil recovery methods.

Marginal Well Tax Credit

Marginal wells average no more than 15 barrels per day and produce heavy oil. At least 95 percent of the well output is water and the well produces no more than 25 barrels per day of oil. Marginal gas wells do not produce more than 90 metric cubic feet (Mcf) per day.[316] Collectively, they are believed to comprise 20 percent of oil production and 12 percent of natural gas production. Marginal wells produce 17.8 percent of U.S. domestic oil and 9 percent of domestic natural gas. There are approximately 119,255 of these wells across the country.[317]

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[314] Website of the Joint Committee on Taxation, "Description Of Revenue Provisions Contained In The President's Fiscal Year 2012 Budget Proposal."JCS-3-11, June 14, 2011, http://www.jct.gov/publications.html?func=startdown&id=3796, accessed July 5, 2011, 336-337.

[315] Website of the Congressional Research Service, "Energy Tax Policy: Historical Perspectives on and Current Status of Energy Tax Expenditures," May 2, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=R41227&Source=search#_Toc292174215, accessed July 5, 2011.

[316] Website of the Independent Petroleum Association of America, "Marginal Well Tax Credit," April 2009, http://www.ipaa.org/issues/factsheets/tax_capital/2009-04-MarginalWellTaxCreditFactSheet.pdf, accessed July 5, 2011.

[317] Website of the State of Oklahoma, "Marginal Well Commission," http://www.ok.gov/marginalwells/About_MWC/Quick_Facts/index.html, accessed July, 5, 2011.

This credit was created in 1994 to keep these low-production, marginal wells in operation during periods of low pricing and on-hand surpluses. The credit provides $3 per barrel on the first three barrels of daily production and a $0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production.

Though currently inactive, under current law, a $3 a barrel tax credit is available for the first 3 barrels of daily production from an existing marginal oil well, plus a $0.50 per Mcf tax credit for the first 18 Mcf of daily natural gas production from a marginal well. The credit is available only if prices in the previous year were below designated averages – $18/barrel in the case of oil and $2/Mcf in the case of gas. This credit is currently phased out and should be ended permanently.

Advanced Nuclear Power Credit

The Advanced Nuclear Power Credit provides 1.8 cents per kilowatt hour (kWh) for nuclear power from new facilities for the first eight years of operation. The credit is capped at 6,000 megawatts, which is enough for approximately four to five reactors. However, applicants have filed applications for more than five times that amount of nuclear energy generation capacity by the end of 2008.[318] Recent estimates for production put new energy capacity at about 17,000 megawatts by 2021.[319] This credit was established in the same Act as Sec. 1703 nuclear energy loan guarantees, which are sufficient to bridge the gap between consumer demand and private investment to meet the high capital costs of nuclear construction.

Although this provision's current costs are negligible, as new nuclear power comes online, it could become very expensive. ,.[320] In order to prevent significant future revenue losses, therefore, this plan repeals the Advanced Nuclear Power Credit.

RESOURCEFUL REVENUE PROPOSALS

There are numerous creative strategies the federal government could employ to generate revenue for deficit reduction.

As an example, the Department of Transportation could sell the right to name federal highways, inviting individuals to propose naming the highway after particular individuals or events they wish to commemorate. The federal government also owns considerable online real estate, and could sell ad space on its websites at market rates as most private websites do.

Each of these proposals would need to include rules to ensure conflicts of interests do not exist between agencies and the private companies they regulate. If implemented properly however, these proposals would generate revenue for deficit reduction and help address runaway deficits.

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[318] Website of the Congressional Research Service, "Nuclear Energy Policy," RL33558, May 10, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL33558&Source=search#_Toc292897883, accessed July 5, 2011.

[319] Website of the Congressional Research Service, "Nuclear Energy Policy," RL33558, May 10, 2011, http://www.crs.gov/pages/Reports.aspx?PRODCODE=RL33558&Source=search#_Toc292897883, accessed July 5, 2011.

[320] Website of the Senate Budget Committee, "Tax Expenditures: Compendium of Background Material on Individual Provisions" *Congressional Research Service*, December 31, 2010, http://budget.senate.gov/democratic/index.cfm/files/serve?File_id=8a03a030-3ba8-4835-a67b-9c4033c03ec4, accessed June 25, 2011.

The reforms below would allow the federal government to better utilize existing resources and generate over $30 billion over the next ten years.

Sell Federal Lands

The government now owns so much land that federal land experts are only able to provide rough estimates of the total acreage under federal control. The Congressional Research Service, which estimates a total of 650 million acres, notes, "The total federal land in the United States is not definitively known, and this figure is an estimate based on several government sources."[321] This estimate of total acreage translates into the federal government owning one of every three acres nationwide, and nearly one of every two acres in the western United States.[322]

Forth Worth Federal Center, Fort Worth, TX
around 1,000,000 square feet on 75 acres of land

With untold acres of land under federal purview, it is little wonder maintenance costs are soaring. In fact, the federal government is struggling to meet some of the most basic and urgent upkeep needs on public lands. According to the Government Accountability Office, the nation's largest land management administrator, the Department of the Interior, faces a maintenance backlog estimated to range from $13.5 billion to $19.9 billion.[323]

Yet, in an era of record budget deficits and soaring maintenance costs, the federal government continues to purchases *more* land, costing taxpayers billions of dollars. Since the start of the most recent recession, the federal government has spent more than $724 million to purchase additional land, and over the past ten years, it has spent more than $2.5 billion to acquire land.[324]

This proposal calls for a five year moratorium on new purchases and require the disposal of lands with net proceeds equal to the amount spent to acquire additional lands since fiscal year 2001—about $2.5 billion. Emphasis should be on land already identified by land management agencies as suitable for disposal, while continuing to preserve access to our nation's most treasured public lands.

Opponents may argue the disposal of any land, however small, in response to budget deficits is short-sighted and threatens environmental protection and public access. This ignores previous analyses,

[321] Congressional Research Service, "Federal Land Ownership: Current Acquisition and Disposal Authorities," December 16, 2010, http://www.crs.gov/Products/RL/PDF/RL34273.pdf.
[322] Congressional Research Service, "Federal Land Ownership: Current Acquisition and Disposal Authorities," December 16, 2010, http://www.crs.gov/Products/RL/PDF/RL34273.pdf.
[323] Government Accountability Office, "Department of the Interior: Major Management Challenges," March 1, 2011, http://www.gao.gov/new.items/d11424t.pdf.
[324] Congressional Research Service, "Land and Water Conservation Fund: Overview, Funding History and Issues," August 13, 2010, http://www.crs.gov/Products/RL/PDF/RL33531.pdf. & Congressional Research Service, "Interior, Environment and Related Agencies: FY 2011 Appropriations," May 12, 2011, http://www.crs.gov/Products/R/PDF/R41258.pdf.

including one by the Department of the Interior performed during the Clinton administration that identified more than three million acres suitable for disposal.[325]

This reform could generate more than $2.5 billion over the next ten years.

Real Property Reform

Office buildings, warehouses, hospitals, laboratories, and ports of entry are just a few examples of the over 1.2 million properties that make up the federal government's real property portfolio.[326]

For decades now, the federal government has faced serious problems managing this portfolio, which has led to millions of tax payer dollars being wasted on excess, "not utilized," and underutilized federal properties. Excess property is defined as property identified by an agency to be no longer needed, while "not utilized" property is currently vacant but may or may not have a future use for the agency.[327] Meanwhile, underutilized property may still be part of the agency's mission, but only a percentage of the building is in use.[328]

To draw much needed attention to this systemic problem, the Government Accountability Office, in 2003, added federal real property to its bi-annual High-Risk list of government programs susceptible to waste, fraud, and abuse.[329] Increased oversight by GAO and Congress, as well as action taken by the Bush Administration and renewed by President Obama, has moved property reform in the right direction. Problems still exist, however, and much more needs to be done to reduce the vast number of buildings the federal government no longer needs. In fact, the GAO included real property yet again in its 2011 High-Risk List.[330] At a time when our country faces an uncertain future due to out of control spending and excessive borrowing, agencies must use every tool available to manage this vast portfolio and be good stewards of taxpayer dollars.

The government currently has over 63,000 underutilized and "not utilized" buildings in its real estate portfolio. Of these properties, over 57,000 are underutilized. That is an increase of over 12,000 underutilized properties from 2009.[331] These buildings are costing the American taxpayer over $1.2 billion to operate. According to OMB, the federal government has roughly 14,000 excess properties that cost the federal government costing over $131.8 million annually to operate.[332] In addition, federal agencies leased almost 635 million square feet of building space with a total of $8.1 billion in operational fees in fiscal year 2009.[333]

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[325] Becker, Bernie, The Hill: "GOP Lawmakers: Sell Some Public Lands to Narrow Deficit," March 18, 2011, http://thehill.com/blogs/on-the-money/budget/150683-gop-lawmakers-sell-some-public-lands-to-narrow-deficit.

[326] Zients, Jeffrey, White House Blog, "Cutting Costs by Getting Rid of Government Buildings We Don't Need," March 2, 2011, http://www.whitehouse.gov/blog/2011/03/02/cutting-costs-getting-rid-government-buildings-we-dont-need.

[327] Government Accountability Office (GAO-11-370T), "Federal Real Property: The Government Faces Challenges to Dispose of Unneeded Buildings, February 10, 2011, See Executive Summary.

[328] U.S. General Service Administration, "2010 Guidance for Real Property Inventory Reporting," See page 9. For example, the guidance states that an office building with less than 75 percent occupation is considered underutilized. The percentage of utilization is different depending on the type of property.

[329] Government Accountability Office(GAO-03-119), "High-Risk Series: An Update", January 2003, See page 23

[330] Government Accountability Office, "High-Risk Series: An Update", February 2011, See page 58.

[331] U.S. General Services Administration, See page 5.

[332] 2010 data from OMB.

[333] Courtney Thompson, Federal News Radio, "Senators want progress report on real property disposal efforts", July 7, 2011, http://federalnewsradio.com/?nid=35&sid=2450478.

This proposal will require the federal government to dispose of all excess federal real properties within five years. Disposal includes selling, demolition and public and private conveyance. If an agency does not sell the excess property, they will be prohibited from building or leasing any new property until they have certified that the excess properties has been disposed of. The proposal would also require OMB to make the Federal Real Property Database available to certain committees in the House and Senate. This will provide greater transparency and oversight into the problems associated with disposing federal real property. In addition, each federal agency, with the help of OMB, should also examine the unacceptable numbers of underutilized properties and find ways to consolidate properties where possible. The President proposed a civilian BRAC process that, if enacted, may be able to reduce the majority of the unneeded and mismanaged property. According to the Obama Administration, there is a potential saving of at least $15 billion if the federal government gets rid of properties it no longer needs.[334]

Collect Unpaid Taxes From Federal Employees

In 2009, the Internal Revenue Service found nearly 100,000 civilian federal employees were delinquent on their federal income taxes, owing over $1 billion in unpaid federal income taxes.[335]

Federal employees have a clear obligation to pay their federal income taxes. The very nature of federal employment and the concept inherent to "public service" demands those being paid by taxpayers to also pay their share of taxes. Federal workers should not be exempt from the laws they enforce. In fact, they should lead by example. Failure to do so is an affront to taxpayers and to the rule of law.

This proposal will save taxpayers at least $1 billion by requiring the Internal Revenue Service to collect unpaid federal income taxes from civilian federal employees.

Rent Smithsonian Buildings for Events

Under current rules, the public is not allowed to rent Smithsonian buildings to host events, which is a privilege retained only for corporate donors.[336] All 19 Smithsonian museum buildings should be

[334] Gregory Korte, *USA Today*, "White House identifies unneeded government property", May 4, 2011, http://www.usatoday.com/news/washington/2011-05-03-government-identifies-surplus-buildings_n.htm
[335] "$9.3 million in overdue taxes owed," *Washington Post*, Farnam, T.W., September 10, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/09/09/AR2010090907023.html

opened up for rental at a rate of $10,000 per evening. If each building were made available ten evenings a month and booked at fifty percent capacity, it would generate $38 million each year. This plan assumes $422 million in generated revenue over ten years from this provision.[337]

Charge $5 Admission Fee for Entrance to Museums

President Obama's National Commission on Fiscal Responsibility and Reform called for charging admission fees as high as $7.50 per person at the Smithsonian's museums, thus keeping pace with the national average.[338] Charging slightly less at $5 per visitor, with 30 million visitors in 2010, would generate $150 million in the first year, and potentially $1.67 billion over ten years.[339]

Collection of Billions in Unpaid Federal Fines

The federal government has failed to collect tens of billions of dollars of penalties owed by swindlers, criminals and others cited for violating federal laws and regulations and this amount has increased dramatically. More than $65 billion in fines and restitution is owed to the federal government as of last year. Yet, the Department of Justice only collected $2.84 billion of this amount.

According to the *USA Today*, "During the past decade, federal judges have ordered hundreds of the nation's biggest swindlers to repay millions of dollars they stole." The newspaper's analysis also found "so far, the government has collected about 2 cents on the dollar."[340] There are few consequences for not making the payments, according to the Government Accountability Office.[341]

"White-collar crime cases account for the largest amount of uncollected debt" according to GAO, but only seven percent of the restitution in such cases is paid. GAO blames a "fragmented processes and lack of coordination" for the failure to pursue the penalties owed.[342]

These unpaid fines have been levied for a variety of violations, including gasoline spills, substandard nursing home care, and exposing workers to radiation. Over a three year period, the Centers for Medicare & Medicaid Services issued more than $5.3 million penalties to nursing homes in Wisconsin, but collected no more than $500,000. Many of these fines are owed by repeat offenders for shoddy care of the elderly and disabled, including the deaths of more than 50 nursing home residents.[343]

As another example, a $3 million fine levied to a pipeline company for a gasoline spill and explosion that killed three people in Washington state was reduced by 92 percent.[344]

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336 "Smithsonian website, http://www.si.edu/giving/giv_faqs.html#faq10
337 Staff estimate.
338 "$200 Billion in Illustrative Savings, " Fiscal Commission website, http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/Illustrative_List_11.10.2010.pdf
339 Staff estimate.
340 Brad Heath, "Swindlers rarely pay huge, court-ordered fines," USA Today, March 7, 2011; http://www.usatoday.com/news/washington/2011-03-07-1Afines07_ST_N.htm .
341 Brad Heath, "Swindlers rarely pay huge, court-ordered fines," USA Today, March 7, 2011; http://www.usatoday.com/news/washington/2011-03-07-1Afines07_ST_N.htm .
342 Martha Mendoza and Christopher Sullivan, "Unpaid Federal Fines Soar to $35 Billion; An AP review finds that financial penalties are often reduced, waived or simply ignored," April 2, 2006; http://articles.latimes.com/2006/apr/02/news/adna-fines2
343 Ben Poston and Mary Zahn, "Fines sometimes go unpaid by nursing homes," Milwaukee Journal Sentinel, July 28, 2008; http://www.jsonline.com/news/wisconsin/29557299.html .
344 Martha Mendoza and Christopher Sullivan, "Unpaid Federal Fines Soar to $35 Billion; An AP review finds that financial penalties are often reduced, waived or simply ignored," April 2, 2006;

The $2.5 million in fines levied on nuclear laboratories for safety violations, including exposing workers to radiation, were "waived as soon as they were issued."[345]

The fines totally more than $1.3 million owed for deaths, injuries and other risks to miners from Alabama to West Virginia owed by coal companies have gone largely unpaid.[346]

Good faith efforts to pay fines over a period of time or come into compliance with laws and regulations merit consideration for some forgiveness in the total amount due. In too many cases, however, the federal government is collecting little or nothing of what is owed. For example, "if a nursing home agrees to accept the financial penalties without appeal, the home is given an automatic 35 percent discount, even in the case of a death," according to the USA Today.[347]

It is impossible to collect every penny of all of these fines, but in too many cases there is not even an attempt to collect a single penny.

The federal government should make a more aggressive effort to collect these fines. This should include deducting full amounts owed from the tax returns of individuals, companies and other entities who owe restitution. Those with outstanding fines should also be barred from receiving federal grants, contracts, leases and loans until the fines are repaid, or they should be levied 100 percent. Reductions in fines should not be allowed for simply not appealing a penalty. This may deter appeals but it does not encourage improvements in meeting standards. Reductions should be limited to those demonstrating good faith efforts for compliance and even in this case, a minimal fine to offset the cost of inspections should be levied.

The federal government should collect at least 15 percent of the $65 billion in unpaid fines, resulting in $9.75 billion in additional revenue over the next decade.

Volunteer Debt Check-Off Fund for Millionaires and Billionaires

Some of the wealthiest individuals in America have been very vocal in suggesting they are willing to pay more in taxes. Now they will have the opportunity.

Warren Buffett has led this effort, advocating higher taxes for the wealthy, claiming "people at the high end – people like myself – should be paying a lot more in taxes. We have it better than we've ever had it." [348]

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http://articles.latimes.com/2006/apr/02/news/adna-fines2 .

[345] Martha Mendoza and Christopher Sullivan, "Unpaid Federal Fines Soar to $35 Billion; An AP review finds that financial penalties are often reduced, waived or simply ignored," April 2, 2006; http://articles.latimes.com/2006/apr/02/news/adna-fines2 .

[346] Martha Mendoza and Christopher Sullivan, "Unpaid Federal Fines Soar to $35 Billion; An AP review finds that financial penalties are often reduced, waived or simply ignored," April 2, 2006; http://articles.latimes.com/2006/apr/02/news/adna-fines2 .

[347] Brad Heath, "Swindlers rarely pay huge, court-ordered fines," USA Today, March 7, 2011; http://www.usatoday.com/news/washington/2011-03-07-1Afines07_ST_N.htm .

[348] Neher, Juliann, "Warren Buffett Tells ABC Rich People Should Pay Higher Taxes," *Bloomberg News,* November 22, 2010, http://www.bloomberg.com/news/2010-11-21/warren-buffett-tells-abc-rich-people-should-pay-more-in-taxes.html

This report proposes a new check-off box on individual tax forms, allowing an individual who may not think they are taxed enough to volunteer to contribute more to the federal coffers. This donation would be directed toward deficit reduction.

Currently, individuals wishing to give a financial gift to the government may do so by mailing in a check or money order, payable to the U.S. Treasury. This reform would streamline this process.[349]

It is unclear how much revenue this provision would generate, but in one year the Bureau of the Public Debt received more than $3 million in financial gifts.[350] This plan would require the IRS to report to Congress how much revenue the volunteer debt check-off generated in the first year.

[349] Website of the Department of the Treasury, "Gifts to the United States Government," http://www.fms.treas.gov/faq/moretopics_gifts.html, accessed July 15, 2011.
[350] CATO, Downsizing the Federal Government, "Charitable Donations to the Government," accessed July 15, 2011, http://www.downsizinggovernment.org/charitable-donations-government.