



Tax Expenditures Methodology and Measurement

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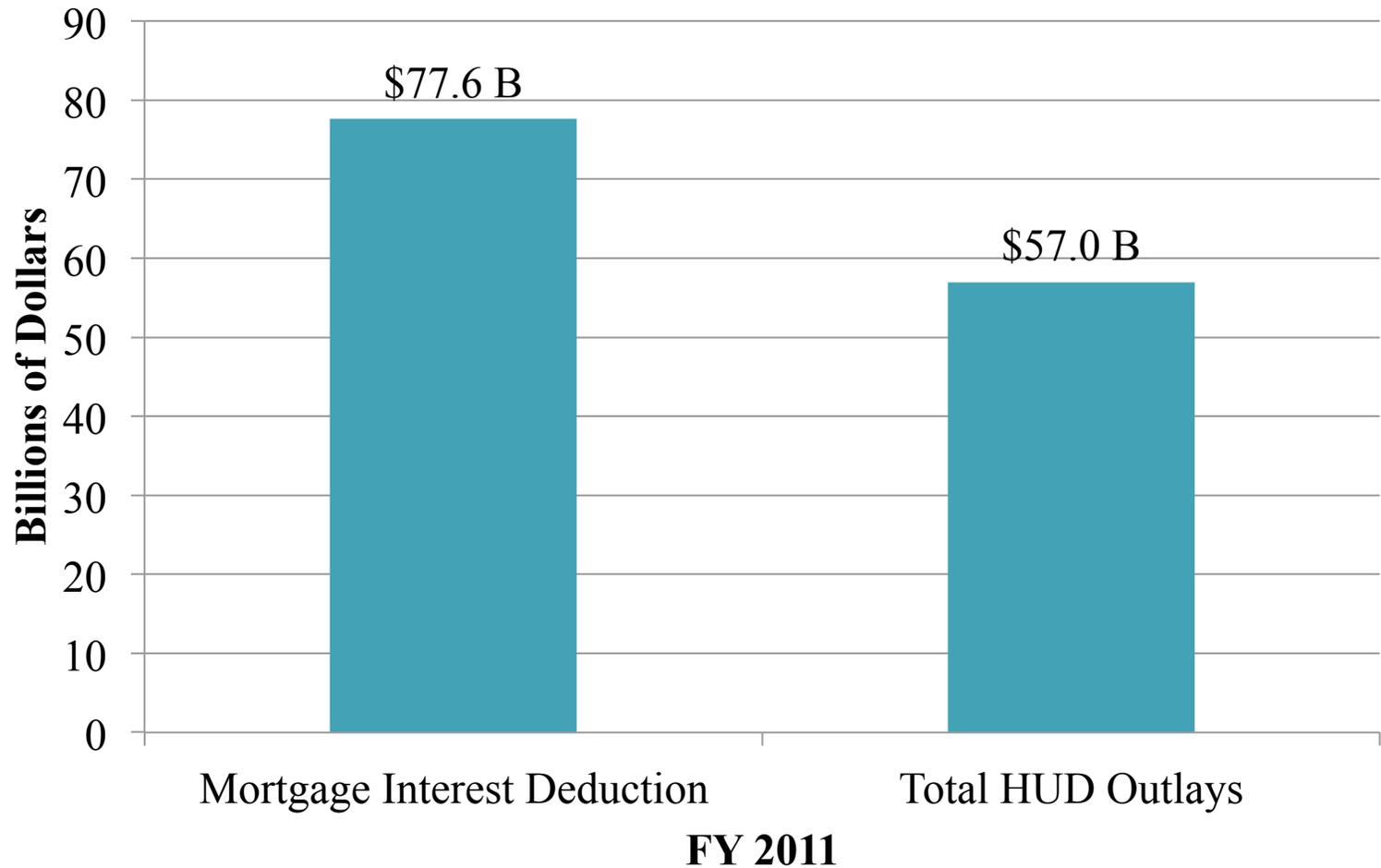
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Purposes of Tax Expenditure Analysis

- Understand the actual size of government
- Uses to which government resources are put
- Tax and economic policy consequences from implicit or explicit choices made in fashioning legislation
- Identify economic benefits of tax laws
- Descriptive not proscriptive- policymakers and public judge desirability
 - evaluate tradeoffs among cost, distributional consequences, alternative means of provision, economic effects

Government Policy and Housing



Source: Joint Committee on Taxation, Office of Management and Budget 3

Definition

- Congressional Budget and Impoundment Control Act of 1974
 - “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”
- Includes all types of provisions because there is an equivalence among them, *e.g.* could structure a special rate as a partial exemption
- Defining tax expenditures requires specification of a baseline.
 - Answer the question: Losses (or gains) relative to what?

Baseline

- Relative to what? – no obvious choice
 - Focus on “gross income”- normal tax law (JCT)
 - Normal income tax law is based on a comprehensive Haig-Simons income tax plus a rate structure
 - Focus on word “special”- reference law (OTA)
 - Reference law is the system of general structural rules to which tax expenditures are special exceptions.
 - Substitutability (design and oversight) with an expenditure program
- Is the baseline an income tax? Consumption tax? Or a hybrid?
 - Other taxes: excise, estate and gift, payroll
- Specifying a baseline and identifying deviations from it involves judgment.

Baseline- continued

- Basic features not considered tax expenditures
 - Separate corporate income tax
 - Realization principle
 - Rate structure (including “zero-rate” bracket of standard deduction and personal exemptions) NB: corporate rates
 - Some accounting rules (cash accounting?)
- Decisions about baseline largely determines the list of tax expenditures



Negative Tax Expenditures

- Special tax treatment that is less favorable than normal income tax law
 - Personal exemption phaseout and AMT disallowance of personal exemption and standard deduction
 - Surtax on unearned income
 - Limits on deductible compensation
- Enforcement/compliance provisions are NOT considered negative tax expenditures
 - Denial of deduction for fines and penalties



History at Federal Level

- Stanley Surrey, AS Tax Policy 1961-1969
 - 1967 speech, FY1968 annual report
- JCT first estimates in October 4, 1972
 - 60 items estimated
- Budget Act of 1974 requires preparation
- OTA estimates appear in FY1976 budget
- Annually since
- JCT FY2011-2015
 - 232 items estimated
 - 34 quantitatively *de minimis*
 - 33 identified but unquantified
 - Caveat on counting, somewhat arbitrary

History at State Level

- 1971- CA adopts reporting, publishes first report in 1976
- 2010- NJ and GA statutes establish reporting
- 42 States and DC report tax expenditures
- No regular reports in AL, AK, HI, IN, NV, NM, SD, WY,
Source: [Center on Budget and Policy Priorities](#)
- NCSL- “For state governments, tax expenditure budgets are ways of enhancing **accountability**.... In addition to identifying the revenue loss from such tax preferences, tax expenditures also provide data that can be used to evaluate the **effectiveness** and **efficiency** of these policies....
Accountability in a larger sense means that policymakers must examine the costs and benefits of using revenue measures as tools to put **nonfiscal policies** into effect.”

Measurement

Tax liability without tax expenditure
- tax liability under present law

Tax expenditure estimate of foregone revenue

- NOT A REVENUE ESTIMATE
 - Tax form behavior only (*e.g.* repeal health exclusion, permit itemized medical deduction)
 - No timing of payments or effective date issues
 - No other interactions with other income tax provisions or payroll, excise, transfer taxes
- Cash flow (JCT) vs. present value (OTA)



Measurement-continued

- Items estimated in isolation
- NOT additive
 - Tax expenditure estimate for multiple exclusions could be MORE than the sum given a progressive rate structure
 - Tax expenditure estimate for multiple itemized deductions could be LESS than the sum given the standard deduction
- *De minimis* items – resource and data constraints



Data sources

- Tax return data
 - Good for credits, deductions, special rates, less so for exclusions and exemptions
- Prior year data (depreciation)
- CBO revenue baseline
- Third party

