

Overview

Almost every debate around tax reform eventually raises the issue of closing “loopholes.” But many of these “loopholes”—technically known as “tax expenditures”—have been an important feature of the tax code for both American companies and middle-class families.

What are “tax expenditures”?

Anything in the tax code that lowers your taxes—such as a deduction for home mortgage interest, extraordinary medical expenses or college tuition—is a “tax expenditure” as defined by the 1974 Budget Act. Almost all economists think of tax benefits as equivalent to direct government subsidies, which is why these breaks are considered “expenditures”—or spending. For example, getting a \$200 tax credit for installing energy-efficient appliances is economically no different from getting a \$200 check from the IRS.

When economists talk about the “cost” of tax expenditures, they are referring to the amount of money the government *would* have collected in the absence of a particular tax benefit. The revenues lost from various tax breaks are the reason why almost no one pays the top tax rates in the current code.

What are the largest tax expenditures?

The Joint Committee on Taxation estimates the ten largest individual tax breaks cost nearly \$3 trillion in lost revenues from 2005 to 2009. Priciest is the one for employer-provided health insurance; employer-paid insurance is essentially tax-free to workers. Barring changes in the law, the projected top five individual tax expenditures for 2013 to 2017 are as follows:

<u>Top five individual tax expenditures</u>	<u>Lost revenue (cost), 2013-2017</u>
• Tax exemption for health insurance premiums	\$1.01 trillion
• Home mortgage interest deduction	\$606.4 billion
• 401 (k) or similar retirement plans	\$428.7 billion
• Exclusion of imputed rental income	\$337.4 billion
• Capital gains	\$321.4 billion

Other popular (and expensive) tax expenditures include deductions for charitable contributions and for state and local taxes, which are estimated to cost a total of \$533 billion from 2013 to 2017.

Why are tax expenditures controversial?

The U.S. tax code has historically been an important tool for achieving such policy goals as encouraging home ownership, defraying the costs of college or raising children or in the case of companies, encouraging investments and job growth. Some argue, however, that too many breaks lead to too much complexity, while others dispute what activities “should” get a tax break and what shouldn’t. Tax expenditures can also be tough to change because of their popularity and their potential to be cast politically as “tax increases” if reduced or eliminated.

Key Facts

- 2011 total revenues (CBO): **\$2.303 trillion**
- 2011 projected budget deficit (CBO): **\$1.30 trillion**
- Loss of 2011 revenues due to tax expenditures (Tax Policy Center):
 - Individual income taxes: **\$974 billion**
 - Corporate income taxes: **\$109 billion**
- Top individual tax expenditure, 2011:
 - Employer exclusion of health care premiums: **\$163.04 billion**
- Top corporate tax expenditure, 2011:
 - Accelerated depreciation of equipment: **\$118.5 billion**

Other Resources

- Congressional Budget Office (CBO) – [Budget and Economic Outlook: Fiscal Years 2012 to 2022](#)
- Joint Committee on Taxation (JCT) – [Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates](#)
- Joint Committee on Taxation – [Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014](#)
- Brookings-Urban Tax Policy Center – [How Large Are Tax Expenditures?](#)
- Brookings-Urban Tax Policy Center – [Projected Income Tax Expenditure](#)
- Office of Management and Budget – [Budget of the United States Government, Fiscal Year 2013, Tax Expenditures Spreadsheet](#)

Links to Other Resources

- Congressional Budget Office—Budget and Economic Outlook: Fiscal Years 2011 to 2022
http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-31-2012_Outlook.pdf
- Joint Committee on Taxation—Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates
<http://www.jct.gov/publications.html?func=startdown&id=3740>
- Joint Committee on Taxation—Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014
<http://www.jct.gov/publications.html?func=startdown&id=3718>
- Brookings-Urban Tax Policy Center—How Large Are Tax Expenditures?
<http://www.taxpolicycenter.org/UploadedPDF/1001526-Expenditure-Estimates.pdf>
- Brookings-Urban Tax Policy Center—Projected Income Tax Expenditures 2013-2017
<http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=614>
- Office of Management and Budget—Budget of the United States Government, Fiscal Year 2013, Tax Expenditures Spreadsheet
<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/teb2013.xls>