The Heritage Foundation

ISSUE BRIEF

No. 4688 | APRIL 20, 2017

Repealing Business Tax Preferences: Not Enough to Markedly Reduce Tax Rates

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The business tax code does not contain nearly as many genuine tax preferences as is usually advertised.[1] Most true tax preferences are provisions used by individuals.[2] Even if all genuine tax preferences were repealed, the result would merely allow an estimated three-percentage-point corporate-tax-rate reduction while maintaining the same tax revenue.

Provisions that allow businesses to deduct their capital expenses or other costs are not tax preferences. These are legitimate business expenses that should be deductible when incurred for purposes of calculating taxable income. For example, the cost of building a factory, buying equipment, purchasing inventory, or advertising should be deductible, and tax provisions that allow such deductions are not tax preferences. In fact, the current tax system often requires businesses to delay deducting these costs, sometimes for many years.

There are, however, business tax preferences that should be repealed. Congress could eliminate some or all of the corporate-tax preferences listed in Table 1 to offset the revenue loss of rate reduction.

"Tax expenditures" do not truly add because of stacking and other issues.[3] Nevertheless, the tax-expenditure figures provided in Table 1 give a good sense of the likely impact on revenues. The true corporate-tax expenditures in the code amount to about $281 billion over 10 years—less than 7 percent of the $3.9 trillion that the corporate income tax is expected to raise over the same period.[4] Thus, at best, repeal of these provisions can be expected to allow approximately a three-percentage-point rate reduction, if the objective is revenue neutrality.[5]

Although the economic-growth effects of corporate-tax-rate reduction will be strong, they are unlikely to be self-financing. The Joint Committee on Taxation (JCT) will undoubtedly score corporate rate reduction as reducing federal revenues dramatically more than it actually will. The economic-growth effects will be larger than JCT models predict, and corporate tax avoidance will decline more than the JCT predicts.

Conclusion

Congress should repeal genuine corporate tax preferences, but there are only enough genuine corporate tax preferences for a three-percentage-point corporate-tax-rate reduction. Individual tax preferences, in contrast, are large.

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This paper, in its entirety, can be found at
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TABLE 1

Business Tax Preferences, FY 2016–2025

TAX PREFERENCE	REVENUE REDUCTION IN BILLIONS OF DOLLARS	
	All Businesses	Corporations Only
Deduction for U.S. production activities	$193	$146
Credit for low-income housing investments	$88	$83
Energy production credit	$19	$15
Excess of percentage over cost depletion, fuels	$13	$10
Exclusion of interest for airport, dock, and similar bonds	$13	$4
Exclusion of interest on water, sewage, and hazardous waste facilities	$8	$2
Tax incentives for preservation of historic structures	$5	$4
Exclusion of utility conservation subsidies	$6	$0.3
Advanced nuclear power production credit	$6	$5
Tax credits for clean-fuel burning vehicles and refueling property	$5	$2
New markets tax credit	$4	$4
Energy investment credit	$5	$4
Credit for investment in clean coal facilities	$1	$1
Credit for holding clean renewable energy bonds	$0.7	$0.2
Exclusion of interest on energy facility bonds	$19	$0.1
Qualified energy conservation bonds	$0.3	$0.1
Total	**$386**	**$281**

SOURCE: Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2017*, Chapter 14, https://obamawhitehouse.archives.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf (accessed March 21, 2017).

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Endnotes

1. See, for example, "Majority Say Wealthy Americans, Corporations Taxed Too Little," Gallup, April 18, 2017, http://www.gallup.com/poll/208685/majority-say-wealthy-americans-corporations-taxed-little.aspx (accessed April 18, 2017); "Making the Wealthy, Wall Street, and Large Corporations Pay their Fair Share," https://berniesanders.com/issues/making-the-wealthy-pay-fair-share/ (accessed April 18, 2017); Jeanne Sahadi, "Crazy Corporate Tax Loopholes? 'Inversions' Are Small Potatoes," CNN, September 23, 2014, http://money.cnn.com/2014/09/23/news/economy/corporate-taxes-inversions-and-other-loopholes/ (accessed April 18, 2017); and Josh Dzieza, "8 Ridiculous Tax Loopholes: How Companies Are Avoiding the Tax Man," *The Daily Beast*, February 25, 2012, http://www.thedailybeast.com/articles/2012/02/25/8-ridiculous-tax-loopholes-how-companies-are-avoiding-the-tax-man.html (accessed April 18, 2017).
2. The author's rough estimate is that there are at least $7.5 trillion in true individual tax expenditures for fiscal years 2016 to 2025. This is more than 25 times the level of true corporate tax expenditures.
3. In reality, the entire corporate tax is a large negative tax expenditure (constitutes overtaxation) because the current tax system double taxes corporate income. It is taxed once by the corporate income tax, and then taxed again by the individual income tax when shareholders receive dividends or have capital gains on corporate stock. Stated differently, the same income is included in the tax base twice. See David R. Burton, "Four Conservative Tax Plans with Equivalent Economic Results," Heritage Foundation *Backgrounder* No. 2978, December 15, 2014, http://www.heritage.org/research/reports/2014/12/four-conservative-tax-plans-with-equivalent-economic-results, and David R. Burton, "Tax Reform: Eliminating the Double Taxation of Corporate Income," Heritage Foundation *Backgrounder*, forthcoming.
4. In January 2015, the Congressional Budget Office (CBO) estimated that the corporate income tax would raise $4,591 billion over the 10-year period FYs 2016–2025 (which corresponds to the period of the tax-expenditure estimates provided by the Treasury Department shown above). However, in January 2016, the CBO projected that over the 10-year period FYs 2017–2026, the corporate income tax would raise only $3,907 billion, and in January 2017, the CBO projected that that over the 10-year period FY 2018–2027, the corporate income tax would raise only $3,882 billion. Accordingly, for calculating the percentage, an estimate of $3.9 trillion was used. See Congressional Budget Office, *Budget and Economic Outlook 2017–2027*, January 2017, https://www.cbo.gov/sites/default/files/115th-congress-2017-2018/reports/52370-outlook.pdf (accessed April 14, 2017) and the two previous years' version of this document. If the higher revenue projection was used, the rate reduction to be funded by tax preference repeal would be lower (2.1 percentage points).
5. $281/$3,900 = 7.2 percent; 0.072 x 35 = 2.52.