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THE INTERNAL REVENUE CODE: A BURDEN FOR TAXPAYERS OR AN INSTRUMENT FOR SOCIAL CHANGE?

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Departmental Honors Thesis

The University of Tennessee at Chattanooga

Accounting

Examination Date: April 3, 2017

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I. Abstract

Social engineering in the tax code has been evident from the beginning of the U.S. tax history. Today, it is as much as ever a part of the fabric of the tax codification, but there is very little research that investigates 1) how social engineering plays a role in the creation of new tax law, and 2) whether tax law is effective in altering taxpayer behavior. This paper streamlines the history of social engineering in the most popular revenue-reducing measures and analyzes how they've affected the U.S. taxpayer, with notes on future policy implications.

II. Introduction

During the 2014 fiscal year, the United States government collected over $3 trillion in revenues, and around 80% of these taxes come from individual taxes and payroll taxes.[1] While taxes are a critical source of revenue for the government, they can also indicate a tremendous amount about what values are important to the government that imposes them. The values and goals of those in charge of creating and overseeing tax code may often be inferred through the code's language and effects on citizens. The use of tax credits and deductions, can often act as an incentive for taxpayers to behave in a certain manner, resulting in a system that not only funds government, but encourages citizens to uphold the values and goals of the authors of the codification.

While there is much research and discussion among experts in the field of tax law on the interpretation, limits, and various exceptions and credits, there is not as much research surrounding how effective a tax credit or deduction may be in altering taxpayer behavior. The width of the research gap between social engineering in the tax laws and regulations and their effectiveness is surprising, considering the volume of U.S. tax revenues each year. Still, the United States Congress continues to approve and continue tax regulations created for the purpose of influencing taxpayer behavior, which makes research into social engineering regarding tax policy timely and fruitful.

[1] Tax Policy Briefing Center, http://www.taxpolicycenter.org/briefing-book/what-are-sources-revenue-federal-government-0

III. Review of Relevant Literature

Social engineering in the tax code has been evident from the beginning of the U.S. tax history, with the first domestic tax on whisky credited to Alexander Hamilton, who cited the health and moral implications of the drink as reasons to support the levy of a tax. Today, this tradition of social engineering burns bright, with a federal tax code that, "each year provides more than $500 billion worth of incentives for activities deemed to have social merit, including home ownership, adoption, child care, charitable giving, saving for retirement and making contingencies for expected health costs."[2]

In order to receive such deductions and credits, all eligibility requirements must be met, careful documentation must confirm the reported amount deducted or credited, and aforementioned documentation must be available to be reviewed upon request up to three years following the filing of a tax form claiming deductions or credits.

Before extensive research on deductions and credits can be presented, it is important to detail how the federal income tax, from which deductions and credits are made, was formed. It was during the American Civil War that the first income tax was created. Such a tax had been considered in other times of crisis, such as the War of 1812,[3] but had not been implemented. The federal income tax was

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[2] Adriel Bettelheim's "The Social Side of Tax Breaks," http://library.cqpress.com.proxy.lib.utc.edu/cqweekly/document.php?id=weeklyreport110-000002443434

[3] Joseph A. Hill's "The Civil War Income Tax," http://www.jstor.org.proxy.lib.utc.edu/stable/pdf/1885003.pdf

made specifically to raise revenues for the Union's role in the Civil War. The struggle that began during a special session of Congress on July 4, 1861, between taking loans and creating new taxes was the most arduous to that date and is a battle that has continued to rage throughout many Congresses to follow. On July 1, 1862, the Revenue Act was approved by the Congress and enacted immediately. This tax was paid by those residing in all Union-controlled areas. The income tax was repealed in 1872 by the Grant administration along with most other emergency martial taxes.[4]

Twenty years later, the U.S. Congress sought to reenact the federal income tax as a permanent fixture for government revenue income. This attempt was struck down by the Supreme Court in 1895 because the tax was not levied on each state based on population as was required by the U.S. Constitution.[5] In 1913, the 16th Amendment to the U.S. Constitution was ratified. The Amendment states that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration,"[6] which laid the foundation for Congress to create a more permanent federal income tax in that same year. Congress approved the formation of a federal income-based tax in order to raise revenues in the face of World War I; though the U.S. was not yet active in the war,

[4] Cynthia G. Fox's "Income Tax Records of the Civil War," https://www.archives.gov/publications/prologue/1986/winter/civil-war-tax-records.html
[5] Austin American-Statesman, "1913 Gave Americans Their First Income Tax That Lasted"
[6] U.S. Const. am. 16

Congress wanted to be financially prepared for such an outcome. Although the first collection of income taxes only affected the richest 5% of U.S. citizens[7], the tax proved successful in its ability to retrieve significant revenues without increasing debts to financial institutions or foreign nations.

In analyzing behaviors surrounding taxes under modern standards, there are two issues which must be addressed: tax salience and tax avoidance. Salience is determined by whether people are aware of information and how they use that information in decision making; the more salient something is, the more aware individuals are of its effect. The theory of tax salience finds its roots in cognitive psychology and behavioral economics, and the majority of research up to this point addresses a debate over whether tax salience is unfair to taxpayers, who decision makers may try to trick or leave ignorant using purposefully complex or hidden tax law, or whether tax salience can be used to raise government revenues without political cost to elected lawmakers. Tax salience was first researched in the 1990s[8] and has since seen modest contributions[9], but gaps in its connection to tax policy are still evident, as exemplified by no existing literature to address most forms of credits, deductions, and exemptions. The only exceptions to this exist for tax code with high salience, such as the charitable contribution tax and the religious exemption. The goal of this article is to add more depth to the

[7] Austin American-Statesman, n.b.
[8] McCaffery's "Cognitive Theory and Tax"
[9] Faulhaber's "The Limits of the Charitable Deduction: An Introduction to Hypersalience," https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1984176

aforementioned existing literature, as well as to address other common forms of credits and deductions, such as medical deductions, housing and mortgage deductions, and employer hiring credits.

Tax avoidance for individuals is a result of the salience of tax policy: the more salient, the more likely avoidance measures will be taken. While tax avoidance, unlike tax evasion, is legal, the action of avoidance still costs the U.S. government untold amounts of revenue. It is also worth noting that tax avoidance behaviors can be distinguished from substitutive behaviors: "…real substitution responses, in which the tax-induced change in relative prices causes individuals to seek a different consumption bundle; and avoidance responses, in which taxpayers undertake a variety of tax planning, renaming, and retiming activities whose goal is to directly reduce tax liability without consuming a different basket of goods."[10] While there has been an increase in attention focused on the ethics of tax avoidance in recent U.S. history,[11] it can be argued that Congress openly accepts and even encourages tax avoidance in order to alter taxpayer behavior. The topic of tax avoidance is also often discussed in reference to corporations which base their operations in the U.S., but also includes individuals.[12]

As existing theory is connected to a timeline, a question becomes increasingly apparent: if Congress has been using tax policy to alter the behavior

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[10] Slemrod's "A General Model of the Behavioral Response to Taxation"
[11] International Tax Compact, https://www.taxcompact.net/documents/ITC_2010-12_Addressing-tax-evasion-and-avoidance.pdf
[12] Washington Post, "More Americans Using Foreign Tax Havens; 'Average' Citizens as well as Drug Traffickers Hide Income in Island Banks, Panel Says"

of taxpayers for hundreds of years, how does the advent of cognitive tax theory add to what is already known? How does the application of this theory change what has already been observed for centuries? Put simply, cognitive tax theory highlights one thing that lawmakers have systemically forgotten to assess for centuries: whether their policies actually work.

IV. Charitable Contributions

Following closely behind the creation of the permanent federal income tax was the very first personal income deduction to ever be available to the American public: charitable contributions. The first form of the charitable contribution deduction came from the War Revenue Act of 1917, a bill which boosted taxes for individuals and businesses to cover expenditures for U.S. involvement in World War I. The language of the bill determined that such a deduction would be granted to taxpayers whose donations met particular criteria:

> "Contributions or gifts actually made within the year to corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or to societies for the prevention of cruelty to children or animals, no part of the net income of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury."[13]

[13] War Revenue Act, ch. 63, section 1201(2) (1917)

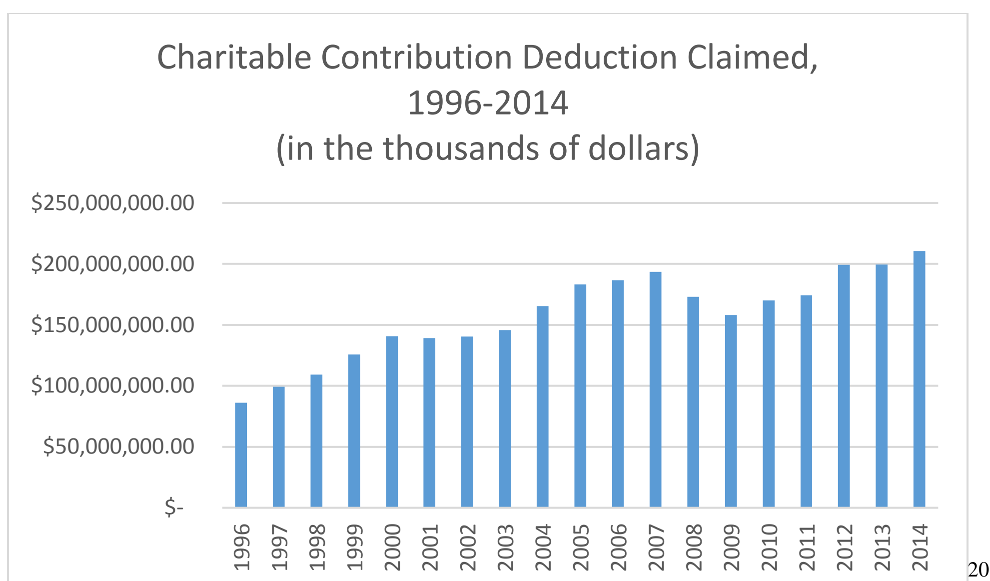
The section of the bill creating charitable contributions was championed by congressmen who believed that the increase in taxes to 15% on households with in the top 5% income bracket would lead to a significant drop in donations to charities, which might in turn cause many institutions to close their doors. The shuttering of charitable organizations could have a devastating effect in many regions, which would demand government attention and detract from the war effort. Universities were a prime concern at the center of this discussion; Senator Henry F. Hollis, a proponent of the deduction, argued that universities were at the greatest risk of collapsing because of reduced donations and a reduction in enrollment due to war recruitment.[14]

Editorials written about the possibility of a charitable contribution deduction during that period were also generally favorable. A unanimous vote of the Senate which approved the charitable contribution amendment to the War Revenue Act was described by the Washington Post as “The most enlightened action that the Senate has yet taken in changing the form of the pending revenue bill…The Senate distinguishes between the wealth used for private purposes and the wealth used in support of educational and charitable institutions which without private contributions would either go out of existence or be a charge upon the public treasury.”[15]

[14] Aprill’s “Churches, Politics, and the Charitable Deduction”
[15] Washington Post’s “Charity Exempted”

While the spirit of the initial deduction has not changed, it has seen several small changes within the last one hundred years. The deduction was initially meant for the wealthy, since few were impacted by the first income tax, but as the levy of the income tax spread across tax brackets to cover the majority of U.S. citizens and residents, the deduction has remained popular.[16] Today, an individual may deduct up to 50% of his or her taxable income, [17] as opposed to 25% in the War Revenue Act of 1917.[18] Congress hoped that this increase would "strengthen the incentive effect of the charitable contributions deduction."[19] This reasoning invokes cognitive theory in taxation twenty-five years before it was first studied; it is clear that Congress sought to alter taxpayer behavior by increasing the ceiling on charitable contribution deductions. The question of whether the deduction has worked as an incentive in bolstering charity can be analyzed by observing growth over time in deduction claims, as seen in the chart below.

[16] Lindsey's "The Charitable Contribution Deduction: A Historical Review and a Look to the Future"
[17] Washington Post's, "Exempting Charity"
[18] I.R.C. § 170(b)(1)
[19] Staff of Joint Commission on Taxation, 91ST Congress, General Explanation of the Tax Reform of 1969



[20]

Not all donations qualify as charitable contributions under IRS rules. One cannot, for example, deduct income based on time spent volunteering, or may not deduct money given directly to a person who is panhandling; for such a donation to qualify under IRS regulation, the donation must be given to an organization which is registered at the time of the donation as a 501(c)(3) and listed at an amount less than or equal to fair market value of the item on the date of the contribution.[21] Any not-for-profit organization may file for 501(c)(3) so long as they meet IRS standards: "organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals."[22] Such organizations must not use donations for any purpose other than those listed in the IRS standards for a

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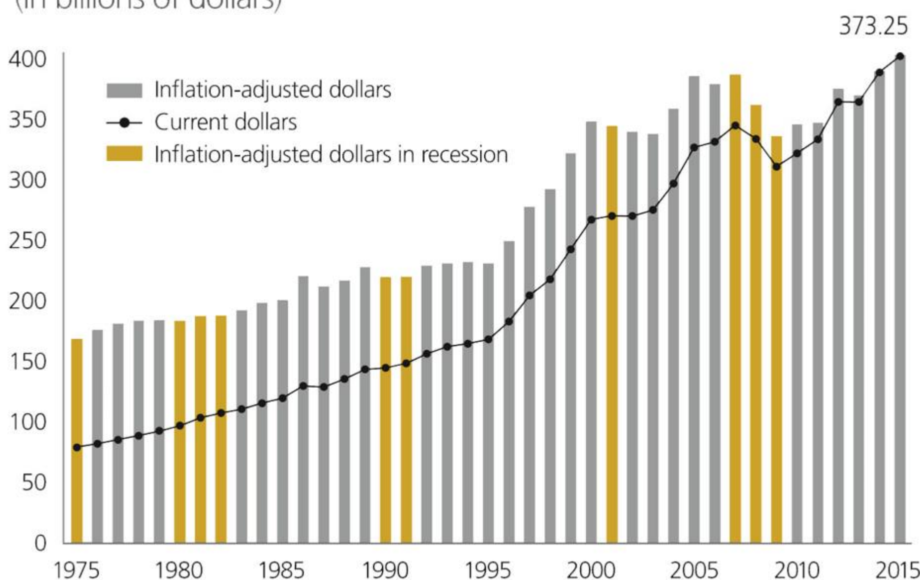
[20] IRS SOI Tax Statistics, Table 1.3, https://www.irs.gov/uac/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report
[21] IRS Publication 561 "Determining the Value of Donated Property," https://www.irs.gov/pub/irs-pdf/p561.pdf
[22] I.R.C. § 1.501(c)(3)-1

501(c)(3), though there is additional language in the code which extends tax-exempt status and charitable deduction benefits to other forms of organization, such as chambers of commerce and social clubs.

Religious organizations received 32% of all charity given in 2013, which was the most contributions out of all categories of organizations.[23] This number does not include non-profits that are religiously affiliated, which would be a much larger category that would encompass universities, homeless shelters, animal shelters, and many other forms of service-based organizations. The total amount of giving in 2015, as demonstrated in the chart below, was $373.25 billion dollars.



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[23] National Center for Charitable Statistics, http://nccs.urban.org/data-statistics/quick-facts-about-nonprofits

[24] Total giving: 1975-2015, https://www.nptrust.org/index.php?/philanthropic-resources/charitable-giving-statistics

The majority of research has found that deductible charitable contributions result in more charitable revenue gained than tax income lost, though that conclusion is not unanimous.[25] But even with some dissent, the massive and steadily increasing dollars that non-profit organizations bring in yearly, as well as the long-standing stature of the United States as the world's leader in development and concentration of non-profit organizations[26], and considering the effort charities have put into protecting the deduction,[27] it is evident from the continuous growth of American charitable involvement in the last one hundred years that charity has become a part of the American identity, and that while the charitable deduction is not the sole purpose for donating, that the charitable deduction does indeed support charitable organizations.

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[25] Bradley's "A Robust Estimation of the Effects of Taxation on Charitable Contributions"
[26] Reck's "Accounting for Governmental & Nonprofit Entities"
[27] USA Today's "Charities Fight Possible Changes on Tax Deductions," http://www.usatoday.com/story/news/nation/2012/12/09/charitable-deduction-lobbying/1750943/

V. Tax-Exempt Status

Donors to public-serving 501(c)(3) organizations are not the only ones who are able to avoid taxes. 501(c)s, which are member-serving organizations, are also able to avoid taxes through an exemption. This exemption prevents taxes from being levied on revenue, property, parsonage, and purchases, among a number of other less common taxable activity. Member-serving organizations encompass a wide variety of organizations, but the largest category of non-profit organizations under this segment is churches.

In 2015, there were 345,000 houses of worship in the United States, 235,000 of which were registered with the IRS.[28] The disparity between these numbers is a result of IRS policy, which dictates that churches that receive under $50,000 of revenue on a yearly basis are not required to file with the IRS.[29] Consideration of religious service as a charity means that act of spreading gospel is a tax-deductible act. It is much more difficult to measure tax revenue lost from the 501(c) exemption than it is to measure deductions and credits used, but the number has been estimated in recent years to be as high as $71 billion.[30]

The role of charitable contributions intersects with religious institutions through the issue of electioneering, or involvement on the part of churches and affiliated charities with U.S. politics. The involvement of religious institutions has

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[28] The Urban Institute's "The Nonprofit Sector in Brief 2015: Public Charities, Giving, and Volunteering," http://www.urban.org/research/publication/nonprofit-sector-brief-2015-public-charities-giving-and-volunteering

[29] I.R.C. § 1.509(c)(3)

[30] Cragun's "How Secular Humanists and Everyone Else Subsidize Religion in the United States"

caused academics and politicians to question whether it is appropriate for such institutions to participate in such processes while subsisting on public monies which are not subject to taxation. "Congress has explained the prohibition on Internal Revenue Code section 501(c)(3)-n1 organizations including churches, from engaging in electioneering on the grounds that it 'reflects a Congressional policy that the U.S. Treasury should be neutral in political affairs.'"[31]

For this reason, U.S. tax codification specifically prohibits political contributions from churches. Churches may act as a host for a local election commission by allowing church property to be used in collecting precinct votes and may organize voter registration drives, but the church may never donate money or property to a political candidate or official. [32]

The goal of upholding tax-exempt status for covered groups like charities and churches extends further back than the existence of the United States. In colonial America, organizations provided services that neither the distant British government nor the local colonial government could. Though the tax exemption did not appear in statutory regulation until 1894, the charity sector was already well-developed:

> "The popularity of voluntary charitable organizations in the United States, even in the midst of strengthening State and Federal governments, suggests that perhaps these organizations, with their well-established structures and

[31] H.R. REP. NO. 100-391 (II), at 1625, 1627 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2313-1.
[32] I.R.C. § 1.501(c)(3)-1(c)(3).

> programs, were able to fill a gap in social welfare programs where the young Government's efforts proved insufficient."[33]

Another theory regarding the origin and persistence of the non-profit exemption is that some may have preferred a decentralized, community-controlled system of services out of wariness grown from the bureaucracy and burdens administered by Britain. These reasons for the tax exemption of many not-for-profit organizations is still relevant today. Each year, millions of non-profit organizations receive funding at the local, state, and federal level to perform services for which there is no available government equivalent. For example, the small city of Chattanooga, TN, offers no shelter for homeless residents, but instead relies on a network of churches and non-profits to provide food and shelter to those in need.[34] In spite of this, the city has managed to reduce its reported numbers for homelessness by focusing on finding homes for veterans.[35] While the city did have one person on staff to find housing for veterans, it relied heavily on other non-profits to care for the veterans until they could be housed, and continues to rely on these non-profit organizations for non-veteran services.

There is debate surrounding whether the modern church meets these standards. Particularly with the rise of televangelism and "mega-churches" over

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[33] Internal Revenue Service's "A History of the Tax-Exempt Sector: An SOI Perspective"
[34] Chattanooga Community Kitchen, http://community-kitchen.org/
[35] CBS News Channel 12, http://wdef.com/2017/02/09/chattanooga-effectively-ends-veteran-homelessness/

the past 40 years, many academics,[36] journalists,[37] and even comedians[38] have taken issue with what defines a church, and where the limits of the tax exemption should be for churches that appear to amass great wealth for the pastors rather than for charity or the church itself. In order to make a point about how easy it is to receive non-profit tax benefits, comedian John Oliver created a church called "Our Lady of Perpetual Exemption" and announced it on an episode of his show investigating televangelists.[39] Of course, the mega-church is not representative of most houses of worship in the United States, but does pose questions about whether receiving and maintaining tax exempt status should require more rigor.

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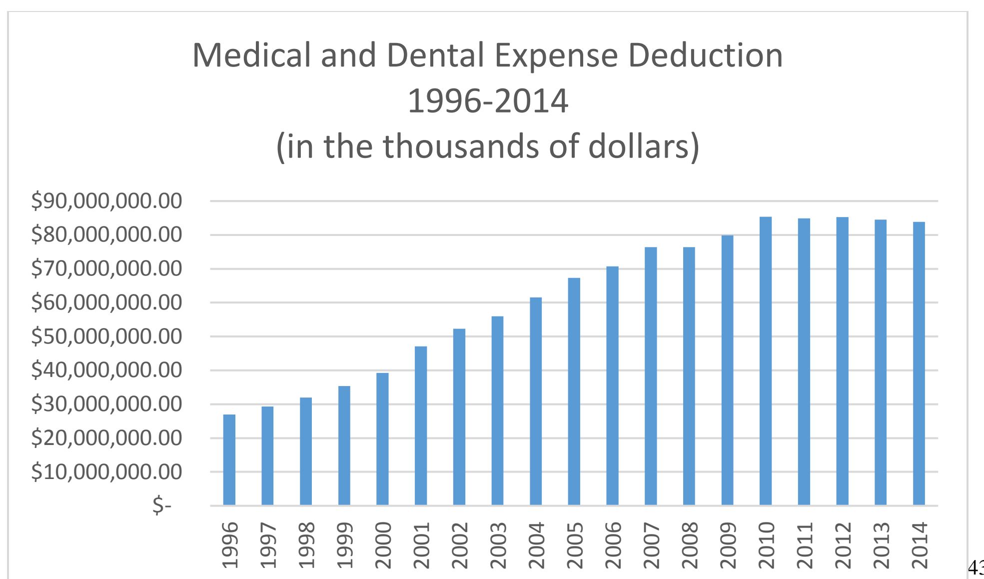
[36] James's "Reaping Where They Have Not Sowed: Have American Churches Failed to Satisfy the Requirements for the Religious Tax Exemption?"
[37] The Huffington Post's "The Failure of the Mega-Church," http://www.huffingtonpost.com/tim-suttle/the-failure-of-the-megachurch_b_954482.html
[38] Last Week Tonight with John Oliver's "Televangelists," https://www.youtube.com/watch?v=7y1xJAVZxXg
[39] Last Week Tonight, n.b.

VI. Medical

Similar to the charitable contribution deduction, the medical expense deduction finds its origins in a Congressional session in the midst of war. This deduction was included in the War Revenue Act of 1942, which President Franklin D. Roosevelt called, “the greatest tax bill in American history.”[40] Like the legislation that spurred the charitable contribution deduction in World War I, the medical expense deduction was originally meant to be a temporary measure that lifted some burden off the wealthiest taxpayers, who were already being billed higher taxes to pay for U.S. involvement in World War II. However, the deduction became permanent and was streamlined into the code, receiving its own section in 1954.[41]

Today, the medical expense deduction is still used, with over eight million households taking the deduction in 2014, costing a combined $83.8 million in avoided taxable income.[42]

[40] Forbes’ “Deduct This: The History of Medical Expenses,” https://www.forbes.com/sites/kellyphillipserb/2011/06/20/deduct-this-the-history-of-the-medical-expenses-deduction/#71b21e03478c
[41] Forbes’ “Deduct This: The History of Medical Expenses,” n.b.
[42] IRS SOI Tax Statistics, Table 1.3, n.b.



[43]

Unlike many other revenue-reducing measures, this deduction does not seek to change taxpayer behavior because it doesn't encourage people to get hurt or to live without insurance, for whom there is a separate deduction regarding health savings accounts. This deduction also must be equal to or greater than ten percent of the taxpayers adjusted gross income before it can be claimed,[44] which likely contributes to the smaller numbers of households which claim this deduction. However, there is still some social engineering in determining what medical expenses are covered in the Code. One of the most notable examples of how the Code is influenced by its authors is in its coverage of Viagra and other erectile dysfunction drugs, which may also be called "lifestyle pills," while the cost of maternity clothes is not deductible. Maternity clothes are needed by pregnant women in order to adjust to the changes their bodies undergo during pregnancy,

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[43] IRS SOI Tax Statistics, Table 1.3, n.b.
[44] I.R.C. § 1.213-2

which makes it seem like it would fit the Code's description of what qualifies as a medical expense: "For medical expenses paid (including expenses paid for medicine and drugs) to be deductible, they must be for medical care of the taxpayer, his spouse, or a dependent of the taxpayer and not be compensated for by insurance or otherwise."[45] This decision might indicate that some gendered bias may have played a role in the creation of the specific rules regarding medical deductions, which is something that should be guarded against at each point in the lawmaking process. Indeed, it shows that, on occasion, tax code may also be socially engineered at the cost of taxpayers.

[45] I.R.C. § 1.213-2, n.b.

VII. Housing

Housing is a more complicated topic for tax, though rife with policy meant to influence the American taxpayer. The oldest of these tax-reducing policies is the mortgage interest deduction, which was actually part of the federal income tax that was struck down by the Supreme Court in 1894 as unconstitutional. The deduction was also included in the 1913 act which established the permanent federal income tax. Many people today seem to think the sentiment behind the tax break is to encourage home ownership.[46] But in fact, there is no evidence from the time of the deduction's implementation to support this assumption. The original legislation included a floor—or minimum amount that would make a taxpayer eligible for the deduction—of $3,000 for single filers and $4,000 for married filers. In 1913, only a fraction of the top 1% of income-earners made that much in a year.[47]

This deduction is a double-edged sword: for the government, it costs $68 billion in taxable income each year,[48] and for homeowners, it allows those selling homes to rationalize higher prices without any thought to whether the deduction will actually be able to be used by the homebuyer or not. This is because over 60% of taxpayers use the standard deduction,[49] which means they cannot also have

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[46] https://turbotax.intuit.com/tax-tools/tax-tips/Home-Ownership/Deducting-Mortgage-Interest-FAQs/INF12051.html
[47] New York Times's "Who Needs the Mortgage Interest Deduction," http://www.nytimes.com/2006/03/05/magazine/who-needs-the-mortgageinterest-deduction.html
[48] Alpanda's "Housing and Tax Policy"
[49] IRS SOI Tax Statistics, Table 1.1, n.b.

itemized deductions. It seems that in this case, there is very little thought behind this revenue-reducing measure. That does not bode well for its success as a policy. If there is no set goal in creating the policy beyond its function, there is no way to measure its success beyond its ability to meet that function. Even by that measure, the mortgage interest deduction is a failure.

Although the mortgage interest deduction costs more in output loss than it provides in benefits, there are many other housing-based credits and deductions which have proven more successful in their implementation. The Low-Income Housing Tax Credit (LIHTC), which was first created in the language of the Tax Reform Act of 1986, was driven by the needs of over four million Americans who either paid more than half their income in rent or lived in unsafe rental housing.[50] This program quickly became the largest federal housing program in the United States and has resulted in the creation of 2.15 million housing units in the years 1995-2014.[51]

This particular act is interesting in that, unlike any of the others listed in this thesis, there is a large quantity of publicly available government reports with regard to the creation of the tax credit and its continued existence. The website for the U.S. Department of Housing and Urban Development (HUD) even has a database available through which reports regarding LIHTC can be queried, downloaded, and shared to social media.[52]

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[50] Wallace's "Evaluating the Low-Income Housing Tax Credit"
[51] See https://www.huduser.gov/portal/Datasets/lihtc/tables9514.pdf
[52] See https://www.huduser.gov/portal/datasets/lihtc.html#publications

One other characteristic which separates the LIHTC from other tax policies is that there is space within the language of the Code for states and local governments to play a role in administering and enforcing the standards of the credit. This appears to have contributed to the marketing and recruitment of rental owners.[53]

While most research regarding the LIHTC has returned positive results, there has been some indication that this credit may be contributing to the gentrifying of neighborhoods in urban areas by increasing property values—and therefore property taxes—to such a point that rental owners and neighboring homeowners may struggle to continue renting or living in the area.[54] That said, a majority of the available literature also shows that the beneficiaries of LIHTC are families which make under 60% of their regional average family income.[55] Many LIHTC-participating housing complexes are only partially low-income housing, and in many cases needy families become the neighbors of families which make 1.3 times the poverty line.[56]

LIHTC is the best-documented success story of a revenue-reducing tax measure which alters taxpayer behavior, and its effects can be felt in other governmental arenas, such as education and crime prevention.[57] LIHTC is the

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[53] http://www1.nyc.gov/site/hpd/developers/lihtc-qualified-action-plan.page

[54] Baum-Snow's "The Effects of Low-Income Housing Tax Credit Developments on Neighborhoods"

[55] U.S. Office of Policy Development Research's "Assessment of the Economic and Social Characteristics of LIHTC Residents and Neighborhoods," https://www.huduser.gov/portal/publications/affhsg/lihtc.html

[56] U.S. Office of Policy Development Research's "Assessment of the Economic and Social Characteristics of LIHTC Residents and Neighborhoods," n.b.

[57] https://www.huduser.gov/portal/datasets/lihtc.html#publications, n.b.

easiest revenue-reducing measure to link directly to results out of all listed in this thesis, and its success gives lawmakers a model for how to implement successful cognitive tax policy.

VIII. Employment Credits

In times of economic downturn and high unemployment throughout U.S. history, there has been massive pressure exerted by the public on the federal government to alleviate the working class's suffering by using government policy to stimulate the economy and lessen the burden on taxpayers. While the most commonly discussed of these programs is the Civilian Conservation Corps, which was established by President Roosevelt during World War II to employ Americans who were struggling under the economic burden of the Great Depression, a more recent program came in the form of a tax credit during the Great Recession of 2008.

The Great Recession of 2008 left millions unemployed and, in many cases, homeless. Presidential candidates from both major parties were challenged to include detailed plans on how to respond to the financial crisis, and measures for reducing unemployment were the key policy takeaways from debates for both primary and party-nominated candidates. Two years after the election of Barack Obama, the Hiring Incentives to Restore Employment (HIRE) Act became the law of the land. The HIRE Act was a temporary stimulus package aimed at incentivizing employers to hire people who had become unemployed over a longer period of time due to the Recession. Unlike many of the revenue-reducing measures discussed in this thesis, the HIRE Act explicitly states its goals as well as its target population: "The HIRE Act is aimed at providing hiring incentives to restore some of the jobs lost in the latest economic recession. The goal is to help

put Americans back to work as soon as possible."[58] However, there is little evidence of whether the HIRE Act was effective in alleviating the high unemployment rate. While the economy improved marginally over the year of 2010,[59] there is little research on how effective the bill was in reducing unemployment rates. Despite the temporary nature of the measure, the HIRE Act costed $17.5 billion, so it is important to know whether the program was worth the money spent.

Employment credits have also been used in promoting the employment of vulnerable populations which are subject to higher levels of unemployment, such as veterans, SNAP/TANF recipients, youth, the long-term unemployed, and formerly incarcerated people. The Work Opportunity Tax Credit (WOTC) offers a credit of $1,200 for summer youth hires, $2,400 for most other qualified populations, and up to $9,000 over two years for long-term TANF recipients.[60] The program, like LIHTC, is sponsored by a government agency separate from the IRS—in this case, the U.S. Department of Labor—and while the program is also sometimes a focus of state and local government, it does not have the same participation from these entities as LIHTC. Because of that, the burden of informing companies of this credit is often left to their accountants, many of

[58] http://hireact.org/
[59] https://data.bls.gov/timeseries/LNS14000000
[60] https://www.doleta.gov/business/incentives/opptax/benefits.cfm

whom might not themselves know of this credit, and therefore many businesses which might benefit from the tax credit do not take advantage of the credit.[61]

The WOTC has the potential to reduce veteran homelessness, criminal recidivism, delinquency, and more. The success of this credit is linked to the success of other social measures, and in some places, it's worked. Some small businesses have found great success in hiring the formerly incarcerated,[62] and many corporations have pushed for hiring certain groups which are also a part of the tax credit's covered populations[63]. But while the credit has had success in short-term hiring, there is little evidence of sustained benefits.[64] This means that this credit is most important to the employment of vulnerable populations during bouts of higher unemployment, when these groups are competing with unafflicted populations for fewer jobs, and that the credit could be more effective for long-term employment solutions if paired with other initiatives at the state and local levels.

[61] Chattanooga Mayor's Council for Women: Justice Committee
[62] http://theweek.com/articles/544438/should-small-businesses-hire-more-exconvicts
[63] http://www.businessinsider.com/starbucks-to-hire-15000-more-veterans-2017-3
[64] Hamersma's "The Effects of an Employer Subsidy on Employee Outcomes: A Study of the Work Opportunity and Welfare-to-Work Tax Credits"

IX. Final Analysis

To tax effectively, governing bodies must seek to determine the possible consequences of the form of taxation being considered—both its desired and undesired effects, both financial and non-financial. The application of cognitive theory in creating tax policy can be useful in asserting taxes that fund government activities without excessive avoidance on the part of taxpayers while also encouraging some form of taxpayer behavior, such as giving to charity or driving a more environmentally friendly vehicle.

This would require the Senate Finance Committee to think deeply about what the goals of each bill are beyond their function—if there are goals beyond the function of the bill—and consider how the bill would affect taxpayer behavior to produce the desired results. It is already safe to say that affecting a behavior preference upon the entire population cannot be done by using revenue-reducing measures such as tax credits, deductions, and exemptions at the individual level because households in the lower two-thirds of income are unlikely to use itemized deductions.[65] However, revenue-reducing measures for rental properties and businesses may have effects which seep into the foundation of the community in which the enterprise is based.

There are many ways that lawmakers can adjust the way that revenue-reducing measures are reviewed both before and after their legal inception. One of

[65] IRS SOI Tax Statistics, Table 1.2, n.b.

these options could be to develop a procedure which requires written documentation of the goals of the bill, the estimated amount it would cost the U.S. government, and the estimated amount it would contribute to the cause to which the measure relates. These numbers should be calculated well in advance, and there are several offices within the government structure that can assist lawmakers with determining each aspect. This method would likely slow the process of lawmaking, but could lead to higher quality and more fruitful legislation. The most successful revenue-reducing measures each had high levels of publicly-available documentation, which makes the program easier to track and share with interested parties.

Such a method would also be important in reviewing current portions of the U.S. Tax Code. Many of the most ineffective methods today are the result of changes to the Code which were meant to be temporary, then later forgotten. Ensuring that pilot programs have expiration dates, also called “sunsets,” would require Congress to agree to a timeline with which the change can be implemented, research can be gathered, and the results can be reviewed.

One other aspect of changes to the Code which has been systemically ignored is whether the public is informed of measures which are meant to ease their tax burden. As noted in the case of LIHTC, the program has gained much of its success because government agencies outside the IRS—HUD, states, and cities—have taken upon themselves the effort of recruiting and educating landlords and contractors about the benefits available to them under LIHTC. Such

marketing would likely be helpful in attaining success for other credits and deductions, such as the WOTC. States and cities are key in the success or failure of various tax policy, as these entities have a better understanding of their population's needs, the state or local market for opportunities to promote the measure, and are able to communicate with their populaces more effectively.

One final policy implication lies in the lesson learned from the medical deduction: good policy cannot be made and upheld without the input of those affected by it. Lawmakers must make efforts to include affected populations in the creation of laws which affect them in order for the laws to have a higher likelihood of success. To exclude the affected from the lawmaking process is likely to result in an unbalanced tax burden on needy groups, which would likely sustain their need, ultimately costing them and the U.S. government money over time.

X. References

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