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# United States Senate

COMMITTEE ON  
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510-6250

RICHARD J. KESSLER, STAFF DIRECTOR  
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July 24, 2013

Dear Senators Baucus and Hatch,

As the Finance Committee considers a long-overdue restructuring of the tax code, many in Washington are clamoring to defend their own slice of the tax expenditure pie. It is my hope the Committee will adhere to its "blank slate," and advocate ardently a flatter and fairer tax code. In support of your efforts, attached is a list of more than twenty-five tax expenditures, which should be eliminated, reduced, or reformed. This list is by no means exhaustive, and should be considered in the context of revenue-neutral tax reform.

By most estimates, special preferences in the tax code add up to more than \$1.3 trillion in annual spending, doled out to a variety of special interests, big businesses and banks, and even millionaires. Masquerading as tax cuts, many of these programs are no different from any other federal program that spends taxpayer money. Further, this form of spending is subject to virtually no oversight given the opaque nature of the tax code, making it even more difficult for taxpayers to know who is getting tax subsidies and who is not.

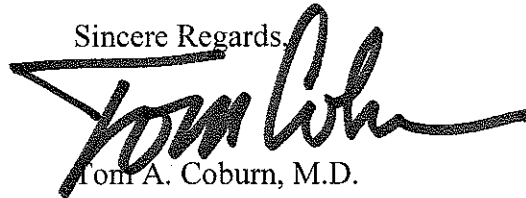
The method you are pursuing, to closely examine each individual provision in the code, is to be commended. We must remember the fundamental purpose of the tax code is to raise revenue to fund the operations of the federal government, not to hand out benefits to favored constituencies or to engage in industrial policy. Unfortunately, Congress has veered off course over the years and the tax code has become a massive federal spending program. Many carve-outs have existed for decades and are no longer merited. Further, some are manipulated to reduce tax liabilities for entities and individuals other than those originally intended.

These severe shortcomings of the current system would be avoided entirely by replacing the current income-based tax structure with a flatter, fairer consumption-based approach. I have long supported ending the income tax system, which punishes success, and instead moving to a consumption tax. While I am encouraged by the Committee's work, I ask you to consider other options for a complete overhaul, including the possibility of a new tax structure based on consumption. The tax code has become an inherently unfair distributor of federal benefits, and I am hopeful your work to reform it will be successful.

As part of a \$9 trillion deficit reduction plan, *Back in Black*, I recommended eliminating more than forty special interest tax giveaways and reforming other major tax spending programs. While many are reflected below, I urge you to examine this document for even more tax expenditures that can be eliminated. Please take particular note of the discussion of misdirected energy tax expenditures, many of which should be eliminated or severely curtailed.

As the Committee undertakes tax reform, please include the following proposals to eliminate and reform tax expenditures. To be clear, the list is just a starting point, and I continue to strongly support eliminating all tax expenditures and lowering income rates for all Americans. However, these special preferences represent a wide array of the types of provisions the Committee should consider jettisoning, should your efforts lead to revenue-neutral comprehensive tax reform legislation. Thank you for your effort, and I look forward to collaborating with you on this endeavor.

Sincere Regards,

A handwritten signature in black ink, appearing to read "Tom Coburn", with a stylized flourish extending to the right.

Tom A. Coburn, M.D.

United States Senate

## TAX EXPENDITURE ELIMINATIONS AND REFORMS

Many, though not all, of these recommendations are also included in the deficit reduction report *Back in Black*. For more extensive details and even more areas for reform, please view the tax chapter of [this document](#).

### **End Corporate Welfare & Special Industry Carve-Outs**

There are countless examples of special tax breaks throughout the code designed to benefit certain industries, big businesses, and even some of the most lucrative financial entities in the country. These tax breaks should be eliminated, and instead the individual and corporate income tax code should be restructured to encourage fair competition and private-sector growth, and ensure certain well-connected companies and businesses do not receive special treatment.

**New Markets Tax Credit.** Corporations investing in businesses that provide capital to projects in low-income communities can apply for New Markets Tax Credits. However, those benefitting the most from these tax credits are big Wall Street banks like Goldman Sachs, JP Morgan, and the Merrill Lynch Community Development Company, which have used millions of taxpayer dollars to renovate glitzy downtown hotels, fund Starbucks, IHOP, and Subway stores, sports arenas, doggie daycares, solar panels for conventions centers, a trolley tour and a car museum.

Further, the program is highly inefficient and much of the money intended for projects is siphoned away by legal fees and administrative costs. The flawed design and complex structure of the tax credits means that more money is getting in the hands of accountants and lawyers than is getting to the low-income communities. The program, which is inefficient and duplicative of countless other federal economic development efforts, should be eliminated.

**Logging Industry Subsidies.** The federal tax code has several breaks for tree planting in the timber industry. Maintenance costs, such as thinning, disease and pest management, and fire costs are all approved deductions. Reforestation expenses may also be deducted by multiple individuals for the same unit of property, which by regulation can be as small as one acre. This particular tax subsidy singles out the tree planting and timber industry and provides them with significant benefits, costing taxpayers more than \$2 billion over the next ten years.

**Credits for Historic Preservation and Rehabilitation of Non-Historic Structures.** Current law provides for two separate tax credits for historic preservation of structures. One is applied to structures certified by the National Park Service as historic structures, while the other is a preservation tax credit for other structures not certified as historic. These tax credits are highly duplicative of numerous other federal grant programs such as the Community Development Block Grant, the National Community Development Initiative, and USDA's Rural Development Program. The credit also provides funding for lower-priority projects outside the federal purview, such as \$27 million development of a beer garden and microbrewery at a former Coca-Cola syrup plant in St. Louis, a conversion of Milwaukee's historic Loyalty Building into a

Hilton Garden Inn, and renovations to the luxury Lafayette Hotel in Buffalo. This tax credit should be eliminated.

**Residential Energy Efficient Property Credit.** The Residential Energy Efficient Property Credit provides up to \$500 to homeowners for the purchase of high-efficiency improvements (appliances) to existing homes. The credit was increased to \$1,500 in the stimulus legislation. The U.S. Treasury Investigator General recently exposed structural problems in the administration of this tax credit. The IG's findings showed the tax credits were wrongly awarded to 262 prisoners and 100 underage individuals younger than 18. 216 of these individuals were under 14 years old, and at least one of whom was under 3 years old. 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. The credit should be eliminated.

**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. 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. This provision substantially lowers the cost of track maintenance for the qualifying short-line railroads, with tax credits covering half the costs for qualifying firms. Repealing this tax credit would enable more efficient allocating of private funds to address transportation needs.

**Tax Break for Eskimo Whaling Captains.** Despite the fact that commercial whaling is banned in U.S. territorial waters, after seven years of lobbying by the Alaska congressional delegation, effective in 2005, Congress decided to provide a tax benefit to whaling captains. Specifically, the tax code now allows Native Alaskan whaling captains to claim up to a \$10,000 per year in a charitable tax deduction to offset their equipment, fuel, and certain other costs for the annual subsistence whale hunts, which are generally conducted in the Beaufort Sea.

**Hollywood Tax Breaks.** Designed as an incentive to encourage Hollywood to produce feature films and television programs in the United States, the tax code allows entertainment companies to deduct, at the time in which the costs are incurred, up to \$15 million in certain production costs when at least 75 percent of the costs are for work performed on U.S. soil. Hollywood film production is also being subsidized through state tax incentives in nearly 40 states. The film industry is in no need of federal support. For example, the movie *Hangover Part II*, brought in more than \$232 million in one month. Yet with production costs of only \$80 million, the movie netted a profit in the first weekend, alone. Nor do movie goers appear to be hindered by the current economy. Meanwhile, it remains unclear if these incentives, whether at the state or

federal level, actually pay for themselves. There is no conclusive evidence these projects bring in enough revenue during production to offset the cost of the multi-million dollar write-offs and tax breaks.

**Brownfields Tax Break.** Non-profit organizations are subject to tax 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 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 Congressional Research Service outlined some concerns with this provision, stating this “expensing is inefficient because it makes investment decisions based on tax considerations rather than inherent economic considerations.” The 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.”

These concerns should be further considered, given there are numerous other federal programs intended to aid cleanup and redevelopment efforts of brownfields. The Committee should eliminate these duplicative initiatives and focus on ensuring the remaining federal programs do not overlap.

**Low-Income Housing Tax Credit.** As one of the purest examples of a direct spending 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 certain tenants. Over a period of ten years, the nonrefundable credit compensates companies for roughly 70 percent of their investment, 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 largely duplicative of countless programs at the Department of Housing and Urban Development, which provides and other federal assistance to provide help for 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 costs and payouts to private companies instead of applied directly to the housing projects. This credited, which is poorly targeted, very expensive, and duplicative of other government efforts, should be eliminated.

## **Limit Tax Breaks for Millionaires**

The tax code provides a large number of deductions and credits, many of which accrue heavily towards the wealthy. To the tune of more than \$28 billion a year, millionaires are getting special tax breaks on everything from vacation homes to energy efficient home improvements, while writing off their gambling losses, cancelled debts, and rental expenses. Congress should reform our government to make sure safety net programs do not become a hammock for the rich. Limiting the following benefits for wealthy individuals will save billions of dollars without reducing benefits for those in need.

While some of these special exemptions and credits should be eliminated entirely, others are in need of reform to ensure those any assistance is targeted to those in need.

**Childcare Tax Credit.** Individuals can claim this credit for expenses related to the care of children under the age of 13. The credit is a percentage of the total amount spent on the child, up to \$3,000. That percentage decreases as one's income increases. Individuals making \$43,000 or more are allowed to deduct 20 percent of childcare expenses (up to \$3,000).

For example, under current code, a family making \$43,000 takes the same deduction as a millionaire, since no income limits exists on the credit. The credit includes any expense related to household services related to the child, including a maid or cook. From 2007-2009, millionaires claimed over \$18 million through the child care tax credit. The tax code should not provide a credit for childcare expenses and the provision should be entirely repealed.

**Electric Vehicles.** To help encourage the purchase of certain plug-in electric vehicles, the government provided a tax credit of \$7,500. However, a government audit found that individuals were claiming the credit who had not purchased the right car to qualify. In 2009, millionaires claimed over \$12.5 million in qualified plug-in electric car credits. Even more, this is an industry-specific credit, which should be entirely repealed.

**Forgiven Debt.** The tax code allows for cancelled debt to be excluded from income, which includes debt cancelled in a Title 11 bankruptcy case. From 2008-2009, millionaires excluded over \$128 million in cancelled debt from their income. At the same time, these individuals earned \$1 million or more. This provision should be thoroughly reviewed by the Committee.

**Gambling Losses.** If an individual loses money at the craps table, that is deductible under the current tax code. However, the deduction may not be more than what that individual claimed in winnings. From 2006-2009, millionaires deducted over \$20 billion in gambling losses. This deduction should be entirely eliminated.

**Rental Expenses.** Millionaires are also allowed to deduct expenses related to renting investment properties, including, property depreciation, cleaning and maintenance, and mortgage interest.

From 2006 to 2009, millionaires deducted over \$64 billion in rental expenses. While some deductions are a natural part of business, the Committee should review this provision carefully.

### **Eliminate Sporting Subsidies**

There are numerous sports subsidies throughout the tax code which should be eliminated. Several of these tax breaks are outlined below and should be considered for elimination.

**Tax-Exempt Status for Professional Sports Leagues.** The National Football League, the National Hockey League, and the Professional Golfers' Association classify themselves as non-profit organizations to exempt themselves from federal income taxes on earnings. Smaller sports leagues, such as the National Lacrosse League, are also using the tax status. Taxpayers are losing millions of dollars subsidizing these tax loopholes for professional sports leagues that generate billions of dollars annually in profits.

**Resident Alien Exemption for Foreign Professional Golfers.** Enacted as part of tax reform in 1986, current tax law exempts foreign athletes participating in certain charitable events in the United States from being required to count this time in the States toward their permanent resident alien status (183 days). As such, these athletes are not subject to U.S. income taxes on their world-wide earned income.

Because the PGA Tour donates a portion of the earnings from large tournaments, these events are considered charitable, which allows professional foreign golfers to remain in the States for extended periods of time, without being subject to taxes on their non-U.S. earnings. The carve-out was targeted to the PGA, and at the time, The Philadelphia Inquirer reported, "The PGA's decision to seek Quayle's help may have been influenced by the fact that one of the senator's staff members - Greg Zoeller - is the cousin of 1984 U.S. Open champion Fuzzy Zoeller, Juday [a Quayle aide] said" Twenty-seven years later the provision remains.

**PGA Exemption for Deferred Compensation.** In 2004, Congress granted the PGA an exemption for its unique deferred compensation structure, which allows a portion of player winnings to be put into a tax-free account based on their performance. Of note, the PGA is not referenced by name in the law. Instead, Congress listed requirements exempt organizations, which only the PGA could meet, including being an entity "incorporated on July 2, 1974."

The 2004 American Jobs Creation Act limited the use of certain types of compensation packages used to avoid taxes, but exempted the professional golfers receiving compensation packages from the PGA, further reducing their income on which they paid taxes.

**Tackle Box Tax Break.** While historically required to pay a 10 percent excise tax on all sold equipment, manufacturers, producers, and importers of fishing tackle boxes were given a break in 2004 when the tax was reduced to only three percent. Other sport fishing equipment remains

subject to the full excise tax, including fishing rods and poles, fishing reels, lures and hooks. Ending this tax break would, once again, treat tackle boxes the same as other fishing equipment.

**Dog and Horse Racing Gambling Tax Break.** Foreigners who gamble at horse and dog tracks in the United States were once subject to a withholding tax on their winnings; that is no longer the case. 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.

**MotorSports Speedways Accelerated Depreciation.** The cost of “motorsports entertainment complexes” can be written off over seven years. One of the main beneficiaries of this tax subsidy is the International Speedway Corporation, owners of the Daytona Speedway and 11 other NASCAR tracks. The company’s estimated benefit from this provision is approximately \$38 million. Many businesses also take advantage of a 15 year depreciation schedule for “land improvements.”

### **Additional Areas for Reform**

#### **Full Review and Reform of the Tax-Exempt Status and Charitable Designations**

There are more than 1.6 million tax-exempt organizations in the United States, nearly one million of which are public 501(c)(3) charitable organizations. This number continues to grow, as a recent Department of Treasury Inspector General report revealed the IRS receives more than 60,000 applications for charitable status every year. Recently, several investigations revealed extensive abuse and fraud associated with many of the entities taking advantage of the tax-exempt structure.

For example, an April 2013 ESPN investigation of charities run by high-profile athletes found “74 percent of the nonprofits fell short of one or more acceptable nonprofit operating standards.” Further, their work revealed several athlete charitable groups stopped filing tax returns completely, while others provided misinformation on their IRS filings. More recently, an extensive study by the Tampa Bay Times, CNN, and the Center for Investigative Reporting, exposed serious concerns of the activities and financial structures of dozens of charitable 501(c)(3) organizations, many of which diverted most of their charitable donations to private fundraising companies instead of to the charitable activities advertised to donors. Their report uncovered examples of inappropriate fundraising, such as lying to donors and even embezzlement, as some charities funneled donations to their own for-profit operations.

As the Committee looks to create a fairer and more equitable code, I urge you to consider a comprehensive overhaul of the current tax-exempt structure. The millions of dollars in lost revenue under the current system is not only unfair to taxpayers, but is resulting in misdirected federal subsidies that could instead be used to better the lives of millions through hundreds of exemplary and generous charitable organizations.



### **Employer-Provided Health Exclusion**

As the largest expenditure in the tax code, the employer health exclusion should be under examination by the Committee for reform or elimination. The influx of revenue from changes to this provision should be used to lower costs in the health care sector.

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 reforms to the employer-provided health exclusion to provide a more balanced benefit to everyone and greater fairness.

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.

The Committee should consider a wide range of possible reforms to the employer-provided health exclusion, including the possibility of repealing and replacing it with a more efficient system.

### **Reform Health Exchange Tax Subsidies**

The Affordable Care Act provided tax subsidies to Americans who are forced to purchase government-managed health insurance coverage under the law. Americans with annual income four times higher than the poverty level are eligible for these subsidies. For example, a family of four with annual income of \$92,000 would be eligible for subsidies. However, it is not fair to force millions of Americans to pay higher taxes in order to subsidize the health coverage of Americans – especially wealthier Americans. The Committee should consider limiting those eligible for these subsidies to Americans at 200% of poverty.

### **State and Local Tax Deduction**

One of the largest expenditures in the tax code, the state and local tax deduction, subsidizes high-income Americans in high-tax states. This tax preference is largely skewed to the wealthy – with 80 percent of the benefit accruing to the top 20 percent of the population.

In addition, the deduction subsidizes high-tax state and local governments and in the process encourages them to further raise income and property taxes on hard-working Americans. States do not need incentives to raise taxes, and the rich do not need deductions to help them avoid paying taxes.

The committee should strongly consider eliminating this deduction, in the context of lowering overall income tax rates on all Americans.

### **Mortgage Interest Deduction**

The mortgage interest deduction is one of the most expensive tax breaks in current law, resulting in lost federal revenue of nearly \$88 billion in Fiscal Year 2011. While any assume the deduction largely benefits middle and lower income earners, this is not actually the case. In 2008 alone, millionaires across the country took advantage of more than \$7 billion in mortgage interest deduction tax breaks. The provision of the mortgage interest deduction relating to second homes further highlights that many of those benefitting from this tax break are among the most well off. Even a yacht can be considered a second resident- 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.

The IRS has done very little to verify the validity of claims and 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 own.

One well-known proposal has been discussed by the CBO, as well as included in the President's National Commission on Fiscal Responsibility and Reform. This idea calls for 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, to better target the mortgage deduction to those with the most need, while resulting in significant savings. Other reform options can also be considered, but the Committee should closely examine curtailing, if not entirely eliminating, this tax benefit.

### **Tax-Exempt Interest**

State and local governments have the ability to issue tax-exempt municipal bonds to finance capital projects, such as a roads or government buildings. Investors who purchase these bonds pay no federal taxes on their interest earnings. Because the interest earnings are tax-free, investors are willing to accept lower interest payments on the bonds, lowering borrowing costs for state and local governments. The exclusion, therefore, functions as a subsidy through the tax code for state and local governments.

The subsidy is highly inefficient, however—part of it is directed to the bondholders, functioning purely as a tax shelter for investors without any benefit to state and local governments. The tax exclusion is particularly valuable for higher-income taxpayers. According to the IRS, in 2009, nearly 4 million tax filers earned \$200,000 or more. Of these, 19,551 filers (less than half a percent) paid no taxes to any national government. The IRS conducted a detailed examination of these 19,551 filers to determine the reasons they paid no taxes. These filers reported \$7.6 billion in income, and \$4.6 billion of that income was from tax-exempt interest and therefore was not included in taxable income. Most of the filers used a combination of different provisions to

achieve a tax liability of zero, but for 61 percent of the filers, tax-exempt interest was the largest portion.

The revenue currently lost through this exclusion would be much better spent lowering tax rates for all Americans. Further, although Congress has created a number of rules on how these bonds may be used, the federal government has little control over the specific projects that ultimately benefit from them. As a result, many questionable projects have benefited from this tax subsidy. The Committee should conduct a full review of this exclusion and consider options for reforming and limiting it.

### **Reforms for Safety Net Tax Programs**

Several significant tax expenditures and other prominent features in the tax code should be completely overhauled as the Committee considers comprehensive tax reform. Some of the largest tax expenditures are designed to provide support for low-income families. This safety net for those truly in need is being threatened by the abuse and long-term use of certain tax credits. At a minimum, the Committee should consider the following two reforms.

**Require Proper Beneficiary Identification for Additional Child Tax Credit.** As the refundable portion of the Child Tax Credit, the Additional Child Tax Credit (ACTC) is directed to individuals with very little or no other tax liabilities. However, millions of individuals are able to obtain the tax credit without a valid Social Security number. Instead they use an Individual Taxpayer Identification Number (ITIN), which is available even to those that are not legally authorized to work in the United States. In a review of this significant shortfall in the program, the Treasury Inspector General 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.” Ending the ACTC for individuals without a valid SSN would save at least \$17 billion over five years. Meanwhile, the IRS should also be given more authority by Congress to deny fraudulent claims.

**Reform EITC: Five Year Cap on Earned Income Tax Credit.** 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. Three years later, Congress made the program a permanent welfare program. This tax spending 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 in 2009. Since the tax credit is refundable, an EITC recipient does not need to owe taxes to receive the benefits. The same low-income individuals can qualify for Medicaid, Supplemental Nutrition Assistance Program, Supplemental Security Income, Pell Grants, Temporary Assistance for Needy Families, and the Additional Child Tax Credit at the same time. Limiting the length of time a recipient can receive the benefit help return to the program to its original intent by encouraging recipients to transition from welfare to full time employment within the five year window.