Pennsylvania Legislators Get Stern Warnings from Credit Rating Agencies

Missouri Tax Cut
Missouri legislators overrode the veto of Gov. Jay Nixon (D) to enact the state’s first income tax cut in nearly 100 years.  

FDA Versus E-Cigs
E-cigarettes have no tobacco smoke, but that hasn’t stopped the Food and Drug Administration from proposing rules to treat e-cigarettes much like tobacco-based cigarettes.

‘Wind Down’ Fannie, Freddie
Moody’s Investors Service says it is “time to wind down” Fannie Mae and Freddie Mac.

Regs Cost $1.86 Trillion
Regulations took more than $1.86 trillion out of the U.S. economy in 2013, according to the Competitive Enterprise Institute’s annual Ten Thousand Commandments report on the size and scope of federal regulations.

Unconstitutional Money Grab
The government has announced it will receive another multibillion-dollar “dividend” from Fannie Mae and Freddie Mac.

By Eric Boehm
Once is a fluke. Twice can be a coincidence. Three times is a trend. All three major credit rating agencies have issued stern warnings to Pennsylvania policymakers in advance of the coming budget season.

Pennsylvania’s capital city, Harrisburg.

By the time the McQueeny Group signed up for tax breaks through Kansas’s primary economic development engine, vice president Rod Slump said the business was already considering the move. Tax breaks provided through Promoting Employment Across Kansas were just icing on the cake. This is true for recipient companies across the state, according to a researcher at Washington University.

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Study: Tax ‘Incentives’ Don’t Bring Jobs

Continued from page 1

Department of Commerce.

The state contends McQueeny’s relocation from the Crossroads near downtown Kansas City, Missouri has brought 15 jobs to Kansas, though Slump said only two or three were new to the company after the move.

PEAK allows an employer to retain 95 percent of the payroll tax for creating jobs that pay at or above the county median wage, with the goal of spurring new hiring. In the last two years alone, the program has granted more than $28 million in tax breaks, according to annual reports prepared by the state.

But Slump told Kansas Watchdog all PEAK did was help make the relocation decision easier.

“It’s hard for us to tie creation of jobs to that, as much as it was a business opportunity,” Slump said.

New research suggests McQueeny Group is the rule, not the exception.

“No Evidence Incentives Work”

“It looks like there’s no evidence that PEAK incentives work in the sense of job creation any way we cut this,” said Nathan Jensen, associate professor of political science at Washington University. “Most of the data is that about two-thirds to three-fourths of firms that get an incentive, globally, were basically getting an incentive to do what they were going to do anyway.”

Jensen’s findings are damning his department, said the agency is considering allowing greater levels of transparency regarding the PEAK program but has yet to make an actual decision.

The Docking Institute of Public Affairs at Fort Hays State University

“All of the new employees hired by PEAK firms relocating to Kansas represent additional jobs for the State, regardless of whether they would have been hired without the PEAK Program,” the Docking report stated.

Travis Perry writes for Watchdog.org, from which this article is reprinted with permission.

Poor Transparency

More than anything, Jensen would just like to see a little transparency.

“It’s the sort of thing I think should just be on a Web site,” he said.

Currently, the Kansas Department of Commerce makes PEAK data available only through an open records request. Darla Price, PEAK program director, told Kansas Watchdog she couldn’t say why the information wasn’t posted online; decisions like that aren’t made at her level, she said.

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Credit Rating Agencies Sound a Warning to Pa.

Continued from page 1

burden following years of underfunding and market-driven investment declines,” Fitch warned on April 24. “Continued inability to address these concerns, or worsening of any of these conditions, over the near term could trigger further negative rating action.”

Repeatedly Underfunded
The agencies expressed most concern about Pennsylvania’s $48 billion unfunded pension liability, which is split between the State Employees Retirement System and the Public School Employees Retirement System.

The state has not adequately funded either system in a decade, and the long-deferred costs are causing serious problems. The state spent $1.5 billion on pensions this year—less than half of what is required to keep the plans solvent—and that total is expected to jump to more than $2 billion in the 2014–15 budget.

“Rapidly growing pension contributions will absorb much of the commonwealth’s financial flexibility over the next four years challenging its ability to return to structural balance or make meaningful contributions to the depleted budget stabilization fund,” said Moody’s in an April 24 press release.

Pensions might be the biggest problem, but they are far from the only danger to the state’s credit rating.

Consistently Overspent
Standard & Poor’s warned the state has overspent in recent years and needs to bring the budget into line with existing revenue.

“The budget is not structurally balanced and relies on one-time savings, deferrals and other measures that add uncertainty,” the agency said in an April 28 report calling for “a concerted effort to bring revenues and expenditures into alignment.”

That will be no easy task this June. Gov. Tom Corbett (R) has proposed a $29.4 billion budget for the 2014–15 fiscal year, a 3.3 percent increase over the current year’s spending.

But revenues are coming up well short of that target.

Revenue Falling Short
The state Department of Revenue recently reported the state is nearly $500 million in the hole for the current fiscal year—a hole that must be filled before lawmakers can begin thinking about the millions in additional spending Corbett wants in next year’s budget.

Erik Arneson, spokesman for Senate Majority Leader Dominic Pileggi (R-Chester), said Pennsylvania has some serious budgetary issues to address in the next two months.

“The recent rating agency reports raise some of the most significant issues, including the need for serious pension reform and the need for a budget that is structurally balanced over the long term,” Arneson said.

News reports indicate the Corbett administration plans to scale back its budget plan for next year, perhaps by as much as $1.2 billion. The administration didn’t return requests for comment on the warnings from the ratings agencies.

Benefits Changes Proposed
One place the administration may look for budget savings is by continuing to shortchange the pension plans. For two years, Corbett has been pitching a plan to defer pension payments in the hopes of achieving long-term savings by changing benefit structures for state workers and public school teachers.

But with ratings agencies concerned with Pennsylvania’s funding of its pension systems, adding to the debt could hurt the state, said state Rep. Joe Markosek (D-Allegheny), minority chairman of the House Appropriations Committee.

“Any changes to pensions need to be carefully considered, especially in light of recent warnings from the credit rating agencies,” he said.

Markosek’s fellow Democrats have generally opposed any changes to the pension systems and favor increasing revenue to meet the obligations.

Dem Call for Higher Taxes
In light of the lower-than-expected revenue this year, many Democrats have called for higher taxes on gas drilling companies and the closing of corporate tax loopholes.

“Bond rating agencies have already issued stern warnings that the governor’s proposed budget continues a series of irresponsible budget and financial policies that will result in further downgrades to our bond ratings and significantly raise the cost of future borrowing,” said state Sen. Vincent Hughes (D-Philadelphia), minority chairman of the Senate Appropriations Committee.

Michael Stoll, spokesman for House Appropriations Committee chairman Bill Adolph (R-Delaware), said the ratings agencies’ concerns were “constructive feedback” as budget discussions got underway in Harrisburg.

Unemployment Rate Drops
Stoll pointed to the state’s dropping unemployment rate—down to 6 percent in March from 7.7 percent a year earlier—as a sign that revenue growth would be coming.

The administration forecast 4 percent growth for the current fiscal year, which has so far failed to materialize.

While policymakers in Harrisburg wait for revenue to rise, Pennsylvania’s bond rating might drop.

Eric Boehm writes for the Pennsylvania Independent, where this column first appeared. Used with permission of Watchdog.org.

IN OTHER WORDS . . .

“Larry Morrissey is mayor of the old industrial hub of Rockford, Illinois, and he says that if bankruptcy revived the U.S. auto industry, it might save his city of 151,000 from ‘the slow death’ of pension costs. ‘Bankruptcy is designed to avert that kind of a slow, perpetual indentured servitude for individuals and corporations—why the hell should cities be treated differently?’ said Morrissey.

“This borders on fantasy in Illinois, where municipalities can’t file for court protection without legislative approval. Yet the discussion reveals alarm over mounting shortfalls among the 650 pensions in large and small towns outside Chicago that cover police and firefighters.”

— Tim Jones, Bloomberg.com, May 18, 2014
Mich. Legislator Wants to Legalize Ticket ‘Scalping’

By Tom Gantert

For Tim Kelly, the principle is simple: If someone buys a ticket to an event, it’s up to that person what to do with it.

So the Republican state representative from Michigan introduced House Bill 5108 last year to end a prohibition on scalping tickets that goes back to 1931. The bill was referred to a committee in March 2014 and Kelly (R-Saginaw Township) said he doesn’t expect it to get out unless the public demands it be put to a vote.

According to the state’s House Fiscal Agency, “Anecdotally, it doesn’t appear that the prohibition against ticket scalping (especially in cases where the tickets are initially obtained through legitimate means) is enforced to any great degree.”

“Either prosecute everybody or don’t prosecute anybody,” Kelly said. “Right now, it’s a government-sanctioned monopoly. If somebody buys a ticket, it should be to do whatever they please.”

Powerful Opposition

There’s a lot of opposition to Kelly’s bill.

Casinos, Michigan State University, University of Michigan, all the Detroit professional sports venues, and even a circus have opposed the legislation. Their concern is big-time scalpers who can buy a large number of tickets and then resell them at a much higher price.

The Broadway League, a national trade association that represents theaters across the country, including Michigan State University’s Wharton Center, also came out against the legislation.

Tom Ferrugia, director of government relations for The Broadway League, said his organization’s main concern is businesses that exist solely to resell tickets. Those businesses sometimes aren’t transparent with the pricing of tickets or misrepresent tickets they are reselling. In some instances, consumers may not be aware if they go on a third-party Web site they may be paying a very high mark-up for a ticket, he said.

Transparency and Control

Some venues report angry customers who were misled by a third-party Web site, Ferrugia said.

The Broadway League supports legislation requiring third-party disclosure for customers, he said. Venues should maintain control of their event’s tickets, he said, adding there is no problem if a venue decides to enter into a relationship with a ticket vendor.

One way for a venue to maintain control of its ticket distribution is to have customers sign an agreement stating they are not a ticket broker and won’t sell the ticket for a specified dollar amount above the face value, he said. If that agreement is violated, the sale could be rescinded.

Mark Perry, a University of Michigan-Flint professor of economics, laid out what he thought was unfair about the current scalping law in an op-ed in the Lansing State Journal. Perry said sites like Ticketmaster and StubHub sign deals with teams and venues that give them the exclusive right to resell tickets. In exchange, the teams and venues receive a portion of the scalping revenue.

Under current law, someone wanting to resell a ticket at higher than face value must have written consent from the artist, team, or venue, Perry said.

Market Efficiency Mechanism

Antony Davies, an associate professor of economics at Duquesne University in Pittsburgh, said scalping is the market’s way of fixing a serious inefficiency.

He said the demand for some events can be so great, tickets will sell out within a few hours.

“In the absence of scalping, you have to show up early [for some events, days early] and camp out,” Davies said. “Suppose you need to arrive 24 hours early to get a ticket. If your time is worth, for example, $10 per hour then camping out for those 24 hours cost you $240 in time and energy—time and energy that you could have devoted to other things. So, in total, the [$10] ticket cost you $250. ... When you pay a scalper $250 for a ticket, you aren’t getting ‘ripped off.’ Instead, you have the ability to pay $250 cash for the ticket instead of a combination of $10 cash and $240 in time and effort.”

Tom Gantert is senior Capitol correspondent for Michigan Capitol Confidential, a daily news site of the Mackinac Center for Public Policy.
The announcement went over like a bad hook to a crowd of 300 Edina residents intent on saving “The Fred.”

“I think because we have industry-wide less interest [in golf] now, it’s going to really force all of them [local governments] to examine what they’re going to do and how they’re going to handle it.”

**Rebecca Otto, Auditor - Minnesota**

**$485,000 Annual Subsidy**

One of the few cities anywhere in the country to provide 45 holes of golf, Edina’s three courses require a $485,000 annual subsidy. Last year the nine-hole par 30 Fred Richards course lost $122,000. Still, some 350 residents have signed an online petition, even drafting their own fix-it plan.

“I think an outside observer might have looked at the people attending the meeting—decked out in their matching ‘Save The Fred’ T-shirts—and called them an ‘angry mob,’” Scott Neal, Edina city manager, wrote on his blog. “I would not call them that. For the most part, they were civil, even though some of them were quite angry with this whole idea.”

**Fewer Rounds**

The number of rounds played in Minnesota declined by 10 percent in 2013, due to poor weather and the sport’s declining popularity. Total rounds posted by Minnesota Golf Association (MGA) members in April this year increased to 19,000 compared to 5,800 in 2013, still well below the 89,000 rounds played at this point in 2012 under ideal conditions.

“I’m optimistic for this year. We got started a little bit earlier than I thought we were going to get started,” said Warren Ryan, communications director and editor for the MGA. “This last weekend wasn’t very good, and this week is not going to be very good, but I’m fairly optimistic.”

The question of how challenging municipal links are for players has become a question of how challenging the courses are for taxpayers—even in posh Edina.

“A Watchdog Minnesota Bureau analysis of state audits of city-funded golf courses in 2012—the latest year available—shows only a handful of municipal courses broke even or made money. Nine cities racked up six-figure operating deficits: Buffalo ($539,154) and Moorhead ($538,200) topped the list.

“Before golfing was pretty popular, but maybe there was a course that wasn’t very well-managed and so the numbers weren’t good,” said Rebecca Otto, Minnesota auditor. “I think because we have industry-wide less interest now, it’s going to really force all of them [local governments] to examine what they’re going to do and how they’re going to handle it.”

Following a $12 million makeover, Ramsey County plans to reopen historic Keller Golf Course in Maplewood this summer. Brooklyn Park approved a $2 million upgrade of city-owned Edina Golf Course again in recent months, the city of Two Harbors will pay a private operator about $28,000 to oversee the course with a $1,000 bonus for every $5,000 of net revenue over $185,000.

This season a private management company, Prom Management Group, took over operations at two of St. Paul’s city courses. Phalen and Como golf courses were responsible for about $400,000 of the estimated $1 million divot incurred on city links last year.

“Don’t just do away with it. We need a hole in our head,” wrote Deb McCracken in support.

“Until we get enough in the bank to interest now, it’s going to really force all of them [local governments] to examine what they’re going to do and how they’re going to handle it.”

**Now Nonprofit**

After shutting down for a year and failing to attract a buyer, Mississippi National Golf Links in Red Wing reopened in April—not as a city-operated course but as a nonprofit run by a foundation that will receive up to $600,000 in taxpayer funding for capital improvements if the course meets financial milestones. The course needs to score about 30,000 green fees to get $900,000 and break even.

“It’s been a real big community effort. We just need to bring enough people down from the [Twin] Cities and Rochester here to keep it going this year,” said Nathan Gale, head golf professional at Mississippi National Golf Course.

“Until we get enough in the bank to where we’re comfortable, we just can’t have a bad year, basically.”

Tom Steward writes for Watchdog.org, from which this article is reprinted with permission.
Bill to Force Florida Brewers to Buy Their Own Beer Falls Flat

By Tom Gantert

A bill in Florida that would make small brewers sell their own bottled or canned beer to distributors and then buy it back even though the beer would never leave the premises created a national stir involving the “three-tier” distribution system in that state.

But by the end of the spring legislative session, members of the state House made sure the bill fell flat after it passed the Senate 30–10. A companion bill to the Senate measure was never introduced for a vote in the House.

Florida, like every other state except Washington, has a three-tier system for distributing alcohol that includes producers, distributors, and retailers. The producers may not own the distributors and neither the producers nor the distributors may own the retailers. In addition, a producer must sell its products to distributors who then sell them to retailers.

At issue was how craft brewers are allowed to sell their beer on their own premises and what must be shipped to distributors in a complicated distribution system that has carved out some exceptions for breweries.

Exception for Busch Gardens

State Sen. Kelli Stargel (R-Lakeland) sponsored Senate Bill 1714 requiring craft brewers to sell their beer to a distributor and buy it back even if the beer stays at the brewery.

She said an exception to the three-tier law was made years ago for the Busch Gardens theme park, which brews beer on site, so it could sell its beer at that venue. Anheuser-Busch, which started Busch Gardens, is the largest brewer in the United States. Blackstone Group bought Busch Gardens in 2009. Stargel said the craft industry has thrived under that Busch Gardens exception.

“It was never anticipated they would sell all their packaged products outside of the three-tiered system,” Stargel said.

Some producers were concerned that if they have to move their bottled beers through a wholesaler they may not be able to get their beer back because it’s made in small batches and limited in supply, she said.

To address that concern, Stargel put a provision in SB 1714 allowing breweries to keep their bottled beers on the premises, but still have to go through the process of purchasing it from the wholesaler.

“Florida law requires vendors purchase their beer from a wholesaler,” Stargel said. “My goal was to allow brewers with vendor licenses to have an easier time getting their beer from the wholesaler, but maintaining the exception for beer sold on tap or in growlers.” Growlers are large refillable containers often used for carry out.

Eric Criss, president of the Beer Industry of Florida, Inc., said his organization worked on removing the provision that requires breweries to have to buy their own bottled beer back for resale, which would raise its price.

‘Deterrent to Excessive Promotion, Consumption’

Mitch Rubin, executive director of the Florida Beer Wholesalers Association, called the three-tier system the “societal choice” for how alcohol and cigarettes are sold in the U.S. “The three-tier system provides for orderly markets, efficient and transparent tax collection and helps deter excessive promotion and consumption.”

“Can you buy cigarettes directly from Phillip Morris in Florida?” Rubin asked. “It’s required you buy tobacco from retailers. The legislature doesn’t want direct sales from manufacturers to consumers in competition with retailers who are selling cigarettes. Ditto for alcoholic beverages.”

Rubin says there was a misunderstanding about SB 1714’s exception for “come to rest” for breweries with retail licenses. “Come to rest” is the expression for the legal requirement that beer stop at a distributorship to make certain the beer being shipped matches the paperwork for inspection and tax purposes.

He said distributors and retailers are okay with breweries being able to sell their beer for on-premises consumption as well as in growlers without having to go through a distributor. The exception from “come to rest” is in the law and was in the bill so that brewers may move their beer from the licensed brewery portion of the premises to the licensed retail portion of the premises, said Rubin.

“But if a brewery or brew pub wants to sell cans or bottles, it should have to go through a distributor and receive product like all other retailers. When a brewery places an order for beer, it would buy cans or bottles of beer, including any beer it may have produced, from the distributor as required under the three-tier system. I expect the bill will be amended to clarify the proper procedure,” said Rubin.

‘Wholesalers Have Stranglehold’

Michelle Minton, the Competitive Enterprise Institute’s Fellow who specializes in alcohol regulation, said although all the states but Washington have a three-tier system for alcohol distribution, the exceptions allowed can vary from state to state.

Minton said the controversy surrounding SB 1714 “really highlights the stranglehold that wholesalers have over the regulatory process of beer sales” in Florida.

If craft brewers want to grow their business outside of their state, they still need wholesalers, Minton said. She said wholesalers provide the trucks as well as the connections to bars and restaurants to get the beer sold in the retail market.

But Minton said the decision to use wholesalers should be voluntary. That would introduce a lot of competition and lower prices for consumers, she said.

“My goal [with SB 1714] was to allow brewers with vendor licenses to have an easier time getting their beer from the wholesaler, but maintaining the exception for beer sold on tap or in growlers.”

KELLI STARGEL, STATE SENATOR, LAKE LAND, FLORIDA

Tom Gantert is senior capitol correspondent for Michigan Capitol Confidential, a daily news site of the Mackinac Center for Public Policy.
Missouri Legislators Override Veto, Approve Income Tax Cuts

By Steve Stanek

Missouri legislators in May overrode the veto of Gov. Jay Nixon (D) to enact the state’s first income tax cut in nearly 100 years.

The state’s top tax rate on personal income will decline from 6 percent to 5.5 percent in stages beginning in 2017. The top tax rate starts at taxable income of just $9,000. Missouri also will become the third state to offer a special business-income deduction on personal tax returns.

The tax cuts come with a caveat: They happen only if Missouri’s tax revenues grow at least $150 million above the highest point over the past three years.

State officials estimate income taxes would be reduced for approximately 2.5 million households. Hundreds of thousands of people involved in business partnerships, limited liability corporations, or individual business ventures would benefit from the 25 percent deduction for business income reported on personal tax returns.

The votes to override Nixon’s veto were 23–8 in the Senate and 109–46 in the House.

‘Important First Step’

“Senate Bill 509’s passage is a victory for taxpayers that stands in stark contrast to tax handouts, like Boeing’s, that have bedeviled reformers’ attempts to take the cronyism out of the state’s economic development efforts,” said Patrick Ishmael, policy analyst at the Show-Me Institute in St. Louis, Missouri. “This first tax cut is a small but important first step to ensuring every Missourian, not just a select few with special connections in Jefferson City, is empowered to make this state better.”

As disappointing as it was to see a governor veto tax relief for all Missourians, the legislature should be commended for standing up for taxpayers,” said John Nothdurft, government relations director for The Heartland Institute, which publishes Budget & Tax News. “While the reforms were not as significant as North Carolina’s, this is also yet another signal to other states that they will need to look at tax reform to compete for businesses and labor.”

North Carolina legislators in 2013 approved several major reforms to lower personal income tax rates for all taxpayers, cut corporate income taxes, and repeal the estate tax.

Governor: Schools Need Money

“Missouri families and businesses know that public education is the best economic development tool there is, and that is why I vetoed Senate Bill 509,” Nixon said in a statement after legislators in the Republican-controlled legislature overrode his veto.

“While scaled back from last year’s billion-dollar House Bill 253, Senate Bill 509 fails to prioritize or adequately protect public education at a time when quality public schools are more important than ever to our ability to create jobs in the global economy. And while its authors may have delayed its impact, Senate Bill 509 remains a very real threat to the principles of fiscal discipline that have helped us maintain our spotless AAA rating for decades.”

Legislators last year failed to override Nixon’s veto of a bigger tax-cut bill.

Steve Stanek (sstanek@heartland.org) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.
Critics Say FDA Out to Ruin the E-Cigarette Industry

By Steve Stanek

Electronic cigarettes have no tobacco smoke, but that hasn’t stopped the Food and Drug Administration from proposing rules to treat e-cigarettes much like tobacco-based cigarettes.

The draft regulations also cover cigars, pipe tobacco, and other tobacco products that have not been regulated like cigarettes. Those in the e-cigarettes industry are none too happy about the proposal, which gave the public just 75 days to comment. Some independent tobacco policy researchers and policy experts also have complaints.

“The FDA is overreaching as they always do. They’re doing this to benefit Big Pharma. They leave nicotine strength out [of the proposed rules], and everyone knows toxicity depends on the amount. This is going to be a nasty battle I hoped to avoid,” said Ray Story, chief executive of the Tobacco Vapor Electronic Cigarette Association and former chief executive of Smoking Everywhere, a Florida-based e-cigarettes company.

‘Biased Toward Big Pharma’

“The sad part about it is when we look at the FDA and their past, we know we’re going to have an issue because they’re biased toward Big Pharma,” Story said. Sales of nicotine gums, patches, lozenges and other quit-smoking pharmaceuticals have been falling as e-cigarettes have risen in popularity.

Story added producers of medical marijuana do not have to jump through the regulatory hoops through which e-cigarette makers would have to jump under the FDA proposal. He said this is “because they [the FDA] control the field already. They’re not okay with e-cigarettes because they don’t have control over the manufacturing process.”

He said the FDA could end up ruining the industry. FDA officials say they their proposal is due to safety concerns.

“The proposed rules would give the FDA additional tools to protect the public health in today’s rapidly evolving tobacco marketplace, including the review of new tobacco products and their health-related claims,” Mitch Zeller, director of the FDA’s Center for Tobacco Products, said in a statement.

Heavy Reporting, Sales Ban

E-cigarette companies would have to register with the FDA and submit detailed lists of all ingredients and descriptions of manufacturing procedures. The rules also call for a ban on e-cigarettes sales to minors.

Manufacturers bill e-cigarettes as a safer alternative to actual cigarettes because no smoke is inhaled. Instead, a small battery powers a heater that heats a mixture of nicotine, flavorings, and water into vapor. Many people who want to quit smoking are turning to e-cigarettes to wean themselves off tobacco, which has numerous substances that can harm health if inhaled.

Dr. Gilbert Ross, executive director and medical director of the American Council on Science and Health, noted, “For America’s 44 million smokers, most of whom want to quit yet cannot with the currently available FDA-approved products, the continued availability of electronic cigarettes is reassuring, as this method provides addicted smokers with their best chance of quitting.”

‘Not Based on Sound Science’

Ross also said the rules “will stifle innovation in the e-cigarette marketplace. They are unduly onerous and are not based on sound science, requiring 99 percent of the current products to apply for FDA approval. Many smaller e-cig companies will either go under or seek ‘protection’ from the major tobacco companies.”

He continued, “The FDA estimates that just one application will require over 5,000 man-hours to complete, meaning that the true cost of a single application is likely in the millions.”

Steve Stanek ([sstane@heartland.org](mailto:sstane@heartland.org)) is a research fellow at The Heartland Institute and managing editor of Budget & Tax News.
When Our Government Is Committing Fraud

By Richard Epstein

The government has announced it will receive another multi-billion-dollar “dividend” from Fannie Mae and Freddie Mac. That payment will return to the United States Treasury (with interest) all of the $187 billion in bailout money lent to the two mortgage giants after September 2008, pursuant to the Housing and Economic Recovery Act (HERA) passed in July 2008. HERA authorized the newly minted Federal Housing Finance Agency (FHFA) to throw both Fannie and Freddie into a statutory conservatorship and required FHFA to manage the assets of both corporations to facilitate their orderly return into private hands upon repayment of the government advances.

The initial bailout terms were contained in a Senior Preferred Stock Purchase Agreement (SPSPA). Under its terms, each corporation had to issue a new class of senior preferred stock to the United States, which bore interest at 10 percent per annum. That sum increased to 12 percent if Fannie and Freddie chose to conserve cash instead of paying dividends. For the next two or so years, as conditions in the housing market improved, the arrangement proceeded more or less as planned.

The entire legal landscape, however, was radically changed in August 2012, when the Third Amendment to the 2008 SPSPA was passed. It called for a “net worth sweep” under which FHFA and Treasury entered into a deal that magically converted all the net receipts of Fannie and Freddie as “dividends” to be paid to the government.

New Revelations

This audacious deal ensured the two corporations would never pay off their debts to the United States, no matter how much money they earned. The Third Amendment has been subject to withering criticism, most recently by David Skeel who, writing in The Wall Street Journal, rightly charged the federal government with “astonishingly duplicitous behavior.”

By way of full disclosure, I consult with several hedge funds with positions in Fannie and Freddie. From that perspective, as I have already written in previous Defining Ideas columns, the government shenanigans fairly leap out of the text of the Third Amendment. But Gretchen Morgenson’s New York Times piece, “The Untouchable Profits of Fannie Mae and Freddie Mac,” contains two new revelations that only add fuel to the fire.

The first concerns the release of a key internal Treasury memo dated December 20, 2010 from Jeffrey Goldstein, then undersecretary of domestic finance, to then-Secretary of the Treasury Timothy Geithner. It referred unequivocally to “the administration’s commitment to ensure existing common equity holders will not have access to any positive earnings from the G.S.E.’s in the future.” The Treasury has tried to backtrack from that position by insisting the memo was “only about the importance of repaying the taxpayers for the enormous investment that they made in the G.S.E.’s if the G.S.E.’s ever generated positive returns, which at the time was uncertain to return.”

Not so fast. As Ralph Nader rightly observed in his February 1, 2014 letter to Secretary of the Treasury Jacob J. Lew, no one disputes the government’s claim of first priority to Fannie and Freddie assets. Yet the belated government explanation ignores its intended wipeout, and thus further covers up the simple point that the scheme behind the Third Amendment was hatched some 18 months before that amendment was put into effect.

Specter of Fraud

This one-sentence revelation casts in new light the decision of the Federal Deposit Insurance Company on three occasions to sell large blocks of Fannie and Freddie shares, without first disclosing Treasury’s intention to drive the value of these shares to zero. At the very least, the actions of these two closely intertwined government agencies raise the specter of securities fraud— the kind of conduct that invites criminal investigation of any private parties who behave in similar fashion.

These recent events strongly suggest a continuous pattern of bad-faith government conduct. What they do not do, however, is create a case for money damages against the government that will help the long-term private shareholders of Fannie and Freddie who did not trade during this period. But the real game is the entire dividend stream that has been diverted from all Fannie and Freddie shareholders under the Third Amendment. The key inquiry is therefore into the government defenses against the three charges in the underlying lawsuits: wealth confiscation, the abuse of administrative authority under FHFA, and the breach of its fiduciary duty to Fannie and Freddie’s private shareholders.

The government’s task is not an enviable one, because the cozy deal between FHFA and Treasury looks like the worst form of self-dealing. Recall that both Edward DeMarco, then acting director of FHFA, and his key aide Mario Ugoletti, came to FHFA from Treasury. To remove any taint from the deal, the government has to show first that it exercised due diligence to see that the deal was fair to all parties; and, second, that, more critically, the deal viewed as a whole was in fact fair to the private shareholders. The government has done nothing to satisfy either obligation.

Weak Government Defenses

Faced with these serious obstacles, the first line of the government’s defense is to argue that none of the private shareholders has standing to challenge this collusive deal because HERA provides that the FHFA as conservator shall “immediately succeed” to all shareholder rights in the GSE. That transfer of power is fine insofar as it lets the conservator shall “immediately succeed” to all shareholder rights in the GSE. That transfer of power is fine insofar as it lets the government pursue GSE claims against third persons. The benefit of the rule is that it prevents any third party from wiggling out of its obligations to Fannie and Freddie by arguing that the suit was brought by the wrong party.

It defies common sense, however, to let this language insulate FHFA and Treasury from all lawsuits that the private shareholders bring against them for abuse of power. Now the government faces an unpleasant dilemma. Either it can admit that the “all

"[T]he cozy deal between FHFA and Treasury looks like the worst form of self-dealing.”

“I may expect— i.e. predict—that my shares of stock may never be in the money. But in so thinking I have not renounced my right to cash in those shares when they have positive value. No negative prediction of future consequences can wipe out an entitlement when and if the future unfolds beneficially.”
would earn enough net income—even in the advances “it was unlikely that the GSEs major ploy is to insist that given the size of the Third Amendment. Its out an entitlement when and if the future prediction of future consequences can wipe when they have positive value. No negative renounced my right to cash in those shares—dict—that my shares of stock may never be-

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will shortly be repaid. Second, the govern

ment to guarantee to any interested party a judicial hearing to protect its property.

Nor does the government position become defensible once the door is forced open. Most strikingly, at no point in its legal papers does the government even acknowledge that its advances had been largely repaid. Instead its dubious defense rests on two points: first, that “the value of Treasury’s commitment to the GSEs was ‘incalculably large’”; and second, that in light of the dangerous situation in 2008, “equity holders in the GSEs had no expectation that they would have access to any positive returns that the GSEs might experience in the future.”

Wrong on both counts. First, the level of the Treasury commitment was not “incalculably large”: it was $188 billion, all of which will shortly be repaid. Second, the government indulges in skillful wordplay on the term “expectation.” I may expect—i.e. predict—that my shares of stock may never be in the money. But in so thinking I have not renounced my right to cash in those shares when they have positive value. No negative prediction of future consequences can wipe out an entitlement when and if the future unfolds beneficially.

Next the government offers its own twist ed account of the Third Amendment. Its major ploy is to insist that given the size of the advances “it was unlikely that the GSEs would earn enough net income—even in years when they were otherwise profitable—
to pay Treasury its dividends without the need to take further draws from Treasury.” The Third Amendment was supposed to end this “vicious circle” and lead to “improved market confidence” in Fannie and Freddie.

Really? Note the 2008 agreement contains a standard provision that would avoid the senseless cycle of repaying dividends with fresh advances from Treasury. FHFA could unilaterally decide to hold back needed cash by paying 12 percent interest on late payments. It was hardly necessary to bankrupt Fannie and Freddie to avoid further advances.

Tactical Error in Motion
Worse still, the government committed a serious tactical error in filing its motion to dismiss the entire case before trial. A well-argued MTD takes as true all the allegations in the complaint. But the government’s papers denied that Fannie and Freddie had sufficient funds to pay off these claims when the Third Amendment went into effect.

Factually, the claim seems absurd in light of the robust financial performance of Fannie and Freddie after August 2012. But once that assertion was made, the plaintiffs in Fairholme Capital demanded, through their attorney Charles Cooper, extensive discovery in order to examine the government’s aggressive claim.

Judge Margaret Sweeney [recently] granted Cooper’s motion, sweeping aside the government’s objections that the claims were not “ripe” for review on the ground that “1) future profitability is unknown, and 2) both Fannie and Freddie are still in conservatorship.” Those claims border on the frivolous, given that the government had to know something about its profitability before implementing the Third Amendment. Nor is it credible to assume that the conservatorship should go on forever after the advances have been repaid.

As Judge Sweeney noted, since this evidence “is solely in possession” of the government, discovery is required to equalize the balance, at which point all documents and discussions relating to Treasury’s key decisions should become public record. No wonder the shares of Fannie and Freddie rose substantially on this late-breaking news.

What Is To Be Done?
Going forward, it is hard to disagree with David Skeel that “ideally the government should undo the 2012 sweep,” which would end litigation in which the government’s position seems even more precarious. But if the government continues to fight, it gains nothing from delay. Recall that the plaintiffs’ demand is solely to receive proper credit for the repayment of the government’s advances. The offset for that delay comes in the form of interest that the government has to pay on its late obligations.

It seems, however, that the government has decided to circle the wagons. Republican Ed Royce’s H.R. 3901 is a bill that carries the jingoist title “Pay Back the Taxpayers Act of 2014,” which provides explicitly that the payments to Treasury under the Third Amendment shall go “into the General Fund of the Treasury and shall be used only for reducing the budget deficit of the Federal Government.”

This audacious legislative maneuver attempts to deflect the constitutional and administrative challenges to the Third Amendment by announcing that Congress thinks that the government should keep the Fannie and Freddie dollars. How ironic. Right now Congress is desperately working to find ways in which to increase the private capital invested in mortgage markets. But who will play along when the legislative and executive branches rig the rules after the game is underway? First there was Chrysler and GM, now this.

A government victory against the Fannie and Freddie shareholders may well make the private mortgage lending market a distant memory.”
Regulations Stifling Banking Industry, Fed Official Says

By Phil Britt

Banking industry regulations have grown in number and complexity since the 2007 financial crisis, but the new regulations might not solve financial stability problems and could reduce the competitiveness of U.S. banks, said Daniel Tarullo, a member of the Board of Governors of the Federal Reserve System in a keynote speech at the Federal Reserve Bank of Chicago’s annual bank structure conference in May.

Smaller banks have been hit especially hard by the new regulations, he said.

The “aims of prudential regulation for traditional banking organizations should vary according to the size, scope, and range of activities of the organizations,” he said. He noted in many rural areas, a community bank is the only financial institution that serves the area. Additionally, banks with less than $1 billion in assets account for nearly one-quarter of the commercial and industrial lending and nearly 40 percent of the commercial real estate lending to small- and medium-sized businesses. Their importance is disproportionate to their size. They have less than 10 percent of commercial banking assets, he noted.

Tarullo said the size threshold for middle-range banks, which are subject to increased reporting and regulatory requirements, should be raised from the current $50 million to $100 million.

Another conference speaker, Terry Jorde of the Independent Community Bankers of America, also pointed out much of the new regulation has placed undue burdens on smaller banks, which don’t have sufficient staff to handle the increased paperwork. Ninety percent of community banks have less than $1 billion in assets, with many having much less than that.

Reports Four Times Longer
Jorde noted when she worked as a community banker several years ago, the quarterly call report that all banks file was about 19 pages long. Now that same report is 80 pages long. Call reports include details about a bank’s financial condition. The level of detail is dictated by the size of the bank: the larger banks have to provide more detail. But regulatory changes over the past few years mean even small banks, with small staffs, must file lengthy reports.

William Downe said some of the Fed’s capital reserve requirements have gone too far. Downe is president and chief executive officer of Montreal-based BMO Financial Group, parent company of Chicago-based BMO Harris Bank.

“The thought is that if some [capital] is good, more may be better,” Downe said. But the more capital banks must hold in reserve, the less money they have for lending or for other investments. This limits investment returns. If investors don’t see enough investment opportunity in banks, they won’t provide funding, which also limits how much banks can lend, he said.

Almost No New Charters
This lack of return is one factor in the almost total lack of new bank charter filings over the past few years. There were many more new bank charter filings in other banking downturns, Downe said.

In addition, banking regulations have continued to change, which impedes strategic planning, Downe said. Fear of new regulations or changes to existing ones have kept banks from introducing some new products and services.

Competition from non-bank financial services providers also is having an impact. These non-bank firms provide many of the same services as banks without the same regulatory restrictions, said Karen Shaw Petrou, managing partner of Federal Financial Analytics, Inc. Currently, the assets of shadow banks—non-banks providing financial services—total more than 1.5 times (174 percent) the amount of banking assets in the United States. The global number is 52 percent.

Petrou said this disparity is due in large part to the regulatory environment in the U.S. She noted the U.S. figure is probably an underestimate because it doesn’t include mortgage-servicing payments.

Petrou also said the rules for executive compensation of bank officers could limit the level of talent the industry is able to draw. The shadow banking industry has no such restrictions, she noted.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
‘Time to Wind Down Fannie and Freddie,’ Moody’s Says

By Phil Britt

Moody’s Investors Service says it is “time to wind down” Fannie Mae and Freddie Mac.

The declaration appears in an in-depth analysis of the Johnson-Crapo Finance Reform and Taxpayer Protection Act that was presented in May at a Federal Reserve Bank of Chicago annual bank structure conference. The bill aims to wind down Fannie Mae and Freddie Mac and replace them with a new government agency.

Senators Mike Crapo (R-ID) and Tim Johnson (D-SD) introduced the bill earlier this year. It is awaiting markup.

“It is time to wind down Fannie Mae and Freddie Mac and reform the housing finance system. Since the government took [them] over during the financial collapse more than five years ago, nothing has changed. The government is still making nine out of every 10 loans, amounting to almost $1 trillion annually,” wrote Moody’s Chief Economist Mark Zandi and Senior Director of Consumer Credit Analysis Cristian deRitis in their analysis.

Taxpayers are underwriting this debt even though private investors want to undertake the risk and include some safeguards, according to Zandi and deRitis.

Cash Cows

Another problem with Fannie Mae and Freddie Mac staying in government hands, according to Moody’s, is the threat they will be used for purposes outside of housing. For example, the 2012 payroll tax rollback was funded partially by raising premiums Fannie and Freddie charge homebuyers for insurance. These higher premiums will continue over the next decade.

In the same vein, according to Moody’s, policymakers may begin to rely on these profits to fund future government spending. If that happens, it would be more difficult to shutter the government-sponsored entities.

Their uncertain future is also contributing to tight credit, according to Moody’s. On the other side of the coin, “politicians may be tempted to force Fannie and Freddie to lend to people who really cannot afford mortgages. ... Experience shows that politically driven help can be misdirected or abused.”

The Moody’s analysis further says government rules to protect the financial system against another housing industry collapse have gone too far, with capital requirements more than double what insurers lost in the Great Recession.

Phasing Out Fannie, Freddie

The Johnson-Crapo bill has the following basic provisions:

• Private financial institutions must put up 10 percent in first-loss capital to qualify for the government guarantee, using a combination of insurance, letters of credit and future guarantee fees.
• A new regulator, the Federal Mortgage Insurance Corp., would oversee the securitization and insurance of mortgages. The FMIC would replace the Federal Housing Finance Agency to oversee all aspects of the mortgage finance market.
• Freddie and Fannie would be wound down, and so would the government’s role in housing. The term of the wind-down is initially slated at five years, but the legislation also includes provisions to extend this time.
• There would be a common securitization platform that the FMIC would guarantee. Standardization would make it easier for investors to compare the different investment pools, according to Moody’s.
• The bill eliminates housing goals now required for the GSEs. Instead, there would be a few funds to address affordable housing and home ownership. To avoid any conflict between providing liquidity for the mortgage market and promoting home affordability, the legislation would create two funds with different mandates, according to Moody’s.
• The bill also preserves consumers’ ability to lock in interest rates before closing while also ensuring the availability of 30-year mortgages.
• To ensure community banks and credit unions have access to the secondary mortgage market, the proposed legislation would establish a mutually owned cooperative of small lenders that would provide access to the secondary market as well as securitization services.

Fixable Flaws

“There is a lot to like in the Johnson-Crapo vision of the housing finance system, but it falls short in some important, yet readily fixable respects,” the Moody’s analysis says.

Under the proposed legislation, financial institutions could originate, aggregate, securitize, and guarantee loans. It would be better, according to Moody’s, if the legislation “made a clear break between guarantors and originators: Financial institutions should be one or the other, not both.”

Another concern for Moody’s is that the legislation would allow capital markets to compete with guarantors, which could be destabilizing.

Moody’s acknowledges political divisions in Congress make it unlikely housing reform will pass this year, a sentiment echoed in an American Banker article in mid-May, but adds that failure to wind down Fannie and Freddie and set up a new housing finance system is a large piece of unfinished business for housing reform.

Phil Britt (spenterprises@wowway.com) writes from South Holland, Illinois.
Wisconsin’s Wealthy Pay Disproportionately More

By Ryan Ekvall

The top 0.5 percent of income earners in Wisconsin paid more than one-fifth of the state’s income taxes in 2012.

Combined, those 15,200 taxpayers paid $1.435 billion in income taxes, an average of $94,400 each, which is more than the annual incomes of 80 percent of the tax filers in Wisconsin, according to a new analysis from the Wisconsin Taxpayers’ Alliance.

Wisconsin’s “progressive” income tax structure means the wealthiest few carry the burden of government for the rest of the state. The top 0.5 percent of income earners made 14.7 percent of the state’s income but paid nearly 21 percent of all state income taxes.

Wisconsin’s tax structure until 2013 was among the most progressive in the country.

State Rep. Dale Kooymenga (R-Brookfield) has in the past two sessions of the legislature led a Republican effort to flatten the income tax in Wisconsin. Gov. Scott Walker (R) signed an income tax cut for the lowest tax reduction for all earners in 2013 and an additional cut for the lowest 0.5 percent of income earners in 2014.

Still High on Highest Earners

The state now taxes top earners’ income at 7.65 percent, a mere 0.10 percentage point reduction from the previous 7.75 percent rate. The rate is 4 percent for lower-income earners.

“Higher and more progressive tax codes have a negative effect on labor,” said Lyman Stone, an economist at the Tax Foundation. “It’s not devastating, but when you know working overtime or putting extra investment in your education is going to have a lower return than what you already put in, it’s a disincentive.”

Support for Steeper Tax Rates

Nearly two-thirds of Wisconsinites responding to a recent Marquette Law School poll said they’d support increasing income taxes on those making more than $250,000 to fund a property tax cut.

The Capital Times, Madison’s newspaper, supported that sentiment and added a political slam:

“While the public strongly backs higher income taxes on upper incomes, do you think Gov. Scott Walker would ever stand for even modest increases on the highest compensated among us, many of whom make up his core Republican constituency, his most ardent fans and biggest donors?”

“Right, when pigs fly.”

But there’s a practical, not simply political, reason to flatten the income tax.

The Federal Reserve Bank of Kansas City explained tax “structures that are more progressive ... experience faster growth and more volatility in revenues.”

‘Erratic Incomes, Unstable Revenues’

The incomes of wealthier persons tend to be more volatile than those of lower-income earners. In a down economy, the wealthy may not receive a bonus or close as many sales. That means when the economy goes bust, so do a state’s tax revenues, as is the case with Wisconsin.

“When you have a revenue system that’s dependent on more erratic incomes, the result is unstable revenues,” Stone said. “During the boom years you expand spending, you introduce new government obligations. When bad times come, you have a disproportionately steep revenue fall, and you have liabilities you can’t afford anymore.”

That should sound familiar to Wisconsinites.

Walker late last year floated the idea of abolishing the state income tax. Supporters argued when all things are equal, a tax on goods or services means fewer goods and services are produced. No bill to do this has been advanced.

By Ryan Ekvall

The federal tax code is so complicated even the City of Madison, Wisconsin has trouble deciphering it.

Wisconsin’s capital city recently reached an agreement with the Internal Revenue Service to pay back $580,000 in taxes to the federal government over its failure to report some life insurance benefits as income for city employees. Madison is also in negotiation with the state Department of Revenue to settle on back taxes owed, which could cost around $300,000.

“We discovered (the error) over the past year-and-a-half and calculated the impact,” said city finance director David Schmiedicke. “When we fully understood the federal tax law in this area we reached out to the IRS.”

Most employees can purchase up to $50,000 in group-term life insurance policies with pre-tax dollars, according to IRS code. In other words, the employee gets a tax break for purchasing some life insurance through work. The employer, too, reduces some of its payroll taxes owed for Social Security and Medicare.

The cost of premiums for any policy with insurance benefits exceeding $50,000 is supposed to be included as income to employees for tax purposes. But Schmiedicke said for decades the city failed to do that for approximately 2,200 employees.

The IRS can look back only three years for missed payments in this area, and the Department of Revenue can look back only four years. That’s millions of dollars in unpaid taxes for which the city and its employees will not be responsible.

Schmiedicke said the city will pay employees’ share of tax liability, which is included in the $580,000 figure, as part of the settlement with the IRS.

To avoid future tax problems, the city has removed pre-tax life insurance policies from its fringe benefits package.

“We are no longer excluding any income associated with premiums paid for life insurance. Now all that is taxable. We’ve taken it out of our cafeteria plan,” Schmiedicke said.


IRS Settles for $580K from Wisconsin’s Capital; Another $300K Owed

By Ryan Ekvall

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“Wisconsin’s ‘progressive’ income tax structure means the wealthiest few carry the burden of government for the rest of the state. The top 0.5 percent of income earners made 14.7 percent of the state’s income but paid nearly 21 percent of all state income taxes.”
By John Kramer

The victory of three independent tax-return preparers over the IRS became final in May, after the agency declined to file a petition seeking review by the U.S. Supreme Court.

The lapse of the deadline marks the conclusion of a two-year battle over whether the IRS had the authority under the “Horse Act” of 1884—a statute passed to govern compensation claims for dead horses brought on behalf of Civil War veterans—to impose a nationwide licensing scheme on tax preparers.

“This brings finality to a major victory for independent tax preparers—and taxpayers—nationwide,” said Dan Alban of the Institute for Justice, lead attorney for the three preparers who filed the suit. “Four federal judges sitting on two different courts have all agreed that Congress never gave the IRS the power to license tax preparers, and an agency cannot just give itself such licensing authority. By not filing a petition for certiorari, the IRS has wisely chosen not to ride this horse law any further.”

By arguing Congress gave the IRS the authority to impose licensing requirements on income tax preparers under a statute enacted in 1884, the IRS claimed a power that would have been granted nearly 30 years before the income tax was enacted and the IRS was created—and before professional tax preparers existed.

Aimed to Help Industry Insiders
If the licensing scheme had not been struck down, some 350,000 tax-return preparers would have been burdened by the new regulations, much to the benefit of entrenched special interests.

“These regulations were classic economic protectionism,” said IJ Senior Attorney Scott Bullock. “The burden would have fallen on small entrepreneurs and consumers, while powerful industry insiders stood to reap the benefits of decreased competition. Instead, taxpayers will enjoy lower prices for tax-preparation services as more preparers compete for their business.”

The case arose when the IRS, following several failures to secure congressional authorization, unilaterally imposed sweeping new regulations requiring all tax-return preparers to obtain a license and submit to ongoing, mandatory IRS-approved education.

Courts Reject Power Grab
Three independent tax preparers—Sabina Loving of Chicago, Illinois, Elmer Kilian of Eagle, Wisconsin, and John Gambino of Hoboken, New Jersey—filed suit in March 2012 in the U.S. District Court for D.C. They argued the IRS exceeded the scope of its authority by attempting to enact the regulations without Congress’s approval. U.S. District Court Judge James E. Boasberg agreed and struck down the regulations as unlawful in January 2013.

In February 2014, a three-judge panel of the D.C. Circuit Court of Appeals upheld the district court opinion, ruling, “The IRS may not unilaterally expand its authority through such an expansive, atextual, and ahistorical reading of [the statute.]” The case is Loving v. IRS.

John Kramer is vice president for communications at the Institute for Justice.


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Va. a Textbook Example of Problems Posed by Targeted Tax Credits

By Kathryn Watson

Virginia’s failure to report how much it doles out in tax credits to each company through the Major Business Facility Job Tax Credit is dragging down the state’s overall spending transparency score.

That isn’t likely to change anytime soon.

Tax credits aren’t spending, per se, even though that tax revenue has to be made up somewhere, either through more taxes or spending cuts.

While a grant to a company would have to be reported, tax credits become easy political tools for state officials to favor particular industries, businesses, or goals with virtually no transparency, said Matt Mitchell, a senior research fellow with George Mason University’s Mercatus Center.

Hidden Handouts

“This is an example where the government could just achieve this exact goal by just granting, handing out cash to these companies,” Mitchell said. “Why don’t they do that? They do that for the very reason that it’s too transparent.”

Tax credits and expenditures through, say, a grant aren’t exactly the same thing, but they generally have indistinguishable effects, Mitchell said. So they should be on display for the public to see.

“One of the things that seems pretty clear when you look at the data is that governments over time tend to gravitate towards the less-transparent ways of privileging firms,” Mitchell added.

“That’s why they used to give out subsidies to farmers and cash payments, and over time, they’ve gravitated towards less-transparent things like price controls, and other things that still cost, from an economic perspective, consumers and/or taxpayers, but they end up being much less transparent.”

Because tax credits aren’t technically expenditures, they aren’t included in the Commonwealth Data Point, the state’s spending transparency website run by the auditor of public accounts. That’s why the Major Business Facility Job Tax Credit, given to qualified companies that transfer or create a threshold of at least 50 jobs in the state, was nowhere to be found by researchers at the U.S. Public Interest Research Group (PIRG) when it released its state spending transparency report.

“The Major Business Facility Job Tax Credit is not a payment, but a credit taken when taxes are filed, and therefore not required to be included in Commonwealth Data Point,” said April Cassada, an auditor with the auditor of public accounts.

No Specifics

And there are more brick walls for taxpayers. Not only does the state not report how much is given through the credit, other than an aggregate total deep in the recesses of the Internet, but Virginia law prohibits the Department of Taxation from releasing information about how much it gives in credits to specific businesses, even in response to a request under the Virginia Freedom of Information Act.

“We couldn’t divulge anything associated with your tax return,” said Joel Davison, communications director for the Department of Taxation. “We can divulge general information about credits, but not specific information as it relates to an individual or a business. Basically, it’s against the law in Virginia.”

The average Virginian should care because, one way or another, someone has to make up for those tax credits, Mitchell said.

Service Cuts or Tax Hikes

“Every time the government chooses to privilege a particular firm, that means either somebody else’s services are cut or their taxes go up,” Mitchell said. “That’s not obvious to the politicians. It’s not a conspicuous cost. All they see is ‘oh, we’ve created 12 jobs in this area.’ Well, those jobs came at the expense of the taxpayers and other companies elsewhere, which is why the data shows these targeted incentives don’t work.”

It’s not just the transparency of the tax credit people should be concerned about, said Nicole Kaeding, budget analyst with the Cato Institute in Washington, DC.

“The more important issue in this situation is whether the state should disclose the recipients of the tax credit, but why does that tax credit even exist?” said Kaeding. “Economic development programs, including programs operated through the tax code, harm economic growth. If Virginia truly wanted to expand job creation, it would be much better off by reforming its tax code.”

Almost a Wash

In 2008, Virginia gave roughly $12.5 billion worth of tax preferences, while raking in just $14 billion in revenue, according to a study by the watchdog arm of the General Assembly. In other words, it gave up nearly as much in all forms of tax preferences as it received in tax revenue.

A new legislative commission is working, however slowly, on re-evaluating the state’s entire swath of tax preferences. The incentive for reform isn’t great, though.

“This is a case where it’s unfortunately sort of bipartisan, because Democrats or progressives or liberals like [the tax credit] because it’s a way to allow the government to allocate capital and craft an economy, but Republicans like it too because it seems like a tax cut, but it’s not a genuine tax cut,” Mitchell said.

Kathryn Watson (kwatson@watchdog.org) is an investigative reporter for Watchdog.org, where this article first appeared.
Regulations Take $1.8 Trillion Bite Out of Economy

By Christine Hall

Regulations took more than $1.86 trillion out of the U.S. economy in 2013, according to the Competitive Enterprise Institute’s (CEI) annual Ten Thousand Commandments report on the size and scope of federal regulations.

The report, released at the end of April, aims to establish a baseline for the largely unknown “hidden tax” of the U.S. regulatory state, because more than 99 percent of federal regulations are never subjected to cost-benefit analysis.

“Federal agencies crank out thousands of new regulations every year, but we have little information on the cost or effectiveness of most of them,” said report author Clyde Wayne Crews Jr. “There is little transparency and no reliable source of information on exactly what benefits all these rules are supposed to be generating or if they are serving their intended purpose.”

“Most of the country is focused on our spending and debt problem, but unless we also address our nation’s regulatory burden, our economy will remain under water,” Crews said. “When compared to federal spending, the cost of federal regulations was more than half the size of the federal government’s 2013 budget of $3.5 trillion, and this is part of what is holding back American innovation and wealth creation.”

Crews said an already huge regulatory state has grown at an alarming rate during the Obama administration.

‘Hidden Tax on All Consumers’

“The president has said publicly he will not wait for Congress to pass legislation because he has a ‘pen’ and a ‘phone.’ This means the administration aims to implement policy through regulation, which will add a hidden tax on every form of commerce and trickle down to all consumers,” he said.

Highlights from the 2014 edition of Ten Thousand Commandments include:

• This is the 21st edition of Ten Thousand Commandments. Since the first edition was released, 87,282 final rules have been issued. That’s more than 3,500 per year, about nine per day.
• Compliance costs and economic impacts of federal regulations reached $1.863 trillion in 2013. That is larger than the entire economy of some countries, notably Canada and Australia.
• There were 51 rules for every law in 2013. This “Unconstitutionality Index” is the ratio of regulations issued by agencies compared to legislation passed by Congress and signed into law by the president. There were 72 new laws, but 3,659 new rules. That’s a new rule every 2½ hours.
• Regulatory costs amount to an average of $14,974 per household—23 percent of the average household income of $65,596 and 29 percent of the expenditure budget of $51,442. This exceeds every item in the household budget except housing—more than health care, food, transportation, entertainment, apparel, services, and savings. Some 63 departments, agencies, and commissions have regulations in the pipeline.
• The 2013 Federal Register contains 79,311 pages, the fourth highest ever. The top two all-time totals are 81,405 pages in 2010 and 81,247 in 2011, both under President Obama.

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Ever since President Barack Obama signed the ill-conceived Foreign Account Tax Compliance Act (FATCA) into law in 2010, I’ve been warning about the death of the dollar.

And I haven’t been alone. Other experts have cautioned about FATCA’s potential to literally shut down the global economy when it goes into full effect July 1. But the IRS has now postponed that day of reckoning, for at least some, until January 1, 2016.

The idea behind FATCA is simple: Demand that other countries enforce America’s imperialistic tax laws. And to do so by the confiscation of foreign assets, if necessary.

Under the provisions of FATCA, interest, dividends, rents, and similar payments leaving the United States will be subject to a 30 percent withholding tax. The only way that most foreign banks and other foreign companies will be able to avoid this tax is to act as unpaid IRS informants.

Foreigners investing in the U.S. will be affected, too. If their foreign bank isn’t FATCA compliant, their U.S. income will get whacked by 30 percent. It will be possible to recover the tax in some cases, but even so, I can’t think of a better way to scare foreign investors away from the U.S.

‘FATCA Contagion’

Something I call “FATCA contagion” would be even worse. In this scenario, because they couldn’t be completely certain that foreign recipients are FATCA compliant, U.S. banks might start routinely deducting 30 percent from international funds transfers—and letting the IRS sort it all out.

You can probably imagine what this might do to the value of the U.S. dollar. It could sink like a stone. If there’s panic selling out of the dollar, the U.S. Treasury could impose foreign exchange controls overnight. If it went on for more than a day or two, it would shut down much of the global economy.

The IRS seems to have become dimly aware of this possibility. On May 2, it released regulations that give many of the companies and financial institutions affected by FATCA another 18 months—until January 1, 2016—to become fully compliant. But this extension will apply only if the IRS thinks the particular institution is making a “good-faith effort” to do so. If it’s not, withholding begins July 1.

How is any U.S. bank supposed to know if the foreigner to whom it’s sending money has made a good-faith effort to become an IRS spy? Sure, the IRS has exempted entire categories of foreign recipients from the withholding tax, and others will be “deemed compliant” if they just try to comply.

Many Non-Compliant

Entire countries are labeled “compliant” if they sign what the IRS calls a “Model 1” FATCA agreement. This requires that banks in those countries send the information demanded by the IRS to their own tax authorities to subsequently be sent to the IRS.

But because it’s expensive to set up a FATCA compliance program, thousands of what the IRS calls “foreign financial institutions” or “non-financial foreign entities” have made no effort to become FATCA compliant. Unless the IRS delays the withholding mandate entirely, there’s a real potential for disaster.

I don’t have a reputation as a fear-monger. But FATCA has me very worried. The only way the IRS can stave off the possible collapse of the U.S. dollar after July 1 is to delay withholding for everyone until January 1, 2016.

Don’t get me wrong. I’m pleased the IRS made a halting step away from the dollar precipice. But it’s already too late to avoid stepping over it eventually. Here’s why:

Decline of ‘Dollar Imperialism’

To many foreigners, FATCA was simply the last straw. They’re fed up with what many are calling “dollar imperialism.” America is already the world’s largest debtor. Our government owes more money to more people than anyone else in the world. And in just the past seven years, our nation’s central bank has created $4 trillion out of thin air through quantitative easing. If you or I tried that trick, we’d go to jail for counterfeiting.

And now FATCA.

In response, the rest of the world is finally setting up the financial and contractual infrastructure to avoid the dollar entirely. That’s a big reason China has signed agreements calling for the use of its currency, the yuan, in financial exchanges with numerous major countries including Germany, Russia, and India. Japan and India have signed a currency deal linking their currencies closer together. Saudi Arabia and other oil-producing states in the Middle East plan to end dollar-for-oil exchanges and instead settle deals with a basket of non-U.S. currencies and gold.

All these arrangements, and many more, lessen the world’s dependency on U.S. dollars. FATCA only accelerates this process, and delaying FATCA will merely delay disaster. There’s no way to stop it. Even if the dollar doesn’t collapse shortly after July 1, the handwriting is on the wall. The dollar is doomed.

It’s time to start thinking about Plan B for your assets. Today couldn’t be too soon.

Mark Nestmann (assetpro@nestmann.com) is president and CEO at The Nestmann Group, Ltd. Used with permission of Nestmann.com.
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