The $1.2 trillion United States tax expenditures in 2011: A Deeper look into Corporate Tax Expenditures

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Abstract

The $1.2 trillion U.S. tax expenditures in 2011: A Deeper look into the Corporate Tax Expenditures examines U.S. Federal government revenue losses attributed to tax expenditures. This paper will discuss the rationale, functions, and benefits of the 173 tax expenditures within the U.S. Tax Code. Specifically, this paper will concentrate on three significant provisions that benefit corporations predominantly: accelerated depreciation of machinery and equipment, deferral of income from controlled foreign corporations, and deduction for US production activities. The *U.S. tax expenditures in 2011: A Deeper look into the Corporate Tax Expenditures* solely aims to inform readers about one perspective to the tax reform debate. The readers are encouraged to continue to seek more information in order to participate within political dialogue.

According to the Congressional Budget and Impoundment Control Act of 1874, tax expenditures are "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit a preferential rate of tax, or a deferral of tax liability." Alternative definitions for tax expenditures include:

"Tax provisions favoring one activity or another or providing benefits to a limited number of tax payers." (Tax Reform Panel)

"…reductions in a taxpayer's tax liabilit[ies] that are the result of special exemptions and exclusions from taxation, deductions, credits, deferrals of tax liability, or preferential tax rates." (U.S. Government Accountability Office)

"…revenue losses attributable to tax provisions that often result from the use of the tax system to promote social goals without incurring direct expenditures."
(Tax Policy Center, Urban Institute and Brookings Institution)

Therefore, a tax expenditure is a policy instrument that allocates revenue through the U.S. Federal income tax system. In other words, the U.S. Federal government distributes revenue to individuals and corporations by special tax provisions that allow for deductions, exclusions, exemptions, credits, deferrals, and preferential tax rates within the tax law.

The discussion of tax expenditures have become the forefront of political debate within recent years. Tax expenditures significance within political debates can be explained by its magnitude, tax expenditures "account for one-fourth to one-third of all benefits and subsidies granted to the public" from the U.S. Federal government (Tax Policy Center, Urban Institute and Brookings Institution). The political debates on U.S. Federal tax expenditures center on its reform. Within the debates, tax expenditures have been labeled "loopholes," been deemed a tool to increase spending for high income entities, and considered as the resolution to U.S. Federal approximately $14.8 trillion deficit.

The purpose of *The $1.2 trillion United States tax expenditures in 2011: A deeper look into corporate tax expenditures* is to isolate U.S. Federal tax expenditures from the political debates, partisan accusations, and narrow-minded jargon on tax expenditures. Therefore, this paper will disclose the rationale, functions, and beneficiaries of the 173 special tax provisions within the U.S. Federal income tax system. Specifically, this paper will concentrate on three significant provisions that benefit corporations: accelerated depreciation of machinery and equipment, deferral of income from controlled foreign corporations, and deduction for US production activities.

Tax Expenditures

For the fiscal year ending in December 31, 2011, there were 173 tax expenditures within the U.S. Federal income tax system.

Table 1: List of U.S. Federal Tax Expenditures in the Internal Revenue Code

	National Defense:
1	Exclusion of benefits and allowances to armed forces personnel
	International affairs:
2	Exclusion of income earned abroad by U.S. citizens
3	Exclusion of certain allowances for Federal employees abroad
4	Inventory property sales source rules exception
5	Deferral of income from controlled foreign corporations (normal tax method)
6	Deferred taxes for financial firms on certain income earned overseas
	General science, space, and technology:
7	Expensing of research and experimentation expenditures (normal tax method)
8	Credit for increasing research activities
	Energy:
9	Expensing of exploration and development costs, fuels
10	Excess of percentage over cost depletion, fuels

11	Alternative fuel production credit
12	Exception from passive loss limitation for working interests in oil and gas properties
13	Capital gains treatment of royalties on coal
14	Exclusion of interest on energy facility bonds
15	Energy production credit
16	Energy investment credit
17	Alcohol fuel credits
18	Bio-Diesel and small agri-biodiesel producer tax credits
19	Tax credit and deduction for clean-fuel burning vehicles
20	Exclusion of utility conservation subsidies
21	Credit for holding clean renewable energy bonds
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy
23	Credit for investment in clean coal facilities
24	Temporary 50% expensing for equipment used in the refining of liquid fuels
25	Natural gas distribution pipelines treated as 15-year property
26	Amortize all geological and geophysical expenditures over 2 years
27	Allowance of deduction for certain energy efficient commercial building property
28	Credit for construction of new energy efficient homes
29	Credit for energy efficiency improvements to existing homes
30	Credit for energy efficient appliances
31	Credit for residential energy efficient property
32	Qualified energy conservation bonds 5
33	Advanced energy property credit
34	Advanced nuclear power production credit
	Natural resources and environment:
35	Expensing of exploration and development costs, nonfuel minerals
36	Excess of percentage over cost depletion, nonfuel minerals
37	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities
38	Capital gains treatment of certain timber income
39	Expensing of multiperiod timber growing costs
40	Tax incentives for preservation of historic structures
41	Exclusion of gain or loss on sale or exchange of certain brownfield sites
42	Industrial CO2 capture and sequestration tax credit
43	Deduction for endangered species recovery expenditures
	Agriculture:
44	Expensing of certain capital outlays
45	Expensing of certain multiperiod production costs
46	Treatment of loans forgiven for solvent farmers
47	Capital gains treatment of certain income

48	Income averaging for farmers
49	Deferral of gain on sale of farm refiners
50	Expensing of reforestation expenditures
	Commerce and housing:
	Financial institutions and insurance:
51	Exemption of credit union income
52	Exclusion of interest on life insurance savings
53	Special alternative tax on small property and casualty insurance companies
54	Tax exemption of certain insurance companies owned by tax-exempt organizations
55	Small life insurance company deduction
56	Exclusion of interest spread of financial institutions
	Housing:
57	Exclusion of interest on owner-occupied mortgage subsidy bonds
58	Exclusion of interest on rental housing bonds
59	Deductibility of mortgage interest on owner-occupied homes
60	Deductibility of State and local property tax on owner-occupied homes
61	Deferral of income from installment sales
62	Capital gains exclusion on home sales
63	Exclusion of net imputed rental income
64	Exception from passive loss rules for $25,000 of rental loss
65	Credit for low-income housing investments
66	Accelerated depreciation on rental housing (normal tax method)
67	Discharge of mortgage indebtedness
68	Credit for homebuyer
	Commerce:
69	Cancellation of indebtedness
70	Exceptions from imputed interest rules
71	Treatment of qualified dividends
72	Capital gains (except agriculture, timber, iron ore, and coal)
73	Capital gains exclusion of small corporation stock
74	Step-up basis of capital gains at death
75	Carryover basis of capital gains on gifts
76	Ordinary income treatment of loss from small business corporation stock sale
77	Accelerated depreciation of buildings other than rental housing (normal tax method)
78	Accelerated depreciation of machinery and equipment (normal tax method)
79	Expensing of certain small investments (normal tax method)
80	Graduated corporation income tax rate (normal tax method)
81	Exclusion of interest on small issue bonds
82	Deduction for US production activities
83	Special rules for certain film and TV production

	Transportation:
84	Deferral of tax on shipping companies
85	Exclusion of reimbursed employee parking expenses
86	Exclusion for employer-provided transit passes
87	Tax credit for certain expenditures for maintaining railroad tracks
88	Exclusion of interest on bonds for Highway Projects and rail-truck transfer facilities
	Community and regional development:
	Investment credit for rehabilitation of structures (other than historic)
90	Exclusion of interest for airport, dock, and similar bonds
91	Exemption of certain mutuals' and cooperatives' income
92	Empowerment zones and renewal communities
93	New markets tax credit
94	Expensing of environmental remediation costs
95	Credit to holders of Gulf Tax Credit Bonds
96	Recovery Zone Bonds
97	Tribal Economic Development Bonds
	Education, training, employment, and social services:
	Education:
98	Exclusion of scholarship and fellowship income (normal tax method)
99	HOPE tax credit
100	Lifetime Learning tax credit
101	American Opportunity Tax Credit
102	Education Individual Retirement Accounts
103	Deductibility of student-loan interest
104	Deduction for higher education expenses
105	Qualified tuition programs
106	Exclusion of interest on student-loan bonds
107	Exclusion of interest on bonds for private nonprofit educational facilities
108	Credit for holders of zone academy bonds
109	Exclusion of interest on savings bonds redeemed to finance educational expenses
110	Parental personal exemption for students age 19 or over
111	Deductibility of charitable contributions (education)
112	Exclusion of employer-provided educational assistance
113	Special deduction for teacher expenses
114	Discharge of student loan indebtedness
115	Qualified school construction bonds
	Training, employment, and social services:
116	Work opportunity tax credit

117	Welfare-to-work tax credit
118	Employer provided child care exclusion
119	Employer-provided child care credit
120	Assistance for adopted foster children
121	Adoption credit and exclusion
122	Exclusion of employee meals and lodging (other than military)
123	Child credit
124	Credit for child and dependent care expenses
125	Credit for disabled access expenditures
126	Deductibility of charitable contributions, other than education and health
127	Exclusion of certain foster care payments
128	Exclusion of parsonage allowances
129	Employee retention credit for employers in certain federal disaster areas
130	Exclusion for benefits provided to volunteer EMS and firefighters
131	Making work pay tax credit
	Health:
132	Exclusion of employer contributions for medical insurance premiums and medical care
133	Self-employed medical insurance premiums
134	Medical Savings Accounts / Health Savings Accounts
135	Deductibility of medical expenses
136	Exclusion of interest on hospital construction bonds
137	Refundable Premium Assistance Tax Credit
138	Credit for employee health insurance expenses of small business
139	Deductibility of charitable contributions (health)
140	Tax credit for orphan drug research
141	Special Blue Cross/Blue Shield deduction
142	Tax credit for health insurance purchased by certain displaced and retired individuals
143	Distributions from retirement plans for premiums for health and long-term care insurance
	Income security:
144	Exclusion of railroad retirement system benefits
145	Exclusion of workers' compensation benefits
146	Exclusion of public assistance benefits (normal tax method)
147	Exclusion of special benefits for disabled coal miners
148	Exclusion of military disability pensions
	Net exclusion of pension contributions and earnings:
149	Employer plans
150	401(k)-type plans
151	Individual Retirement Accounts
152	Low and moderate income savers credit
153	Self-Employed plans

	Exclusion of other employee benefits:
154	Premiums on group term life insurance
155	Premiums on accident and disability insurance
156	Income of trusts to finance supplementary unemployment benefits
157	Special ESOP rules
158	Additional deduction for the blind
159	Additional deduction for the elderly
160	Tax credit for the elderly and disabled
161	Deductibility of casualty losses
162	Earned income tax credit
	Social Security:
	Exclusion of social security benefits:
163	Social Security benefits for retired workers
164	Social Security benefits for disabled workers
165	Social Security benefits for spouses, dependents and survivors
	Veterans benefits and services:
166	Exclusion of veterans death benefits and disability compensation
167	Exclusion of veterans pensions
168	Exclusion of GI bill benefits
169	Exclusion of interest on veterans housing bonds
	General purpose fiscal assistance:
170	Exclusion of interest on public purpose State and local bonds
171	Build America Bonds
172	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes
	Interest:
173	Deferral of interest on U.S. savings bonds

(Office of Management and Budget)

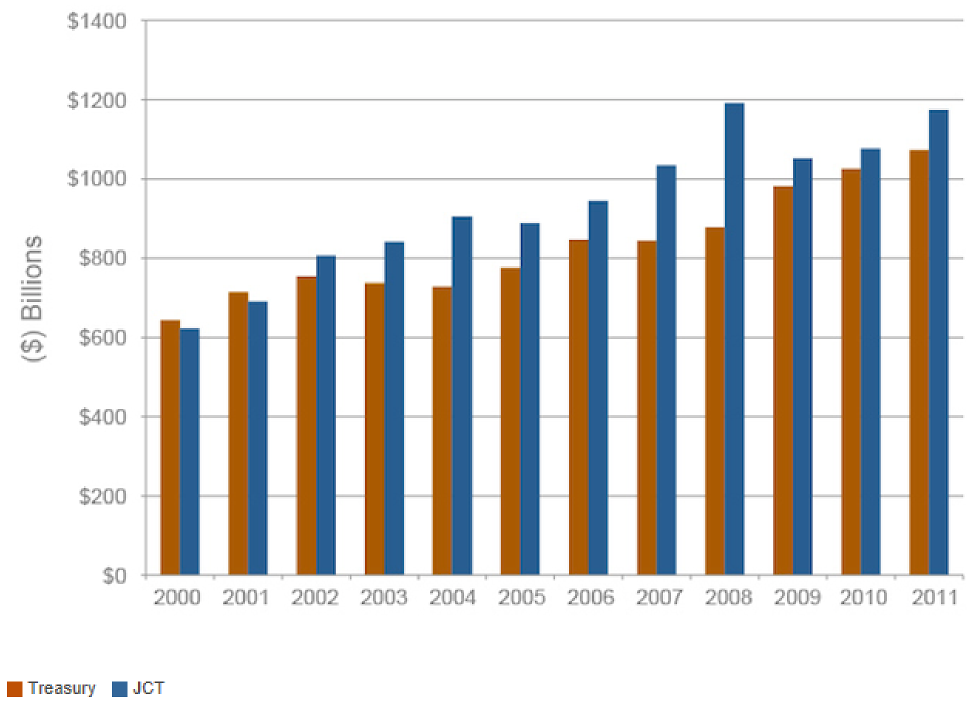
Within the U.S. Federal income tax system, every tax expenditure has a budget function. Tax expenditures budget functions include National Defense; International affairs; General science, space, and technology; Energy; Natural resources and environment; Agriculture; Commerce and housing; Transportation; Community and regional development; Education, training, employment, and social services; Health; Income security; Social Security; Veterans benefits and services; Interest and other general purpose fiscal assistance. The predominant budget functions implemented by tax expenditures are Commerce and Housing; Health; and Income security policies (Pew's Tax Expenditure Database).

Tax expenditures benefit individuals, corporations, and other types of businesses every year (*Note:* In the **Tax Expenditures** section and proceeding sections of *U.S. tax expenditures in 2011: A Deeper look into the Corporate Tax Expenditures* the beneficiaries of tax expenditures are narrowed to individuals and corporations only; corporations are businesses classified as C-corporations for tax purposes while individuals are individual taxpayers and businesses not classified as C-Corporations for tax purposes). Among the 173 tax expenditures, 149 special tax provisions are utilized by individuals and 80 utilized by corporations (U.S. Government Accountability Office 11). Within the fiscal year 2011, the U.S. Federal government incurred a revenue loss of $891 billon to individuals and $181.4 billion to corporations through tax expenditures (U.S. Government Accountability Office 10). Individuals predominately benefit from these special tax provisions because they represent approximately 83% of the revenue loss attributed to tax expenditures within the U.S. Federal tax system.

Measuring Tax Expenditures

The revenue losses attributed to tax expenditures for individuals and corporations are measured by the Treasury Department's Office of Tax Analysis (OTA) and the congressional Joint Committee on Taxation (JCT) annually. The measurement of revenue impact is performed every year because it is required under the Congressional Budget and Impoundment Control Act of 1874.

Figure 2: Total Tax Expenditure Estimates by the OTA (Treasury) and JCT, Fiscal Years 2000-2011



(Pew's Tax Expenditure Database)

Although both estimates are based on reductions from the normal tax system, the OTA and JCT use different assumptions when estimating the revenue impact of tax expenditures.

The OTA and JTA difference in assumptions are reflected by the rankings of the top five largest tax expenditures for individuals and corporations. According to the OTA, the top five largest tax expenditures for fiscal year 2011 were: exclusion of employer contributions for medical insurance premiums and medical care; accelerated depreciation of machinery equipment; deductibility of mortgage interest on owner-occupied homes; 401 (k) plans; and capital gains (except agriculture, timber, iron ore and coal) (Pew's Tax Expenditure Database). According to the JCT, the top five largest tax expenditures for 2011 were: exclusion of employer contributions for medical insurance premiums and medical care; reduced rates of tax on dividends and long-term capital gains; deductibility of mortgage interest on owner-occupies homes; depreciation of equipment in excess of alternative depreciation system; and earned income tax credit (Pew's Tax Expenditure Database).

Figure 3: Top Five Largest Treasury and JCT Tax Expenditures in Fiscal Year 2011 ($ Billions)

Rank	Treasury Department (Office of Tax Analysis)	Estimate
1	**(132)** Exclusion of employer contributions for medical insurance premiums and medical care	$163
2	**(78)** Accelerated depreciation of machinery and equipment (normal tax method)	$119
3	**(59)** Deductibility of mortgage interest on owner-occupied homes	$72
4	**(150)** 401(k) plans	$53
5	**(72)** Capital gains (except agriculture, timber, iron ore, and coal)	$47

Rank	congressional (Joint Committee on Taxation)	Estimate
1	**(132)** Exclusion of employer contributions for medical insurance premiums and medical care	$109
2	**(71)/(72)**Reduced rates of tax on dividends and long-term capital gains	$90
3	**(59)** Deductibility of mortgage interest on owner-occupied homes	$78
4	**(76)** Depreciation of equipment in excess of the alternative depreciation system	$76
5	**(162)** Earned Income Tax Credit	$60

(Pew's Tax Expenditures Database)

When comparing the rankings of the OTA and JCT, both agree that the exclusion of employer contributions for medical insurance premiums and medical care and capital gains rank among the top five largest tax expenditures and differ otherwise.

Among the rankings of the top five largest tax expenditures, only one tax expenditure that impacts corporations is listed, the accelerated depreciation of machinery and equipment. The remainder of expenditure rankings impact individuals only. For the remainder of *The $1.2 trillion United States tax expenditures in 2011: A deeper look into corporate tax expenditures*, tax expenditures that impact individuals will no longer be discussed and corporate tax expenditures will be the focus.

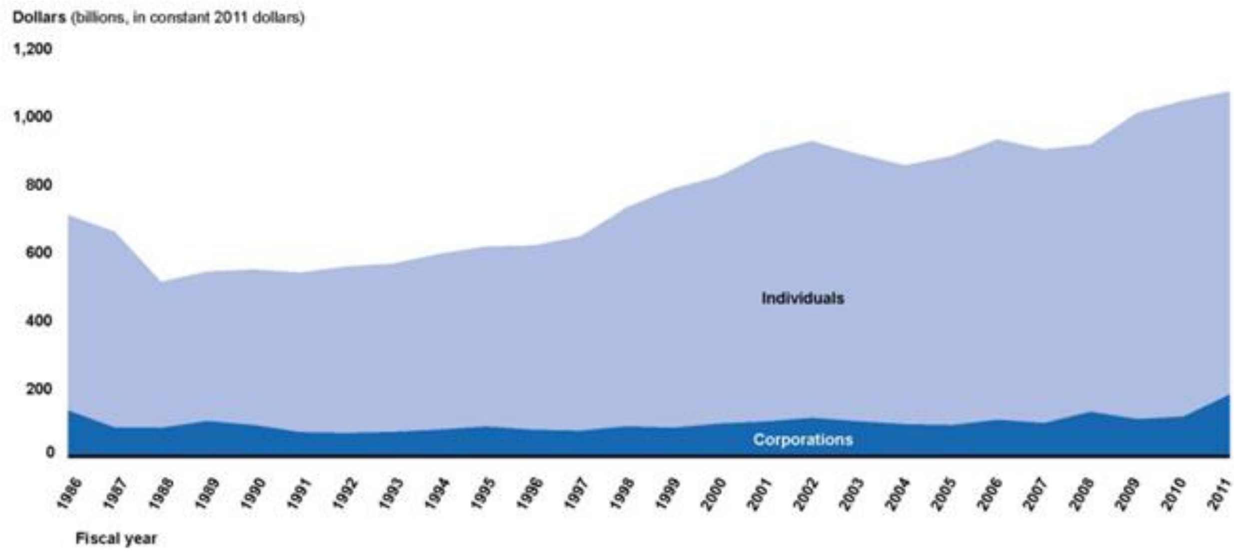
Corporate Tax Expenditures

Corporate tax expenditures are deductions, exclusions, exemptions, credits, deferrals, and preferential tax rates within the U.S. Federal income tax system for corporations. A corporation, for purposes of this paper is a business classified as C corporations within the U.S. Tax Code. A C corporation files IRS forms 1120, 1120-F, and 1120-L. C corporations are generally large publically traded companies who income and dividends (at the individual level) are taxed. (*Note:* There are alternative types of corporations that do not fall under the C corporation categorization.)

Over the past years, there has been a decline in registered C corporations. Businesses have been changing their business structure to avoid taxation under the income tax system by switching to a different form of structure that does not get taxed, such as the S Corporation. In fiscal year 2010, the Internal Revenues Services reported that almost 1.7 million C corporations filed form 1120, down from 1.9 million in 2009 (U.S. Government Accountability Office 6).

Although there has been a decline in IRS form 1120 filling to the U.S. Internal Revenue Services, there has also been an increase in revenue loss from corporate tax expenditures (U.S. Government Accountability Office 7). (*Note:* There has been a higher rate of increase in revenue loss from individual tax expenditures.)

Figure 4: Comparison of U.S. Federal Tax Revenue Loss Due to Tax Expenditures for Corporations and Individuals, Fiscal Year 1986-2011

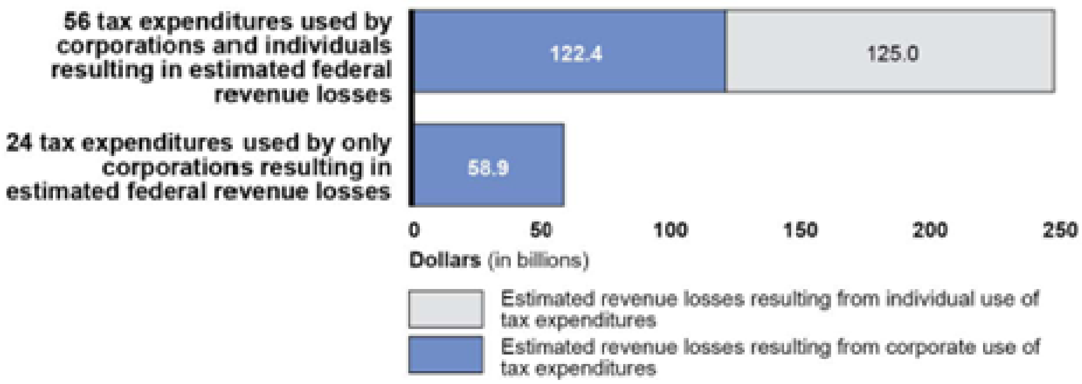


(U.S. Government Accountability Office 9)

For fiscal year 2011, the revenue loss attributed to tax expenditures used by the corporations totaled $181.4 billion (U.S. Government Accountability Office 10). The $181.4 billion does not only represent the amount of revenue that was forgone by the U.S. Federal government in fiscal year 2011 but also represents the estimated amount that was collected by corporations that year (U.S. Government Accountability Office 10).

Among the 173 tax expenditures within the income tax system, 80 of them were utilized by corporations (U.S. Government Accountability Office 11). Among the 80 of those used by corporations, 56 of them were also used by individuals as well (i.e. 24 tax expenditure were used by corporations only). Among the 56 tax expenditures used by individuals and corporations, $122.4 billion was attributed to corporations and $125 billon to individuals. For the 24 tax expenditures used by corporations only in fiscal year 2011, the total amount was $58.9 billion. It is important to remember that the 24 tax expenditures used by corporations can only be explained by some tax expenditures including provision requirements that make them only available to corporations and not individuals.

Figure 5: Estimated U.S. Federal Tax Revenue Losses for Corporate Tax Expenditures, Fiscal 2011



Source: GAO analysis of Office of Management and Budget budget data on tax expenditures, fiscal year 2013.

(U.S. Government Accountability Office 12)

There are certain tax expenditures that are dominantly used by corporations. Of 80 tax expenditures utilized by corporations in 2011, “two expenditures accounted for 65 percent of all estimated corporate revenues losses in 2011 while another five tax expenditures—each with at least $5 billion or more in estimated revenue loss for 2011—accounted for an additional 21 percent of corporate revenue loss estimates” (U.S. Government Accountability Office 10). The budget functions of predominantly used corporate tax expenditures are generally commerce and housing; international affairs; and general science, space, and technology.

Figure 6: Five Largest Corporate Tax Expenditures, Fiscal Year 2011

Tax expenditure	Federal revenue loss estimates resulting from corporations (dollars in billions)	Share of total estimated corporate tax revenue losses
Accelerated depreciation of machinery and equipment[a]	$76.1	42%
Deferral of income from controlled foreign corporations	41.4	23
Deduction for US production activities[b]	9.8	5
Credit for increasing research activities[c]	8.3	5
Exclusion of interest on public purpose State and local bonds[d]	7.6	4

(U.S. Government Accountability Office 11)

Figure 7: The Estimated Federal Revenue Losses Resulting from Corporate Tax Expenditures by Budget Function, Fiscal 2011

Budget function	Number of corporate tax expenditures	Estimated corporate tax revenue losses (dollars in billions)[a]	Federal outlays (dollars in billions)
Commerce and housing	16	$96.3	$(12.6)[b]
International affairs	3	50.8	45.7
General science, space, and technology	2	9.3	29.5
General purpose fiscal assistance	1	7.6	7.5
Energy	20	6.1	12.2
Education, training, employment, and social services	10	4.0	101.2
Health	5	2.8	372.5
Community and regional development	8	1.8	23.8
Natural resources and environment	8	1.5	45.5
Income security	1	1.0	597.4
Transportation	3	0.2	93.0

(U.S. Government Accountability Office 14)

It is important to remember that not every special-tax provision used by corporations are used for its intended budget function. For example, the credit for low-income housing investments provision is a special tax provision with the purpose to develop affordable rental property for low-income households. Companies have utilized this provision by deviating from main business and investing in low income properties.

For example, in fiscal year 2011 Google, Inc. invested in new low-income housing in Des Moines, Iowa (The New York Times).

The proceeding sections of *The $1.2 trillion U.S. tax expenditures in 2011: A Deeper look into the Corporate Tax Expenditures* will focus on the top three corporate tax expenditures that cause the federal government the largest revenue loss. Therefore, the proceeding will discuss: accelerated depreciation of machinery and equipment; Deferral of income from controlled foreign corporations**;** and Deduction for US production activities.

Accelerated depreciation of machinery and equipment

The accelerated depreciation of machinery and equipment special-tax provision is located within Section 68(e)(3) of the U.S. Tax Code. This tax expenditure allows the acquisition costs of certain assets to be "capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolesce" (Office of Management and Budget 272). In other words, the special tax provision allows a corporation to depreciate certain assets faster than their financial records pernit. This tax expenditure allows corporations to record a higher depreciation expense in earlier years of the asset acquisition, reducing net income, therefore, reducing tax liability. The forms that are used by corporations to calculate their tax benefit from the accelerated depreciation of machinery and equipment provision are IRS form 1040's Schedule C Profit or Loss From Business and IRS form 1040's Schedule C-EZ (Internal Revenue Services).

Buildings, machinery, vehicles, furniture, equipment and certain types of intangible property are assets that qualify for the special tax provision. In order to qualify for the tax expenditure, the asset needs to meet certain requirements: it needs to be owned by the business, it must be used in the business, it needs to contain a determinable useful life, and contain an expected life of more than one year (Internal Revenue Services). Assets that do not qualify for the tax expenditure include land, equipment used to build capital investments, and certain intangibles (Internal Revenue Services).

This tax provisions that allow corporations to depreciate assets using two different methods: Accelerated Cost Recovery System (ACRS) and the Modified Accelerated Cost Recovery System (MACRS). The depreciation method that is used by most corporations is MACRS because most assets qualify for it. MACRS has two types of depreciation systems: General Depreciation System (GDS) and Alternative Depreciation System (ADS) (Internal Revenue Services). The GDS is the depreciation method that is predominantly used unless it is required by law to use ADS. ADS applies for assets used 50% or less for business use; asset used predominantly outside the United States during the year; any tax-exempt use asset; any tax-exempt bond-financed assets; all asset used predominantly in a farming business and placed in service in any tax year; and any assets imported from a foreign country for which an Executive Order is in effect because the country maintains trade restrictions or engages in other discriminatory acts (U.S. Internal Revenue Services). Assets depreciated under the ADS method do not qualify as special tax provisions of depreciation, therefore, assets depreciated according to GDS are considered a tax expenditures and those under ADS are not.

The assets that qualify for MACRS's GDS are classified under nine categories. The nine categories include: 3-year property; 5-year property; 7-year property; 10 year property; 15-year property; 25-year property; residential rental property; and nonresidential real property (U.S. Internal Revenue Services).

Figure 8: The nine asset classifications under MACRS's General Depreciation Systems (GDS)

3-year property
Tractor units for over-the-road use.
Any race horse over 2 years old when placed in service. (All race horses placed in service after December 31, 2008, and before January 1, 2014, are deemed to be 3-year property, regardless of age.)
Any other horse (other than a race horse) over 12 years old when placed in service.
Qualified rent-to-own property.

5-year property
Automobiles, taxis, buses, and trucks.
Computers and peripheral equipment.
Office machinery (such as typewriters, calculators, and copiers).
Any property used in research and experimentation.
Breeding cattle and dairy cattle.
Appliances, carpets, furniture, etc., used in a residential rental real estate activity.
Certain geothermal, solar, and wind energy property.

7-year property
Office furniture and fixtures (such as desks, files, and safes).
Agricultural machinery and equipment.
Any property that does not have a class life and has not been designated by law as being in any other class.
Certain motorsports entertainment complex property.
Any natural gas gathering line placed in service after April 11, 2005.

10-year property
Vessels, barges, tugs, and similar water transportation equipment.
Any single purpose agricultural or horticultural structure.
Any tree or vine bearing fruits or nuts.

Qualified small electric meter and qualified smart electric grid system placed in service on or after October 3, 2008.

15-year property
Certain improvements made directly to land or added to it (such as shrubbery, fences, roads, sidewalks, and bridges).
Any retail motor fuels outlet, such as a convenience store.
Any municipal wastewater treatment plant.
Any qualified leasehold improvement property.
Any qualified restaurant property.
Initial clearing and grading land improvements for gas utility property.
Electric transmission property (that is section 1245 property) used in the transmission at 69 or more kilovolts of electricity placed in service after April 11, 2005.
Any natural gas distribution line placed in service after April 11, 2005 and before January 1, 2011.
Any qualified retail improvement property.

20-year property
Farm buildings (other than single purpose agricultural or horticultural structures).
Municipal sewers not classified as 25-year property.
Initial clearing and grading land improvements for electric utility transmission and distribution plants.

25-year property *(This class is water utility property, which is either of the following:)*
Property that is an integral part of the gathering, treatment, or commercial distribution of water, and that, without regard to this provision, would be 20-year property.
Municipal sewers other than property placed in service under a binding contract in effect at all times since June 9, 1996.

Residential rental property
This is any building or structure, such as a rental home (including a mobile home), if 80% or more of its gross rental income for the tax year is from dwelling units.

Nonresidential real property
This is section 1250 property, such as an office building, store, or warehouse, that is neither residential rental property nor property with a class life of less than 27.5 years.

(U.S. Internal Revenue Services)

The assets that qualify corporations for the accelerated depreciation of machinery and equipment provision predominantly fall under one of the MACRS's GDS category. The

MACRS's GDS utilized by corporations is demonstrated in Publication 946, Appendix A with tables of depreciation rates that allow companies to identify their depreciation rate for their asset.

The revenue effects of the tax expenditure can be demonstrated by a simple example. On January 1, 2011, Firm A, a C corporation buys a truck for $10,000 with an expectancy life of 5 years that will be used for company purposes. On January 1, 2011, the purchase of the truck is capitalized in Firm A's financial records by increasing assets by $10,000. The method used for Firm A's financial reporting is the straight-line method (a method commonly used by corporations), in other words, the acquisition cost of the truck will be amortized equally for the next five years starting on January 1, 2011.

On December 31, 2011, Firm A's financial reports contain total revenues of $202,000 and a depreciation expense of $2,000 ($10,000/5 years) because the truck cost was amortized under the straight-line method, resulting in a net income (revenues-expenses= net income) of $200,000. Prior to reporting their net income of $200,000 on IRS form 1120, Firm A completed Schedule C to utilize the accelerated depreciation of machinery and equipment provision by using the MACRS's GDS method to calculate depreciation expense for the truck. Under MACR's GDS, depreciation expense is now $4,000 according to Table A-1 of Publication 946. Therefore, the net income that will be reported on the Firm A's tax return will not be $200,000 but $198,000. (*Note:* This example only looks at one year of the accelerated depreciation of machinery and equipment. While it is true that the company receives more tax depreciation deduction the first year of acquisition, over the next 4 years, the company will have $8,000 depreciation expense in its financial statements and only $6,000 on its tax returns. Over the 5 year period, tax deductions for depreciation will eventually equal the depreciation expense in the financial statements (Redemske). Although the government is going to collect the same total tax within the proceeding years, the provision is classified as a tax expenditure because the depreciation expense does not reflect the true economic standing of the company within the year.)

For the fiscal year 2011, the U.S. Federal government subsidized $76.1 billion to corporations according to OTA ($52.3 billion according to JCT) from the accelerated depreciation of machinery and equipment provision (Pew's Tax Expenditure Database). OTA estimates that the accelerated depreciation of machinery and equipment provision represented approximately 42 percent of total revenue loss attributed to corporate tax expenditures (U.S. Government Accountability Office 11). The accelerated depreciation of machinery and equipment tax expenditure produces both significant revenue loss for the U.S. Federal government and provides substantial benefits for the corporations.

Deferral of income from controlled foreign corporations

The deferral of income from controlled foreign corporations provision is located in Section 957 of the U.S. Tax Code. According to the Office of Management and Budget, the deferral of income from controlled foreign corporations is a special-tax provision that defers the taxation on “active income of foreign corporations controlled by U.S shareholders [that] is not subject to U.S. taxation when it is earned. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from the foreign stockholdings.” In other words, this tax expenditure does not allow certain income from foreign operations owned by certain U.S. shareholders to be taxed until income is distributed as dividends to shareholders.

In order to understand the application of the deferral of income from controlled foreign corporation tax expenditure, it is important to understand the terms U.S. shareholders and ownership within its definition. A U.S. shareholder according to Section 951(b) of the Internal Revenue Code is a U.S. person who owns 10 percent or more ownership. For example, a foreign corporation with thirty U.S shareholders who each own 9 percent of shares would not qualify as a U.S. shareholder under this provision.

In addition to U.S. shareholder, the definition of ownership is also important. Ownership within a controlled foreign corporation is defined as either more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote or the total value of the stock of such corporation is owned by U.S. shareholders on any day during the taxable year (U.S. Internal Revenue Code). Section 958(a) in the Internal Revenue Code elaborates the definition of share ownership to include persons who own shares directly or indirectly. For example, a foreign corporation has a one foreign shareholder that owns 50 percent of the stock and 2 U.S. shareholders who own 25% each. The foreign corporation would not qualify for the deferral of income from controlled foreign corporation provision because U.S. shareholders do not own more than 50 percent of the foreign corporation.

The deferral of income from controlled foreign corporations tax expenditure is not only strict about the eligibility of foreign operations, but also eligibility of income of foreign operations that applies to this provision too. The U.S. Federal income tax system operates in that any foreign corporations (not mattering if it is U.S. or foreign owned by shareholders) is eligible to U.S. income taxation. As long as the foreign corporation “is effectively connected with the conduct of a U.S. trade or business or if the foreign corporation has a permanent establishment in the U.S.” that business is subject to U.S. income taxes (AVC Advisory). As previously stated, certain types of income of foreign operations are eligible for this provision, not all. Deferral of income from controlled foreign corporations only relates to certain type of income of foreign operations from taxation until distribution to U.S. shareholders, therefore, not all income from foreign operations is deferred until distributed as dividends.

The income earned by controlled foreign corporations that are not allowed for the special-tax provision and eligible for U.S. taxation is called Subpart F income. Subpart F income include: insurance income; foreign base company income; income from countries subject to international boycotts; illegal bribes, kickbacks and similar payments; income from countries where the U.S. has severed diplomatic relations; foreign personal holding company income; foreign base company sales income; foreign base company services income; foreign base company shipping income; and foreign base company oil related income (Internal Revenue Code). (*Note:* The preceding five types of income are described as foreign base company services income). The income that applies to foreign controlled corporations the most are generally foreign base company income (AVC Advisory). Subpart F income is generally any foreign source of income that can be connected to the U.S. In other words, the income that is only eligible for the provision is income that “has no U.S. source income connected with a U.S. trade or business and has no permanent establishment in the U.S.” until it is distributed as dividends to U.S. shareholders (AVC Advisory).

The impact of the deferral of income from controlled foreign corporations tax expenditure can be best demonstrated by an example. One example will demonstrate income from a controlled foreign corporation that is Subpart F tax (so therefore does not qualify for the provision) and the second example will represent controlled foreign corporation income that is eligible for the provision. Example #1: Firm A is a U.S. corporation owns a foreign operation in Ireland. In fiscal year 2011, the Irish corporation purchases products from Firm A and sells them to customers throughout Europe. The income earned from the Irish corporation would be considered subpart F income, therefore, would not be eligible for the *deferral of income from controlled foreign corporations* tax expenditure (Deloitte 27). Example #2: Firm B is a U.S. corporation owns a German corporation. In fiscal year 2011, the German corporation earned $100 of income from its own operations (i.e. no interaction with the U.S. corporation). For fiscal year 2011, the income earned by the German subsidiary is not eligible for taxation until the income is paid to U.S. shareholders according to the definition of the provision (Deloitte 33). (*Note:* The preceding examples demonstrate the simplified idea and principle of the deferral of income from controlled foreign corporations tax expenditure.) The examples conclude that corporations will be able to hold non Subpart F income invested overseas until the company pays a dividend to U.S. shareholders.

The revenue loss attributed to the deferral of income from controlled foreign corporations provision is approximately $41.4 billon according to the OTA ($15.3 billion according to the JCT) (Pew's Tax Expenditure Database). The provision is ranked as the second highest tax expenditure that is utilized by corporations in the fiscal year

2011. In addition to its magnitude, this special tax provision represents approximately 23 percent of corporate tax expenditures.

Deduction for U.S. production activities

In Section 199(a)(1) of the Internal Revenue Code, the deduction for U.S. production activities provision states "in general there shall be…a deduction…[with an] amount equal to 9 percent of the lesser of the qualified production activities income of the taxpayer of the taxable year or the taxable income for the taxable year." In other words, a percentage of income that is attributed to domestic production for a corporation is eligible for a deduction. (*Note*: The deduction for U.S. production activities provision is not only applicable to corporations.)

The qualifications of domestic production are defined broadly under Section 199 of the Internal Revenue Code. In general, eligible production activities can be categorized under three categories: manufacturing activities of tangible person property, (as a whole or a significant part); construction of real property in the U.S.; and performance of engineering or architectural services in the U.S. for real property projects in the U.S. (Journal of Accountancy). Therefore, domestic production activities include manufacturing, mining, oil extraction, farming, construction, architecture, engineering and the production of software, recordings and films, and products partially made in the U.S. (Journal of Accountancy).

As previously stated, the calculation for the special tax provision is based on the lower of the two options: qualified production activities income and taxable income. Qualified taxable income is defined under Section 199(c)(1) as the difference between the domestic production revenue and related cost of goods sold, expenses and losses

(Internal Revenue Services). When calculating the qualified production activities income, revenues that should not be included in the calculation are sales of foods or beverages prepared by the taxpayer; the transmission or distribution of electricity, natural gas, or portable water; and the lease, rental, license, sale, exchange other disposition of land (Internal Revenue Services). In addition to restrictions on revenues, expenses are restricted to include only 50 percent of wages allocable to qualified production activities expenses. The calculation of the qualified production activities differs from the taxable income because it calculates revenues and expenses that relate only to domestic production.

The application of the deduction for U.S. production activities tax expenditure for a corporation can be demonstrated in five steps established by the Journal of Accountancy. The implementation of this special tax provision begins with corporations (1) identifying areas of potential qualified production activities; (2) calculating domestic production gross revenues; (3) allocating cost of goods sold to the domestic production; (4) calculate the net income; and (5) calculating the deduction by selecting the lower of the taxable income or qualified production activities.

The U.S. Federal government acquired a revenue loss of approximately $9.8 billion for the fiscal year 2011 according to the OTA ($8.9 billion according to the JCT) for the deduction for U.S. production activities tax expenditure. Although this special tax provision does not only impact corporations, the provision was ranked as the third largest tax expenditure for corporations in fiscal year 2011. In other words, this tax expenditure represented approximately 23% of the share of corporate tax expenditures in fiscal year 2011.

Conclusion

The $1.2 trillion U.S. tax expenditures in 2011: A Deeper look into the Corporate Tax Expenditures demonstrates the complexity of the tax reform debate. As the debate on tax reform continues to be discussed in the political arena, it is important for citizens of the United States to be informed. The debate cannot be discussed in simple terms but it contains a multitude of layers and perspectives.

This paper attempts to provide readers with only one perspective to this complicated debate by discussing tax expenditures. The 173 tax expenditures that impact individuals and corporations every year require an in-depth knowledge on the U.S. Tax Code. Therefore, it is important for readers to seek additional sources before participating within the political discourse on tax reform.

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