

National Taxpayer Advocate

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EVALUATE THE  
ADMINISTRATION OF  
TAX EXPENDITURES

## Evaluate the Administration of Tax Expenditures<sup>1</sup>

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## EXECUTIVE SUMMARY

### Background

The National Taxpayer Advocate has identified legal complexity as a most serious problem of tax administration, particularly with respect to social benefits delivered through the tax law. Complexity arises in large part from tax expenditures, or government spending structured through the revenue system, which continue to proliferate, although measures of their effectiveness are lacking. Whatever the nature of a particular tax expenditure, implementation falls to the IRS as a matter of tax administration.

### Analysis

To the extent that any tax expenditure has a purpose other than modulating revenue collection, policy-makers should know if that purpose has been achieved. Like pure spending, such tax expenditures should be subject to evaluation. This evaluation should account for the effectiveness of the IRS as administrator of a particular tax expenditure.

With respect to social benefit programs, the National Taxpayer Advocate previously has observed that the fundamental design question is whether a program would be better suited to the tax system or to a pure spending program. Further, a social tax expenditure should incorporate effectiveness measures. If effectiveness measures would exceed IRS constraints, such as those on paperwork burden, then the program would not be suited to the tax system.

Assuming a tax expenditure is under consideration, evaluation could take place both before and after enactment of a tax expenditure. During consideration of legislation, evaluation would focus on design implications with projected costs and benefits. After enactment, actual administrative data would become available.

### Recommendation

The National Taxpayer Advocate recommends adoption of a process to evaluate whether a tax expenditure presents an administrative challenge, and if so, the extent to which it achieves its intended purpose. Specifically, tax expenditures would be sorted into two categories. First, those which require minimal administration would not be assessed or evaluated for administrative purposes. Second, tax expenditures that involve expertise beyond the institutional competence of a revenue collector would be subject to further research. Tax expenditures should be subject to evaluation with respect to their programmatic intent. The efficacy of the IRS as the institutional host, or resources required to transform the IRS into an effective administrator of a particular tax expenditure, also should be assessed. Although the National Taxpayer Advocate's recommendation is limited to administration of tax expenditures, research also could evaluate the policy performance of tax expenditures. While some tax expenditures may turn out to be efficiently administered by the IRS, others may add confounding complexity to the tax system.

## INTRODUCTION

The National Taxpayer Advocate is charged in part with identifying problems of tax administration and recommending legislative amendments to mitigate those problems.<sup>2</sup> Toward that end, she has identified complexity as an administrative problem to be reformed by simplification of the tax law.<sup>3</sup> In particular, the National Taxpayer Advocate has focused on the problem of delivering social benefits through the tax system, which complicates the mission of the IRS, resulting in a dual mission of welfare administration as well as revenue collection.<sup>4</sup> Social benefit programs in particular and tax complexity in general arise in large part from tax expenditures, or government spending structured through the revenue system. To address the complexity and other implications of tax expenditures, the National Taxpayer Advocate recommends adoption of a process to evaluate whether a tax expenditure presents an administrative challenge, and if so, the extent to which it achieves its intended purpose.

Tax expenditures continue to proliferate, yet measures of their effectiveness are lacking. Approximately one quarter of government spending consists of tax expenditures.<sup>5</sup> Various conceptualizations, tax expenditures may range from time-honored capital cost recovery allowances such as accelerated depreciation of machinery and equipment (\$1.2 billion) to the recently enacted Making Work Pay credit (\$14.2 billion).<sup>6</sup> The largest tax expenditure is the exclusion of employer contributions for medical insurance premiums and medical care (\$177.0 billion).<sup>7</sup> Whatever the nature of a tax expenditure, implementation falls to the IRS as a matter of tax administration.

Classification of tax expenditures is inherently controversial inasmuch as it marks deviation from an accepted tax base (*i.e.*, the amount on which tax is imposed) regardless of particular rationale. Some tax expenditures may have come into being as economically justified adjustments to the tax base rather than as government spending *per se*. Other tax expenditures may have been conceived as spending mechanisms. For example, the tax law allows a credit that is now refundable even in excess of tax due (as well as an exclusion of employer assistance) for expenses of adopting a child (\$460 million).<sup>8</sup> It is difficult to view

<sup>2</sup> See Internal Revenue Code (IRC) § 7803(c)(2)(A).

<sup>3</sup> See Most Serious Problem: *The Time for Tax Reform Is Now*, *supra*; National Taxpayer Advocate 2008 Annual Report to Congress 3 (Most Serious Problem: *The Complexity of the Tax Code*); National Taxpayer Advocate 2004 Annual Report to Congress 2 (Most Serious Problem: *The Confounding Complexity of the Tax Code*).

<sup>4</sup> See Most Serious Problem: *The IRS's Mission Statement Does Not Reflect Its Increasing Responsibilities for Administering Social Benefits*, *supra*; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75 (*Running Social Programs Through the Tax System*).

<sup>5</sup> See Thomas L. Hungerford, *Tax Expenditures and the Federal Budget*, Cong. Res. Serv., RL34622 (Aug. 19, 2008) 17.

<sup>6</sup> See Ofc. of Mgmt. & Budget, *Budget of the United States Government FY 2011*, Analytical Perspectives (hereinafter *USG Budget*), Ch. 16 (Tax Expenditures), Table 16-1, lines 76 & 130 at 210-11 (relating to 2011).

<sup>7</sup> See *USG Budget*, Table 16-3 at 220 (relating to 2011).

<sup>8</sup> See IRC §§ 36C (reflecting amendment by the Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148); *USG Budget*, Table 16-1, line 119 at 211 (including adoption credit and exclusion for 2011). The Tax Reform Act of 1986, Pub. L. No. 99-514, repealed a 1981 itemized deduction of expenses for adopting children with special needs in part because of a belief that assistance payments could best be made by agencies with expertise in the placement of special needs children. See Cong. Res. Serv., *Tax Expenditures: Compendium of Background Material on Individual Provisions*, S. Print 110-667, 110th Cong., 2nd Sess., Comm. on the Budget 709 (Dec. 2008).

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this provision as other than a government spending mechanism to subsidize adoption.<sup>9</sup> As long as a tax expenditure is a spending mechanism, the administrative question is what capabilities does the mechanism require? With respect to adoption assistance, compare the IRS (a revenue collection agency) with an agency that may have pre-existing subject-matter expertise (here child welfare).

In the case of spending formally structured as a budgetary appropriation, various measures of efficiency apply.<sup>10</sup> To the extent that any tax expenditure has a purpose other than modulating revenue collection, policy-makers presumably would want to know if that purpose has been achieved. Like pure spending, such a tax expenditure should be subject to evaluation. This evaluation should account for the effectiveness of the IRS as administrator of a particular tax expenditure.

## BACKGROUND

Tax expenditures may be conceptualized through academic or legislative definitions. Either way, the definition can have political ramifications by highlighting exceptions from integral provisions of tax law.

### **A tax expenditure may be characterized as a deviation from a base**

Classically, an academic concept of a tax expenditure proceeded from the proposition that an economic measure of income should be the tax base in an income tax system. That is, tax should be proportionate to consumption and saving (and, therefore, ability to pay). Manipulation of the scope of the base could result in a tax expenditure, akin to government spending, but introduced by the congressional tax-writing committees and administered by the IRS. Such manipulation thereby introduces government spending policy into what otherwise would be an exercise in economic measurement. An underlying premise of this academic conceptualization may have been that tax expenditures represented a deviation from the tax base, introduced complexity into the tax law, and imposed a spending function on an agency best suited to revenue collection. At the same time, tax expenditures could be perceived as tax cuts while reducing the amount reported as spending in the government budget. Consequently, this concept of a tax expenditure fit within a particular view of what taxation should be. In particular, tax expenditure analysts may have contemplated a comprehensive base of all income, divorced from spending, which would be a separate function in another part of government.<sup>11</sup>

<sup>9</sup> A parity argument could be made to the extent that obstetrical expenses are deductible under a pre-existing tax expenditure. See Treas. Reg. § 1.213-1(e)(1)(ii).

<sup>10</sup> See, e.g., Government Performance and Results Act of 1993, Pub. L. No. 103-62.

<sup>11</sup> A primary proponent of the term “tax expenditure” was Stanley Surrey, a Harvard Law professor who served in the Kennedy and Johnson Administrations as Treasury Assistant Secretary for Tax Policy and previously during the Roosevelt and Truman Administrations as Tax Legislative Counsel. See Stanley S. Surrey & Paul R. McDaniel, *Tax Expenditures* (Cambridge, Mass.: Harv. Univ. Press, 1985); Surrey, *Pathways to Tax Reform* (Cambridge, Mass.: Harv. Univ. Press, 1973); Surrey, *The Federal Tax System – Current Activities and Future Possibilities* (speech before Boston Economic Club, May 15, 1968) and *The U.S. Income Tax System – The Need for a Full Accounting* (speech before Money Marketeers, Nov. 15, 1967) in ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FYE June 30, 1968, 313, 322 (Washington, DC: Gov’t Printing Ofc., 1969).

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At the same time, some scholars noted that policy judgment is implicit in the income tax base. The first question is: what is income? As long as there are theoretical variations on the scope of the base, the “lack of an agreed conceptual model makes it impossible to say whether a large number of structural features of the existing federal income tax laws are, or are not, ‘tax expenditures.’”<sup>12</sup> Thus, any classification of tax expenditures proceeds from policy premises.

**“Tax expenditure” has a budgetary definition**

Subsequent to the introduction of the academic term “tax expenditure,” an official definition was adopted into law for budgetary purposes. The Congressional Budget Act of 1974 (1974 Act) defined tax expenditures as:

those 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; and the term “tax expenditure budget” means an enumeration of such tax expenditures.<sup>13</sup>

This definition suggests there should be a listing of government expenditures in the federal tax laws parallel to the appropriated budget.

Historically, a motivation for listing tax expenditures may have been a desire to eliminate them as an administrative burden beyond the mission of the IRS. Nevertheless, case-by-case analysis may reveal justification for a tax expenditure.<sup>14</sup> For example, federal tax law allows a deduction of certain state tax.<sup>15</sup> This deduction has been classified as a \$70.2 billion tax expenditure that may act as an incentive to pay state tax, indirectly subsidizing states.<sup>16</sup> At the same time, review of legislative history summarized by the Congressional Research Service (CRS) for purposes of tax expenditure analysis reveals that in originally enacting the deduction, a rationale of Congress was that state tax is a mandatory reduction in disposable income that should be deductible because it reduces a taxpayer’s ability to pay federal tax.<sup>17</sup> As an administrative matter, a deduction for state tax may be processed like any other monetary adjustment to gross income, verifiable by a third party, even though this particular deduction is a tax expenditure.

<sup>12</sup> Boris I. Bittker, *Accounting for Federal “Tax Subsidies” in the National Budget*, 22 Nat'l Tax J. 244, 258 (1969).

<sup>13</sup> Pub. L. No. 93-344, § 3(3).

<sup>14</sup> See Michael J. McIntyre, *A Solution to the Problem of Defining a Tax Expenditure*, 14 U.C. DAVIS L. REV. 78, 86 (1980) (suggesting a “need to examine individually the myriad purposes for distinguishing tax expenditures from normal tax rules”); but see Bittker, 22 NAT'L TAX J. at 252 (stating “one would either have to accept the formal statements by the President or the Congressional committees as conclusive, or engage a staff of political scientists and psychoanalysts to ascertain the ‘real’ purpose of the statutory change”).

<sup>15</sup> See IRC § 164.

<sup>16</sup> See *USG Budget*, Table 16-1 at 212 (summing deductibility of property taxes on owner-occupied homes with other non-business state and local taxes for 2011).

<sup>17</sup> See CRS, *Tax Expenditures* at 918. Another consideration is that deduction of state tax may be the inverse of imputing state benefits. Calling state tax deductions an expenditure “rests on the view that disallowing them would be a good enough proxy for directly including the value of the benefits.” See Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 224 (2004).

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As it happened, a great reduction in tax expenditures was a by-product of the Tax Reform Act of 1986, which reduced total tax expenditures by \$190 billion.<sup>18</sup> Forty percent of this cut in monetary value was due to base broadening, or repeal of special provisions such as the investment tax credit, and 60 percent was due to rate reduction.<sup>19</sup> Tax reform, rather than identification of tax expenditures as such, was an historical reason for their reduction.

After enactment of the 1974 Act, congressional and executive agencies annually tabulated tax expenditures. Currently, tabulations are published by the Joint Committee on Taxation (JCT), staffed by nonpartisan economic experts primarily serving the Committees on Finance and on Ways and Means of the Senate and House of Representatives, respectively, as well as by the Office of Management and Budget (OMB) within the Executive Office of the President, using statistics prepared by the Office of Tax Analysis (OTA) under the Treasury Assistant Secretary for Tax Policy. The estimated revenue cost of each tax expenditure as listed in these annual publications is available for congressional and public review.<sup>20</sup> However, taxpayer “behavior is assumed to remain unchanged for tax expenditure estimate purposes.”<sup>21</sup> This means that these estimates do not account for incentive effects that may alter economic behavior. As a practical matter, estimated cost is not a required factor in the scoring or enactment of a revenue or budgetary provision, nor does the cost estimate measure actual incentive effect.<sup>22</sup>

More recently, the Government Performance and Results Act of 1993 (1993 Act) has directed federal agencies to develop strategic plans and report on annual achievements, mostly for direct spending programs. At the same time, legislative history of the 1993 Act contemplates that tax expenditures also may contribute to government performance, stating:

Tax expenditures are similar to spending programs in their impact on the deficit; and like spending, are established to achieve specific national objectives. However, the effect of tax expenditures in achieving these goals is rarely studied.

To increase significantly the oversight and analysis of tax expenditures, the Committee believes that the annual overall Federal Government performance plans should include a schedule for periodically assessing the effects of specific tax expenditures in achieving performance goals.<sup>23</sup>

<sup>18</sup> Otherwise, tax expenditures would have totaled \$510 billion in 1988. See Thomas S. Neubig & David Joulfaian, *The Tax Expenditure Budget Before and After the Tax Reform Act of 1986* 1, OTA Paper 60, Dept. of the Treasury (Oct. 1988).

<sup>19</sup> See *Id.*

<sup>20</sup> See *USG Budget*, Ch. 16 at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2011/assets/receipts.pdf> (last visited Dec. 14, 2010); JCT, *Estimates of Federal Tax Expenditures* FY 2009-13, JCS-1-10 (Jan. 11, 2010), available at <http://www.jct.gov/publications.html?func=select&id=5>. As this report went to press, JCT posted *Estimates of Federal Tax Expenditures* FY 2010-14, JCS-3-10 (Dec. 21, 2010), but the figures herein are from the earlier version.

<sup>21</sup> JCT, *Estimates of Federal Tax Expenditures* 21.

<sup>22</sup> For a discussion of congressional pay-as-you-go budgetary rules, see Edward D. Kleinbard, *Tax Expenditure Framework Legislation*, L. & Econ. Working Paper 109, Univ. of So. Calif. (2010) 14-18.

<sup>23</sup> S. Rep. 103-58, 103rd Cong., 1st Sess., Comm. on Governmental Affairs (June 16, 1993).

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Consequently, OMB's budget contains a brief narrative overview as an appendix to its chapter on tax expenditures. However, this appendix merely suggests "types of measures that might be useful," acknowledging practically that "data availability is likely to be a major challenge, and data constraints may limit assessment of the effectiveness of many provisions."<sup>24</sup> Thus, OMB's analysis acknowledges the outstanding need for research.

### Conceptualizing tax expenditures may be critical

Defining tax expenditures under either academic or legislative definitions isolates "special" provisions from otherwise ordinary exclusions, exemptions, deductions, credits, rates, or deferrals. Classification of a provision as a tax expenditure could be pejorative. For example, commentators with various partisan inclinations have criticized the following tax expenditures:

- Earned Income Tax Credit (\$6.2 billion)<sup>25</sup> – Without using the technical term "tax expenditure," a *Wall Street Journal* editorial belittled refundable credit recipients as "lucky duckies."<sup>26</sup>
- Home mortgage interest deduction (\$104.5 billion)<sup>27</sup> – Commentators have criticized the provision for a second home in particular as a subsidy for those who are wealthy enough to own vacation homes.<sup>28</sup>

While it is true that provisions subject to viewpoint-based criticism may be tax expenditures, it is less clear whether the reason for a criticism is the tax expenditure mechanism itself or the underlying policy of a provision. For instance, various criticisms of government subsidies for either the poor or the rich may persist whether the subsidies take the form of tax expenditures or pure spending.

Academically, the argument against tax expenditures was that the IRS, as a collection agency, lacked institutional expertise in disbursement. If, however, a tax expenditure has eligibility criteria similar to those for other tax provisions, such as income or other dollar amounts reported by third parties, then IRS mechanisms may be effective.<sup>29</sup> Thus, evaluation of tax expenditures should be an administrative rather than a partisan matter.

## DISCUSSION

There are tax expenditures for all types of taxpayers, such as individuals, businesses, and tax-exempt entities. Some tax expenditures subsidize particular industries, while others promote geographic zones. Certain tax expenditures constitute social benefit programs.

<sup>24</sup> *USG Budget*, Ch. 16, App. A (Performance Measures and the Economic Effects of Tax Expenditures) 240, 241.

<sup>25</sup> See *USG Budget*, Table 16-1, line 159 at 212 (relating to 2011, noting a significant additional "outlay" effect of \$51.5 billion).

<sup>26</sup> See *Even Luckier Duckies*, *WALL ST. J.* (June 3, 2003) A-14.

<sup>27</sup> See *USG Budget*, Table 16-1, line 57 at 210 (relating to 2011).

<sup>28</sup> See Sima J. Gandhi, *Cracking the Code: A Closer Look at Tax Expenditure Spending 2*, *Ctr. for Amer. Progress* (Mar. 2010).

<sup>29</sup> See David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 *YALE L.J.* 955, 998 (2004).



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JCT and OMB list over 170 tax expenditures in the following categories:<sup>30</sup>

**TABLE 2.6.1, Tax Expenditure Categories**

Budget Function	\$ Millions for FY 2011	
	JCT	OMB
National Defense	5,400	11,530
International Affairs	25,700	48,210
General Science, Space, and Technology	7,500	8,410
Energy	18,800	16,320
Natural Resources and Environment	1,800	2,160
Agriculture	400	900
Commerce and Housing	356,800	369,180
Transportation	5,000	3,820
Community and Regional Development	9,100	2,580
Education, Training, Employment, and Social Services	137,100	115,920
Health	217,900	204,514
Income Security	157,700	162,961
Social Security	32,400	30,540
Veterans' Benefits and Services	5,500	5,390
General Purpose Fiscal Assistance	79,800	73,040
Interest	1,300	1,220
<b>TOTAL</b>	<b>1,062,200</b>	<b>1,056,695</b>

The JCT and OMB lists are similar, and the Government Accountability Office (GAO) has published a side-by-side comparison.<sup>31</sup> Nevertheless, JCT and OMB differ especially when new incumbents marshal different approaches. In the early 1980s and again in the early 2000s, OMB raised concerns about the tax expenditure treatment of issues such as consumption tax and corporate tax.<sup>32</sup> In sum, OMB raised fundamental concerns about the assumed scope of the tax base: "Because of the breadth of this arbitrary tax base, the Administration believes that the concept of 'tax expenditure' is of questionable analytic value."<sup>33</sup> In 2008, JCT published a detailed methodological study that proposed to identify

<sup>30</sup> See JCT, *Estimates of Federal Tax Expenditures*, Table 1 at 28-45 (totaling 2011 amounts); OMB, *USG Budget*, Table 16-1 at 209-13 (totaling 2011 amounts). Neither JCT nor OMB reports the categorical totals presented here for convenience of the reader, given that simple addition does not account for interaction effects among provisions. See Leonard Burman, Eric Toder & Christopher Geissler, *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* Discussion Paper 31, 3, Amer. Soc. Sci. Assoc'n (New Orleans, La., Jan. 5, 2008), shorter version published in 98 AMER. ECON. REV. 79 (2008) (stating that despite interaction effects, "commentators have added up tax expenditures to make general statements about their magnitude"); but see OMB, *USG Budget* FY 1985, Special Analysis G, Tax Expenditures G-16 (stating "tax expenditure estimates cannot simply be added together to obtain totals for functional areas or a grand total").

<sup>31</sup> See GAO, GAO-05-690, *Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Examined* 100-108 (Sept. 2005), App. III, Table 4.

<sup>32</sup> Savings would not be taxed by a consumption tax system, examples of which include sales tax and value-added tax. See *USG Budget* FY 1985 (Tax Expenditures) G-3.

<sup>33</sup> *USG Budget* FY 2002, Ch. 5 (Tax Expenditures) at 61.

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Tax-Induced Structural Distortions, which JCT ultimately did not do.<sup>34</sup> At this point, the main methodological difference is the baseline against which JCT and OMB estimate revenue cost.

In identifying special provisions as tax expenditures, JCT assumes as a baseline an economically normal income tax that encompasses, in the case of individuals, personal exemptions, standard deductions, and deductions for investment and employee business expenses. In the case of businesses, normal assumptions encompass the accrual method of accounting, the economic performance test for deductibility (allowing write-off when payment is irrevocable), and the concept of matching income with expenses, as well as the existence of a distinct corporate income tax.<sup>35</sup>

Even as a special provision deviating from a normal baseline may result in a tax expenditure, conversely it may result in a negative tax expenditure.<sup>36</sup> For example, the First-Time Homebuyer Credit (FTHBC) as originally enacted by the Housing Assistance Tax Act of 2008 and applicable to purchases that year required recapture of the credit amount, resulting in a tax expenditure followed by a negative tax expenditure in the out years.<sup>37</sup>

Similarly, OMB (through OTA) assumes a normal tax baseline that allows personal exemptions, standard deduction, and deduction of expenses incurred in earning income by individuals. For businesses, OMB likewise assumes that income is taxable only when realized and that there is a separate corporate income tax.<sup>38</sup>

Since 1983, OMB has assumed additionally a “reference tax law” encompassing general rules of taxation from which a provision would have to deviate to be classified as a tax expenditure. The assumption was that “the tax laws provided general rules to enable a taxpayer to determine his income tax.”<sup>39</sup> Thus, for example, reference tax law excludes from gross income most government transfer payments, which are included in gross income under the normal tax baseline. Moreover, reference tax law encompasses accelerated depreciation, which gives rise to a tax expenditure under the normal tax baseline. Consequently, the OMB list annotates normal baseline tax expenditures whose revenue effect would be zero under reference tax law.<sup>40</sup>

<sup>34</sup> While tax expenditures may be characterized as exceptions from a general rule of taxation, some expenditures may not be exceptions *per se*, yet may alter economic decisions. For an example of a so-called Tax-Induced Structural Distortion, current tax law treats debt and equity differently. That is, interest on corporate bonds generally is taxed as ordinary income while gain on capital stock may be taxed at favorable rates, potentially creating an incentive to issue stocks rather than bonds. See JCT, JCX-37-08, *A Reconsideration of Tax Expenditure Analysis* 41 (May 12, 2008).

<sup>35</sup> See JCT, *Estimates of Federal Tax Expenditures* at 5, 9.

<sup>36</sup> See *Id.* at 5.

<sup>37</sup> See IRC § 36.

<sup>38</sup> As an economic matter, corporate income arguably falls outside income conceived as consumption plus net saving. See Henry C. Simons, *Federal Tax Reform* 20-21 (Chicago: Univ. of Chicago Press, 1950).

<sup>39</sup> See OMB, *USG Budget FY 1985, Special Analysis G, Tax Expenditures G-5*. Inspiration for a baseline of reference tax law may be found in Seymour Fiekowsky, *The Relation of Tax Expenditures to the Distribution of the “Fiscal Burden,”* 2 *CAN. TAX’N* 211 (1980).

<sup>40</sup> See OMB, *USG Budget 207-08 & 224*.

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The methodological differences between assumptions that are either normative or referenced by law may result in significant revenue differences reflecting alternative visions of taxation. Generally, a normal tax baseline contains economically normative concepts, while reference tax law implies acceptance of enacted rules.<sup>41</sup> Neither of the baselines reflects a consumption tax, although current law incorporates many elements of consumption taxation, especially income tax exclusions, exemptions, or deferrals, as well as deductions and credits, for saving.<sup>42</sup> Both normal and referential visions, however, may have more relevance for potential tax reform than effective administration of expenditures in whatever form.

### Tax expenditures may be characterized by type of taxpayer.

An overview of tax expenditures may proceed with examples by type of taxpayer. For example, individual taxpayers may benefit (in the amount of \$26.9 billion) from a special tax rate on qualified dividends.<sup>43</sup> That is, qualified dividends are subject to a marginal rate of only 15 percent even if the individual taxpayer who includes them in gross income is in a higher bracket.<sup>44</sup> Critics of tax expenditures for individuals may apply the term “upside down” to such a provision.<sup>45</sup> In an otherwise progressive income tax system characterized by graduated rates and other features that cause high-income taxpayers to pay proportionately more due to their higher ability to pay, logically tax expenditures will tend to be regressive, disproportionately benefitting those with high income.<sup>46</sup> Alternatively, the special rate may be conceived as an attempt to reduce so-called double taxation of dividends.<sup>47</sup>

An example of a business tax expenditure is the domestic manufacturing deduction (\$13.6 billion).<sup>48</sup> Congress enacted this provision in 2004 to encourage production of goods in the United States.<sup>49</sup> Of course, any incentive effect would be subject to empirical verification. As discussed below, authorization of empirical research could help to verify the effectiveness of an intended incentive.

### Tax expenditures may subsidize certain sectors

Examples of tax expenditures may extend beyond types of taxpayers to sectors of the economy. For instance, a significant sector of institutional investment consisting of retirement

<sup>41</sup> For example, at one time, OMB did not reflect in reference tax law the special tax rate on qualified dividends (discussed below) on the theory that if there is a corporate income tax, any dividend taxation is duplicative. See GAO, *Tax Expenditures* at 93-94.

<sup>42</sup> See Bruce Bartlett, *The Flawed Concept of Tax Expenditures*, Nat'l Ctr. for Pol'y Analysis (Feb. 13, 2002); Bartlett, *The End of Tax Expenditures as We Know Them?* 92 TAX NOTES 413 (2001).

<sup>43</sup> See *USG Budget*, Table 16-1, line 69 at 210 (relating to 2011).

<sup>44</sup> See IRC § 1(h)(11).

<sup>45</sup> See, e.g., Sima J. Gandhi, *Audit the Tax Code: Doing What Works for Tax Expenditures*, Ctr. for Amer. Progress 8 (Apr. 2010).

<sup>46</sup> From one perspective, a tax expenditure may seem “to reflect an upside-down idea of policy because the rate of reimbursement is the taxpayer’s marginal tax rate; this results in relatively generous rates of reimbursement for the well-to-do, while it provides nothing at all for the very poor who presumably have the greatest need.” William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 89 HARV. L. REV. 309, 310 (1972).

<sup>47</sup> See JCT, JCS-2-10, *Description of Revenue Provisions Contained in the President’s FY 2011 Budget Proposal* 7 (Aug. 16, 2010).

<sup>48</sup> See *USG Budget*, Table 16-1, line 80 at 210 (relating to 2011).

<sup>49</sup> See IRC § 199.

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funds benefits from a tax expenditure in the form of an exemption from income tax.<sup>50</sup> While accounts such as Individual Retirement Arrangements (IRAs) and the like represent private savings, the tax expenditure amounts to an indirect public subsidy of \$142.1 billion.<sup>51</sup> This may be viewed alternatively as hidden government spending or a consumption tax element within the income tax.

Industrial subsidies account for a significant number of tax expenditures. Specifically, commentators may identify the energy industry as a beneficiary of tax expenditures of \$2.8 billion.<sup>52</sup> Of particular note is the tax expenditure for so-called black liquor. Generally intended as an incentive for “green” biofuel, this provision contains a loophole through which paper mills may claim credit for a pulp by-product.<sup>53</sup> Loopholes are another reason to research the actual effect of tax expenditures.

### Tax expenditures may be interchangeable with spending programs

A tax expenditure may be interchangeable with a direct spending program. For example, the Low-Income Housing Tax Credit (LIHTC) is a \$6.2 billion tax expenditure.<sup>54</sup> Generally, LIHTC allows a credit to investors in qualified buildings that house a prescribed percentage of residents below certain income levels.<sup>55</sup> State housing agencies allocate the credits in stipulated amounts through a competitive process, and they physically inspect the buildings.<sup>56</sup> As long as investors have tax liability against which they wish to claim credit (often organized by real estate developers in syndicated form), LIHTC allows the federal government to subsidize low income housing without direct spending, which would entail an attendant application and administrative apparatus. Arguably, it may be more efficient to allow a tax credit directly to investors than to impose income tax only to pay back upon identifying those investors through a process administered by a housing agency. After all, the point of tax expenditure analysis is to understand the interchangeability of money never paid into the Treasury with money first paid in and then disbursed out.<sup>57</sup>

When investors’ tax liability dried up in the recent economic recession, Congress monetized a portion of the LIHTC by creating counterpart low income housing grants in the American Recovery and Reinvestment Tax Act of 2009, bringing the tax expenditure full circle to a direct outlay program.<sup>58</sup> Incidentally, such a grant program may be subject to a

<sup>50</sup> See IRC §§ 401 *et seq.*

<sup>51</sup> See *USG Budget*, Table 16-1, lines 146-50 at 212 (totaling 2011 amounts).

<sup>52</sup> The President’s 2011 Budget proposes to eliminate this amount of fossil fuel preferences. See *USG Budget*, Ch. 14 (Federal Receipts), Table 14-3 at 186 (relating to 2011).

<sup>53</sup> See *USG Budget* at 177 (explaining that “byproducts derived from the processing of paper or pulp (known as black liquor when derived from the kraft process) . . . would qualify as cellulosic biofuel and, to the extent so qualifying, could result in substantial revenue losses and a windfall to the paper industry”).

<sup>54</sup> See *USG Budget*, Table 16-1, line 63 at 210 (relating to 2011).

<sup>55</sup> See IRC § 42.

<sup>56</sup> See CRS, *Tax Expenditures* at 371 ff.

<sup>57</sup> See Shaviro, 57 *Tax L. Rev.* at 220.

<sup>58</sup> See Pub. L. No. 111-5, Div. B, § 1602.

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number of procedural provisions, such as disclosure of grant recipients' identities, to which a tax credit may not be subject.<sup>59</sup> While theory and experience show that LIHTC and grant programs are interchangeable, administrative differences come to the fore, specifically ones that increase transparency of government spending.

### Tax expenditures add complexity

An example of incremental complexity relates to a tax expenditure for volunteers and employees of the U.S. Peace Corps, an organization whose mission has received bipartisan praise. Since 1997, homeowners have been able to exclude capital gain of up to \$250,000 (\$500,000 for a married couple filing jointly) on the sale of a home where they lived for two of the last five years.<sup>60</sup> In 2011, this tax expenditure was worth \$31.3 billion.<sup>61</sup> In the Heroes Earnings Assistance and Relief Tax Act of 2008, Congress decided to enhance the home-sale exclusion for the Peace Corps by allowing their personnel to suspend the five-year period while serving abroad.<sup>62</sup> Thus, a homeowner could live at home for a year, volunteer for a two-year term abroad, and still have four years, rather than just two, to sell the home free of tax on applicable gain, if any. If the five-year period had been an impediment to volunteering, especially for senior citizens with experience that would be valuable in volunteer service, the provision removed the impediment.

JCT estimated the revenue cost of the provision at less than half a million dollars for any year within the applicable budget window.<sup>63</sup> The Peace Corps has fewer than 8,000 volunteers in a year, whose average age is 28 but of whom seven percent are over 50, as well as a couple of hundred employees abroad.<sup>64</sup> Even if as many as ten percent of these personnel have homes to sell, only about 800 people need information about the special tax provision, which is not a topic in either the 12-page 2009 *Tax Guide for Peace Corps Volunteers* or the hundred-page *Working Overseas Guide: A Guide for Staff and Their Families* (June 2010), also published by the Peace Corps.

Instead, the IRS has altered Instructions, which now run over a hundred pages, to Form 1040, *U.S. Individual Income Tax Return*, the basic form used by about 150 million individual taxpayers.<sup>65</sup> Additionally, the optional suspension of the five-year rule for overseas Peace Corps personnel who might sell a home is explained in IRS Publication 523, *Selling Your Home*, which is 40 pages long, as well as the more general Publication 17, *Your Federal*

<sup>59</sup> Generally, tax return information, including a claim for a credit, is confidential with the IRS. See IRC § 6103.

<sup>60</sup> See IRC § 121.

<sup>61</sup> See *USG Budget*, Table 16-1, line 60 at 210.

<sup>62</sup> See Pub. L. No. 110-245, § 110.

<sup>63</sup> See JCT, JCX-45-08, *Estimated Budget Effects of H.R. 6081, the "Heroes Earnings Assistance and Relief Tax Act of 2008," Scheduled for Consideration by the House of Representatives on May 20, 2008* FY 2008-18, I.10 at 2.

<sup>64</sup> See Peace Corps, *Fact Sheet* (May 21, 2010). The Peace Corps has operations in 77 countries, each of which is staffed at least by a Country Director and an Administrative Officer. See Peace Corps, *Working Overseas Guide: A Guide for Staff and Their Families* 8 (June 2010).

<sup>65</sup> General Line Instructions for Form 1040 (2009) run from page 14 through page 89 (cross-referencing the home sale exclusion). Form 1040 Instructions Including Instructions for Schedules A, B, C, D, E, F, J, L, M, and SE (2009) contain 175 pages (containing the Peace Corps provision). See IRS Pub. 55B, *Data Book* (2009), Table 2 at 4 (reporting number of taxpayers).

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*Income Tax*, which exceeds 300 pages. Taxpayers who use software may be prompted by computer to consider whether they are eligible for the special provision which is targeted at a mere 800 people.

The administrative issue is whether it is more efficient for the IRS to administer the provision by adding it to all the other rules applicable to American taxpayers, or for the Peace Corps to identify the estimated 800 affected persons already on the payroll.<sup>66</sup> If the latter, a cost of a few hundred thousand dollars would become a part of the Peace Corps' \$400 million budget,<sup>67</sup> rather than a revenue deficit to the Treasury.

To be fair, the Peace Corps is only the last of several constituencies of overseas government workers to receive special treatment, after the military, foreign service, and intelligence personnel.<sup>68</sup> In each case, a similar analysis applies. Which is better situated to deliver a housing benefit amount to employees abroad: the IRS or the CIA, State or Defense Department? Accretion of tax expenditures for each of these constituencies, along with numerous other targeted provisions, contributes to the confounding complexity of the tax law.<sup>69</sup>

### Tax expenditures include social programs

A significant type of tax expenditure consists of social benefit programs. Last year, the National Taxpayer Advocate expressed concern about running social programs through the tax system.<sup>70</sup> For example, the FTHBC awards a nominal amount limited to \$8,000 to residential purchasers, many of whom might have bought a house anyway.<sup>71</sup> If this tax expenditure was intended to induce purchases, research should ascertain its actual incentive effect. Similar analysis applies to various social welfare tax expenditures.<sup>72</sup> Moreover, social tax expenditures heighten the question of institutional suitability of the revenue collection agency not only for disbursements but particularly for service to an underprivileged population. This question should be answered in terms of the experience of this population. Elsewhere in this 2010 Annual Report to Congress, the National Taxpayer Advocate

<sup>66</sup> Peace Corps pays volunteers a stipend. See IRC § 912(3).

<sup>67</sup> See JCT, *Estimated Budget Effects of H.R. 6081*, l.10 at 2; Peace Corps, *Fact Sheet*.

<sup>68</sup> See JCT, JCX-44-08, *Technical Explanation of H.R. 6081, the "Heroes Earnings Assistance and Relief Tax Act of 2008," as Scheduled for Consideration by the House of Representatives on May 20, 2008* 22-23.

<sup>69</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 3 (Most Serious Problem: *The Complexity of the Tax Code*) (stating that taxpayers annually devote 7.6 billion hours, or enough work for 3.8 million full-time employees, to compliance with tax filing requirements). Another example of a tax expenditure that would be impracticably complex for tax administration is the charitable deduction of easements for certain conservation purposes under IRC § 170(h), as amended by the Pension Protection Act of 2006, § 1213, Pub. L. No. 109-280. See *Whitehouse Hotel v. Comm'r*, 131 T.C. 112 (2008), vacated and remanded by 615 F.3d 321, 329 (5th Cir. 2010) (characterizing valuation of real property rights that preserve historic facades of houses as "a complex and difficult undertaking that continues to challenge appraisers and the IRS"); *Simmons v. Comm'r*, T.C. Memo. 2009-208 (judging fair market value where "no established market exists" and opining that a private easement "would be subject to a higher level of enforcement" than an applicable historic ordinance); IRS Advisory Council, *General Report* (2009) (focusing on complex distinction "between a legitimate deduction authorized by statute and an abusive tax shelter" especially with respect to valuation, which is "inherently subjective").

<sup>70</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75 ff.

<sup>71</sup> See IRC § 36.

<sup>72</sup> Commentators have dubbed certain tax expenditures the "hidden welfare state." See Christopher Howard, *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States* (Princeton, NJ: Princeton Univ. Press, 1997).

has recommended that the IRS adopt a dual mission statement and hire personnel appropriate to the delivery of social benefits that already have been codified.<sup>73</sup>

## CONCLUSION

Low visibility of tax expenditures has long been a concern of commentators and officials. Yet listing of revenue estimates has had little effect, perhaps because some in Congress would support direct spending counterparts of tax expenditures in any case. Meanwhile, successive administrations have had concerns about evaluation, perhaps because each one favors some tax expenditures that it would rather not highlight as such.<sup>74</sup> On occasion, OMB has argued that a tax expenditure may relate to a direct spending program as apples to oranges.<sup>75</sup> Conceptual concerns do not address efficient administration and the taxpaying public, for whom the question should be whether a tax expenditure could be more successfully structured.

### Research is necessary to evaluate tax expenditures

Tax expenditures may disguise government spending, while administratively compounding the problem of mission fragmentation, program overlap, and service gaps.<sup>76</sup> That is, tax expenditures may divert the IRS from its historically core mission of revenue collection to disbursement in areas where other agencies, such as the Department of Energy or Housing and Urban Development, may have expertise, with an inefficient result.<sup>77</sup> This administrative inefficiency is not measured by annually published tables of revenue estimates. Originally, the motivation behind those revenue estimates may have been to expose tax expenditures as a specific amount of government spending, rather than to analyze their effectiveness at particular programmatic purposes. As discussed above, some tax expenditures may be ably administered by the IRS, while others may be interchangeable with grants or other direct spending programs. Research is necessary to evaluate the programmatic efficiency of tax expenditures.

### Policymakers should review studies of tax expenditures

Assuming that tax expenditures may be an intentional form of government spending, they should be subject to evaluation with respect to their programmatic intent. The efficacy of the IRS as the institutional host, or resources required to transform the IRS into an effective administrator of a particular tax expenditure, also should be assessed. While some tax expenditures may turn out to be efficiently administered by the IRS, others may add

<sup>73</sup> See Most Serious Problem: *The IRS's Mission Statement Does Not Reflect Its Increasing Responsibilities for Administering Social Benefits*, *supra*.

<sup>74</sup> See Leonard E. Burman, *Is the Tax Expenditure Concept Still Relevant?* 56 NAT'L TAX J. 613 (2003) (admitting that the "Treasury Department, of which I was a part . . . , was unenthusiastic about performing these evaluations, reasoning that a comprehensive evaluation of tax expenditures would necessarily raise serious objections to measures enthusiastically advanced . . . the same concerns still hold sway").

<sup>75</sup> See GAO, *Tax Expenditures*, App. II at 83.

<sup>76</sup> See GAO, *Tax Expenditures* at 51.

<sup>77</sup> See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 102 (stating that FTHBC may be better structured as pure spending administered by an agency directly connected with the targeted behavior).

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crippling complexity to the tax system. Of course, evaluation and assessment in turn may be ineffectual unless policy-makers review and act on published reports. The advantage of action is more efficient and effective administration.

## RECOMMENDATION

The National Taxpayer Advocate recommends adoption of a process to evaluate whether a tax expenditure presents an administrative challenge, and if so, the extent to which it achieves its intended purpose.

### Criteria for analyzing tax expenditures

Scholars have argued that the question whether to structure a spending program as a tax expenditure should be “solely a matter of institutional design.”<sup>78</sup> Noting that an organization may be arranged either by function (sales, production, purchasing, etc.) or by purpose (tax collection, national security, education, etc.), they suggest that the answer lies in whether the execution of any particular provision is more mechanical or more discretionary.

In the example of the state tax deduction discussed above, a provision that requires mere verification of amounts, IRS mechanisms may be effective. If discretionary allocation by programmatic experts is required, as in the case of LIHTC, then the tax expenditure may exceed the institutional competence of the revenue collector, who may have to rely on others such as state housing agencies, thus increasing complexity while reducing efficiency. In any case, tax expenditures may be analyzed for design efficiency, assuming that some form of spending has been authorized as a policy matter.

Consider these key criteria:<sup>79</sup>

- **Refundability:** A credit that may be refunded even in excess of tax owed, sometimes called a negative tax, shifts the tax administrator from collection into disbursement mode.
- **Eligibility:** Criteria external to the tax system, such as architecture in the case of the LIHTC, incorporate subject-matter experts into jurisdiction over a tax expenditure.

Criteria like these could help to sort between mechanical and discretionary tax expenditures.

For purposes of evaluation, the National Taxpayer Advocate recommends that all tax expenditures officially identified by either JCT or OMB, however imperfectly, would be sorted into two categories. First, those which require minimal administration, as in the case of the state tax deduction, would not be assessed or evaluated for administrative purposes. Second,

<sup>78</sup> Weisbach & Nussim, 113 YALE L.J. at 957.

<sup>79</sup> See generally Eric J. Toder, *Tax Cuts or Spending – Does It Make a Difference?* 53 NAT'L TAX J. 361 (2000).



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tax expenditures that involve expertise beyond the institutional competence of a revenue collector, such as that of energy or housing experts, would be subject to further research.

### The IRS should be authorized to evaluate tax expenditures

As noted above, there is a dearth of data on the programmatic effectiveness of tax expenditures partly because they are tax provisions to which government performance requirements do not apply. GAO has identified a lack of clarity about the roles of the IRS, OMB, Treasury, and programmatic agencies as an impediment to tax expenditure evaluation.<sup>80</sup>

To the extent that tax expenditures clearly are in an agency's jurisdiction, they fall under the enforcement function of the IRS. Under the Paperwork Reduction Act of 1995 and related requirements, the IRS collects the minimum amount of information necessary for enforcement; that is, to determine the correct liability for collection, or in case of a "negative" tax, the correct credit or other amount for refund.<sup>81</sup> Consequently, IRS forms do not solicit information that would pertain solely to the effectiveness of a tax expenditure. For example, Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, contains ten lines to determine the amount of a credit but does not ask for information that would show whether the purchaser could or would have bought a home without the credit.<sup>82</sup>

Accordingly, IRS data may be incomplete for purposes of the recommended evaluation. While incompleteness itself would indicate that a program exceeds the IRS's traditional role, requiring taxpayers to divulge extraneous information likewise would strain voluntary compliance.<sup>83</sup> Previously, the National Taxpayer Advocate has observed that the fundamental design question for a social benefit program is whether it would be better suited to the tax system or to a pure spending program.<sup>84</sup> Further, a social tax expenditure should incorporate effectiveness measures.<sup>85</sup> If effectiveness measures would exceed IRS paperwork constraints, then the program would not be suited to the tax system. Theoretically, evaluation should take place both before and after enactment of a tax expenditure. During consideration of legislation, evaluation would focus on design implications with projected costs and benefits. After enactment, actual administrative data would become available.

In any case, programs may be enacted as tax expenditures precisely to reduce visibility, as discussed above, of the nature and cost of the legislation in question. While certain

<sup>80</sup> See GAO, *Tax Expenditures* at 5.

<sup>81</sup> See Pub. L. No. 104-13; GAO, *Tax Expenditures* at 53-55.

<sup>82</sup> See CRS, *Tax Expenditures* at 362 (stating "economic theory suggests that the credit may not be very effective at stimulating home demand. Empirical studies have found lack of liquid wealth to be the principal barrier to homeownership for first-time homebuyers").

<sup>83</sup> The prospect of incomplete IRS data for a program codified in the tax law begs the question whether a tax expenditure could be evaluated *ab initio*. Like the 1974 law for periodic tax expenditure budgets, the IRS Restructuring and Reform Act of 1998 requires complexity analysis of pending tax legislation. See Pub. L. No. 105-206, § 4022(b). Nevertheless, increasing tax complexity over the past decade, noted above, indicates that legislative analysis has not forestalled the problem. Although administrative shortcomings of tax expenditures could be projected at the time of legislation, the effect of any such projections remains unclear.

<sup>84</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 86.

<sup>85</sup> See *Id.*

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legislative formulation may extend into matters of policy, administration of tax provisions *per se* is a concern of the National Taxpayer Advocate. Assuming the persistence of tax expenditures, their programmatic efficiency should be subject to evaluation. For this administrative purpose, the IRS should be authorized to conduct relevant research, such as surveys of representative populations. In the FTHBC example, research might investigate rates and sources of down-payment assistance (parental gifts, etc.).

Moreover, IRS statisticians should be authorized to tabulate and analyze relevant data. Generally, the IRS Research, Analysis & Statistics division compiles and analyzes data relevant to tax compliance, such as indicators of tax return irregularity that warrant audit. For tax expenditure evaluation, staffing sufficient for relevant counts, tabulations, and analyses should be authorized. This authorization should extend to collaboration on research design with agencies that have subject-matter expertise, for instance, in energy, housing, or human services. Alternatively, an authorization could allow the IRS to hire subject-matter experts. An intermediate option would be for IRS statisticians to compile relevant data for further analysis by an agency with subject-matter experts. In any case, programmatic agencies could formulate research questions to be answered. Then the IRS could collect the requisite information for analysis by statisticians with expertise in interpreting tax data.

### Evaluation of tax expenditures could extend to policy matters

Although the scope of the instant recommendation is limited to tax administration, it is possible that data also could help to determine if a tax expenditure is effectuating intended policy. For example, a major justification for the home mortgage interest deduction has been a “desire to encourage homeownership.”<sup>86</sup> However, economic research has shown that the deduction “does little if anything to encourage homeownership. Instead, it serves mainly to raise the price of housing and land and to encourage people who do buy homes to borrow more and to buy larger homes than they otherwise would.”<sup>87</sup> Research like this can interest policy-makers. In 2005, a bi-partisan commission recommended substantial modification of the home mortgage interest deduction because it “encourages overinvestment in housing.”<sup>88</sup> As long as relevant data are available, policy evaluation as such is beyond the scope of this recommendation. At any rate, in cases where external data turn out to be sufficient, then no recommendation would be necessary.

If, however, paperwork reduction and related requirements impede collection of relevant data outside the traditional scope of tax administration, expansion of that scope deserves consideration. In the case of the mortgage interest deduction, substantial data on the housing market were available for economic research. In another case, such as that of the

<sup>86</sup> CRS, *Tax Expenditures* at 330-32 (noting that interest historically had been deductible regardless of personal or business purpose).

<sup>87</sup> William G. Gale, Jonathan Gruber & Seth Stephens-Davidowitz, *Encouraging Homeownership Through the Tax Code*, 115 TAX NOTES 1171 (June 18, 2007).

<sup>88</sup> President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* 59 (Nov. 2005); see also *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform* 30-31 (Dec. 2010) (recommending restriction of the mortgage interest deduction to main homes, rejecting secondary residences).

domestic manufacturing deduction mentioned above,<sup>89</sup> it is possible that the IRS could conduct additional research for evaluative rather than administrative purposes. Such research would be parallel to, but outside of, this recommendation. While the National Taxpayer Advocate's recommendation is limited to administration of tax expenditures, research also could evaluate the policy performance of tax expenditures.

### **Taxpayer privacy law should be maintained**

The collaboration recommended above would preserve the taxpayer privacy law, which is a keystone of voluntary assessment that should be preserved, as previously outlined by the National Taxpayer Advocate.<sup>90</sup>

Generally, the taxpayer privacy law, as amended in the Watergate era, is designed to preclude, among other things, partisan manipulation of tax return information.<sup>91</sup> As discussed above, tax expenditure analysis is vulnerable to such manipulation, while the recommended evaluation goes to administrative efficiency. As long as IRS statisticians do the recommended tabulations and analysis, no change to the taxpayer privacy law is necessary. On the contrary, the existing taxpayer privacy law should have the effect of protecting government researchers, as civil servants, from political pressure in evaluating tax expenditures. Under existing law, research results reporting tax data in aggregate form that cannot be associated with any particular taxpayer may be published.<sup>92</sup> Once programmatic experts design research questions and statisticians tabulate the results, the published reports should be directed to the disposition of policy decision-makers.

<sup>89</sup> See CRS, *Tax Expenditures* at 471 (observing that tax provisions cannot “permanently affect the balance of trade, since exchange rates would adjust”).

<sup>90</sup> See National Taxpayer Advocate 2003 Annual Report to Congress 232.

<sup>91</sup> See IRC § 6103.

<sup>92</sup> See IRC § 6103(b)(2).

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