Tax Expenditures Methodology and Measurement

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The views expressed are my own and not necessarily those of the staff or members of the Joint Committee on Taxation.
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

Medium

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

  - 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