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FISCAL FACT

Who Benefits Most from Targeted Corporate Tax Incentives?

By Scott A. Hodge

Taking advantage of the tragic Gulf oil spill, some legislators are attempting to turn the energy bill being debated in Congress into a vehicle to repeal the tax code's "subsidies" to the oil and gas industry.

A White House proposal to eliminate tax expenditures that benefit oil and gas companies would, according to FY 2011 Budget, collect an additional $36 billion over ten years. However, this includes several provisions that benefit a broad cross-section of industries. Some interest groups have piled on, claiming even bigger tax collections are possible.[1]

These charges invite the larger question: How valuable are tax provisions that benefit particular industries or groups of people?

We can find these answers within President Obama's 2011 budget published last February, in a volume titled Analytical Perspectives.[2] This volume contains estimates produced by the Treasury's Office of Tax Analysis of the budgetary costs of all of the tax preferences benefiting both corporate and individual taxpayers. In budgetary parlance, these preferences are called tax expenditures.

When we add up all of the tax expenditures available to corporations in 2011, they total $102 billion.[3] While this is a lot of money to be sure, these preferences taken together are still less than the budgetary cost of popular individual tax breaks such as the mortgage interest deduction ($104 billion), individual tax breaks benefiting state and local government ($96 billion), and the exclusion for employer-provided health insurance ($174 billion).

But even if all of the biggest tax expenditures are on the individual side of the tax code, it is still worth examining those on the corporate side. The $102 billion in corporate tax expenditures break down into five major categories:

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[1] Sima J. Gandhi, "Eliminating Tax Subsidies for Oil Companies," Center for American Progress, May 13, 2010.
[2] Budget of the United States, Fiscal Year 2011, Analytical Perspectives, p. 207.
[3] Tax expenditures are interactive, so the official estimates only apply to eliminating any one of them.

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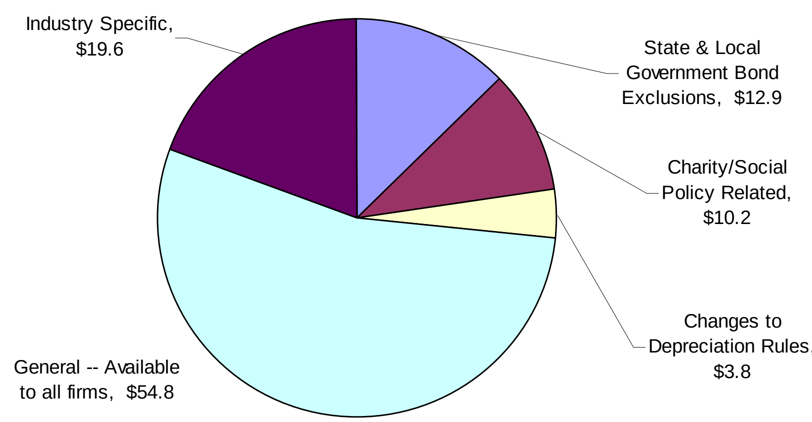
- Provisions that benefit all firms regardless of industry;
- Industry-specific or targeted provisions;
- Tax exclusions for state and local bond activities;
- Provisions benefiting charitable and social policy objectives; and
- Changes to depreciation rules.

Figure 1: Composition of $102 Billion in Corporate Tax Expenditures in 2011

(In $Billions)



Source: FY 2011 Budget

As Figure 1 shows, the largest category of corporate tax expenditures, with a budgetary cost of $54.4 billion in 2011, is the collection of provisions that are generally available to all firms regardless of industry. Some of the tax provisions in this category – such as the deferral of taxes on active income earned abroad and the domestic manufacturing deduction – are the same provisions that the administration wrongly ascribed as unjustly benefiting the oil and gas industry.

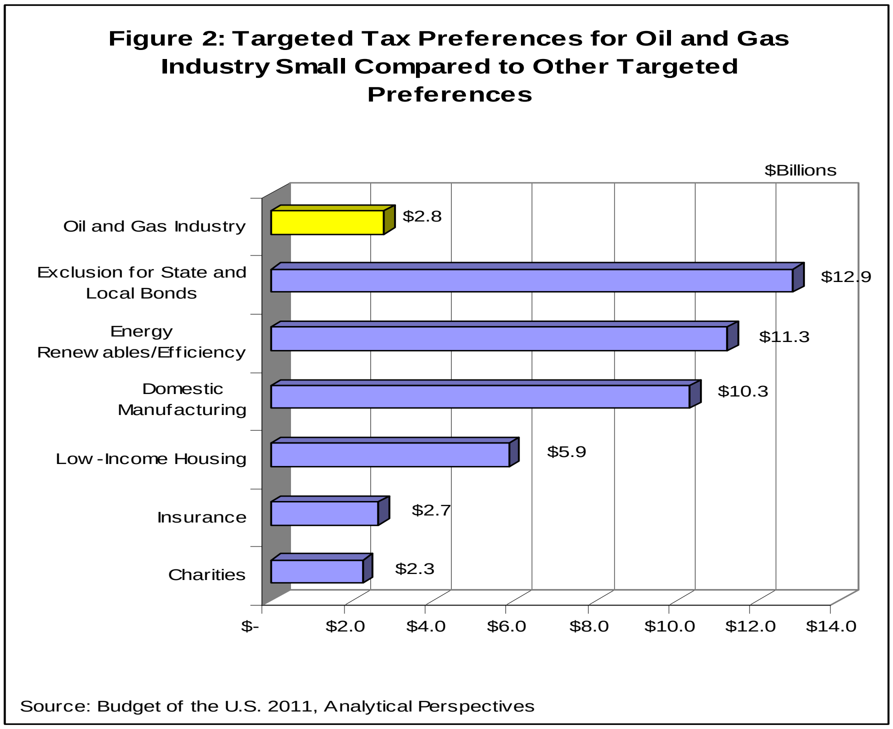
For the administration to argue that it is unjust for oil companies to benefit from a generally available tax provision is no more valid than to argue that because people don't like lawyers, it is somehow "unjust" when a lawyer takes advantage of the mortgage interest deduction. When these generally available provisions are subtracted from the administration's figures, their estimate of the "tax subsidies" benefiting the oil industry is cut by roughly half.

The next largest category is "Industry-Specific Preferences" with a budgetary cost of $19.6 billion in 2011. The majority of these industry-specific provisions, some $11 billion in total, benefit companies engaged in renewable energy activities – the biggest of which is the alcohol fuel credit ($8.85 billion) – and energy production activities – such as the energy production credit ($1 billion). These large tax benefits renewable energy firms are actually tax penalties on the oil and gas industry because wind and solar energy are substitutes for oil and gas.

So where are the "subsidies" to the oil and gas industry? They are to be found in the category "Changes to Depreciation Rules." Over the years, lawmakers have enacted numerous changes to the standard depreciation rules – which require firms to write down an investment over time – in order to persuade firms to invest in activities that Congress thought were not receiving enough investment capital.

The majority of these provisions benefit companies engaged in oil, gas, minerals, and renewable resource activities. The total value of benefits available to oil and gas firms is about $2.8 billion while those available to mining and timber firms is less than $1 billion.

Figure 2 compares the budgetary cost of the different types of corporate tax expenditures that benefit specific industries with those that benefit specific sectors such as state and local governments, charities, and even the "manufacturing" sector.



It turns out that in 2011, state and local governments will benefit more from "corporate" tax expenditures – due to the tax exclusion for municipal bonds – than will any other targeted industry or sector, nearly five times as much as the oil and gas industry alone. However, other types of energy firms, such as those engaged in renewable and energy-efficient activities, will benefit from more than $11 billion in tax expenditures – more than the $10 billion that all domestic manufacturers will benefit from.

The low-income housing industry will benefit from nearly $6 billion in tax expenditures, twice what the oil and gas industry will benefit from. And as the chart clearly shows, the tax benefits available to oil and gas are roughly on-par with the budgetary costs of the tax benefits for the insurance industry and charities.

Conclusion

Not surprisingly, there has been a lot of rhetoric about how much certain industries – such as the oil and gas industry – are being "subsidized" by the tax code. What should surprise people is that all of the corporate tax preferences taken together are still less than the budgetary costs of the preferences available to individuals such as the mortgage interest deduction and the exclusion for employer-provided health insurance.

More surprising still, state and local governments are the biggest beneficiaries of corporate tax expenditures. And among energy firms, producers of renewable energy receive more than four times as much in tax benefits as the oil and gas industry.