STANLEY SURREY'S LASTING INFLUENCE

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I

INTRODUCTION

Stanley Surrey is perhaps best known for his promotion of the concept of tax expenditures—the characterization of various tax preferences as substitutes for direct expenditures. That emphasis understates his lasting influence on the tax policy process. An equally important and lasting achievement was establishing and promoting the integrity and professionalism of the Treasury's Office of Tax Policy (OTP), while garnering the support of much of the wider tax policy community for basing tax policy on the principles of fairness, simplicity, and efficiency.

In this article, we focus mainly on historical developments in the concept and use of tax expenditures both in the United States and abroad. We provide special attention to the significant role played by tax expenditures in the movement that led to the Tax Reform Act of 1986, which is the type of effort that Surrey championed. We relate tax expenditures to other base-defining measures such as economic income, consumption, and ability to pay in both development of that Act and within the continuing tax policy debate.

II

SURREY AND THE OFFICE OF TAX POLICY

After serving as the Director of Harvard's Program for International Taxation, Surrey was appointed as the first Assistant Secretary of the Treasury for Tax Policy.[1] Surrey held the position from 1961 to 1969, serving under Secretaries of the Treasury C. Douglas Dillon of the Kennedy and Johnson administrations, and Henry H. Fowler and Joseph W. Barr of the Johnson

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This Article is also available online at http://lcp.law.duke.edu/.
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1. *Nominations: Hearings Before the S. Comm. on Fin.*, 87th Cong. 7 (1961) (statement of Stanley S. Surrey, Nominee for Assistant Secretary of the Treasury).

administration, respectively.[2] He was succeeded by Edwin S. Cohen, who assumed the position under the Nixon administration.[3]

The OTP was created in 1961 under the U.S. Department of the Treasury.[4] The OTP combined the functions of the Offices of Tax Analysis[5] and International Tax Affairs with the Office of Tax Legislation, which had previously been under the control of the General Counsel. Prior to 1961, the offices of Tax Analysis—with responsibility for tax research and revenue estimates—and International Tax—with responsibility over treaties and international tax matters—had been under the control of an undersecretary, who also had an indirect line of control over the General Counsel's legal advisory staff.[6] The Office of Tax Legislation reported to the General Counsel.[7]

After the OTP was established in 1961, the Assistant Secretary for Tax Policy was put in charge of those three offices,[8] which have been subdivided in years since then. The OTP's chief roles include assisting the Secretary and developing tax policies and programs. It also provides the official estimates of government receipts for the president's budget and revenue estimates for new policy proposals, while participating in fiscal policy decisions in coordination with what is now the Office of Management and Budget. It works closely with the Joint Committee on Taxation and congressional tax staffs on technical issues and advises on the drafting of legislation. Along with the IRS, the OTP engages in

2. *Prior Secretaries*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/about/history/prior-secretaries [https://perma.cc/4BXG-LVJY] (last visited Feb. 6, 2023); William D. Andrews, *A Source of Inspiration*, 98 HARV. L. REV 332, 332 (1984).

3. *Our History: Former Faculty: Cohen, Edwin Samuel (1965-1985)*, UNIV. OF VA. SCH. OF L., https://libguides.law.virginia.edu/faculty/cohen [https://perma.cc/2C57-79SU] (last updated Oct. 1, 2021).

4. *See* U.S. DEP'T OF THE TREASURY, FY 2014–2017: STRATEGIC PLAN 26 (2014), https://home.treasury.gov/system/files/266/2014-2017-US-TreasuryStrategicPlan.pdf [https://perma.cc/QT3S-E984] (noting that the Office of Tax Analysis (OTA) was formerly known as the Division of Tax Research).

5. According to the 1959–60 U.S. Government Organizational Manual, the "Tax Analysis staff prepares analyses of proposed tax legislation, assembles statistical and analytical materials for use in the formulation of tax programs, and studies the effects of alternative programs or measures in the light of economic and budgetary requirements . . . [t]he Staff prepares analytical reports on economic problems in these fields for use by Treasury officials in supplying information requested by the President, the Committee on Ways and Means, the Finance Committee of the Senate, the Joint Committee on Internal Revenue Taxation, individual Members of Congress, other Government agencies, and the public. The Tax Analysis Staff also prepares the official estimates of Government receipts for incorporation in the President's annual budget message and in intervening budget revisions, and it estimates of the revenue effects of proposed and pending tax legislation." OFF. OF THE FED. REG., NAT'L ARCHIVES & RECS. SERV., UNITED STATES GOVERNMENT ORGANIZATION MANUAL 1959–60 at 98, 102–03 (1959) [hereinafter U.S. GOVERNMENT ORGANIZATION MANUAL 1959].

6. *See* OFF. OF THE FED. REG., NAT'L ARCHIVES & RECS. SERV., UNITED STATES GOVERNMENT ORGANIZATION MANUAL 1962–63 at 573, 579 (1962) [hereinafter U.S. GOVERNMENT ORGANIZATION MANUAL 1962].

7. U.S. GOVERNMENT ORGANIZATION MANUAL 1959, *supra* note 5, at 98. Before the position of Assistant Secretary for Tax Policy was established, there was usually a person overseeing tax policy. For example, Dan Throop Smith, an economist, was an advisor to the Secretary during the drafting of the 1954 Code.

8. U.S. GOVERNMENT ORGANIZATION MANUAL 1962, *supra* note 6, at 63, 89.

interpreting statutes through Treasury regulations and revenue rulings and related materials. The office also negotiates tax treaties and represents the United States in meetings dealing with multinational tax policy matters.[9] The Assistant Secretary of the Treasury for Tax Policy is a senior advisor to the Secretary of the Treasury and, at least when White House officials do not interfere, acts as the highest-ranking tax professional representing the president in analyzing, developing, and implementing federal tax policies and programs.[10]

At the time of his appointment to the Treasury, Surrey was already a widely influential and respected tax expert.[11] But he is remembered mainly today as the strong and driving force whose work and presence continues to inspire how analysts approach tax policy. Many of his protégés served that office for years when they were not in academia and other positions. Tax law professors everywhere have expanded upon his approach of using principles to assess tax policy, and some have promoted and refined the concept and measurement of tax expenditures that he initiated. The efforts he made to strengthen Treasury's tax policy staff likely led Congress in a competitive spirit to strengthen the Joint Committee on Taxation. Among the many notable proteges who also served the Treasury Department under Surrey were Donald Lubick and Jerome Kurtz. Lubick served as Tax Legislative Counsel under Surrey and later served as the Assistant Secretary for Tax Policy under both Presidents Carter and Clinton.[12] Kurtz also served later as Tax Legislative Counsel under President Johnson and even later became Commissioner of the IRS.[13]

Protecting the office from inappropriate influence has always been a tough issue. Joseph Guttentag, who served as International Tax Counsel under Surrey in 1967–1968, relays one example. Surrey once received a call from a senior White House official responsible for domestic tax policy. The caller expressed that President Johnson was interested in the status of an IRS ruling. Surrey responded along the lines of "I must have missed the President's call asking me about that ruling," after which the official terminated the call.[14] Thus, early on, Surrey had

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9. *Tax Policy*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/about/offices/tax-policy [https://perma.cc/6SFZ-QHZG] (last visited Feb. 6, 2023).

10. *Id.* The Assistant Treasury for Tax Policy remains the highest-ranking tax professional except in the rare instances where a tax professional holds a top Treasury or White House position.

11. *See generally* Erwin N. Griswold, *In Memoriam: Stanley S. Surrey — A True Public Servant*, 98 HARV. L. REV. 329, 330 (1984). This was not Surrey's first Treasury appointment. Between 1937–1947, he served as the Special Representative of the Treasury General Council at the Internal Revenue Service and served on the Shoup mission to Japan from 1949–1950. *See Stanley S. Surrey Papers*, HARV. LIBR.: HOLLIS ARCHIVES, https://hollisarchives.lib.harvard.edu/repositories/5/resources/7491 [https://perma.cc/2UUW-ZKHM] (last visited Feb. 6, 2023) (describing Surrey's professional history).

12. Howard Gleckman, *Remembering Don Lubick*, TAX POL'Y CTR. (Feb. 9, 2022), https://www.taxpolicycenter.org/taxvox/remembering-don-lubick-0 [https://perma.cc/C8KR-DVA9].

13. Emily Langer, *Jerome Kurtz, IRS Commissioner Under Carter, Dies at 83*, WASH. POST (Mar. 5, 2015), https://www.washingtonpost.com/national/jerome-kurtz-irs-commissioner-under-carter-dies-at-83/2015/03/05/4adf10fe-c282-11e4-9ec2-b418f57a4a99_story.html [https://perma.cc/3BQL-YK8D].

14. E-mail from Joseph Guttentag, Former Deputy Assistant Sec'y for the U.S. Dep't of the Treasury, to C. Eugene Steuerle, Inst. Fellow & Richard B. Fisher Chair, Urb. Inst., and Assaf Harpaz,

to deal with the continued contention between the White House, OTP, and the IRS over regulation and rulemaking. White House intervention is particularly problematic given that most tax regulations and rulings involve interpreting congressional actions, not empowering executive offices to define new responsibilities for taxpayers.

Surrey was instrumental in helping to draft the Revenue Act of 1962, the Revenue Act of 1964, the Tax Adjustment Act of 1966,[15] and the Revenue and Expenditure Control Act of 1968. Peter Barnes, who served in the Office of Tax Policy, rising to deputy international tax counsel, credits Surrey with engineering features of international tax policy that have lasted for decades. In 1962 this included the creation of Subpart F to balance the competitive needs of multinationals—a decision that lasted fifty-five years until amended in 2017 legislation.[16]

In 1962 and 1964, the emphasis was on tax cuts to stimulate the economy. Interestingly, those acts created two of the largest and most contentious tax expenditures—a sizeable investment tax credit and a system of accelerated depreciation.[17] However, it is worth noting that Surrey would not have counted accelerated depreciation as a tax expenditure.

Surrey's influence did not end when he left the Treasury. Indeed, the first major piece of tax legislation enacted in the Nixon administration, the Tax Reform Act of 1969,[18] derived from studies largely crafted during the Democratic Johnson administration.[19] Among the more notable features of that Act were payout and related requirements applying to private nonoperating foundations that sometimes acted more in the interest of the donor than the public they claimed to serve. In addition, the Act introduced a new Minimum Tax on certain tax preferences that tried to deal with the low effective tax rate applying to high-income taxpayers. While tax laws after 1969 both added and removed tax breaks, many of the debates surrounding them were framed around their effect on the tax expenditure budget.

Partly through the continued publication of a tax expenditure budget, Congress continues to benefit from the work performed under Surrey's tenure at

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Visiting Assistant Professor, Drexel Univ. Thomas R. Kline Sch. of L. (May 11, 2022, 9:48 A.M.) (on file with the authors).

15. Andrews, *supra* note 2, at 334.

16. E-mail from Peter Barnes, Int'l Tax Advisor and Of Counsel at Caplin & Drysdale, to C. Eugene Steuerle, Inst. Fellow & Richard B. Fisher Chair, Urb. Inst., and Assaf Harpaz, Visiting Assistant Professor, Drexel Univ. Thomas R. Kline Sch. of L. (Dec. 6, 2022, 7:57 P.M.) (on file with the authors). Barnes also argues that Surrey's opposition to tax sparing, whereby a contracting state agrees to grant relief from residence taxation with respect to source taxes that have not actually been paid, "still controls U.S. tax treaty policy today (as it should)."

17. Still in the Administration at the time, Surrey does not criticize these tax expenditure expansions in his 1966 law review article, which mainly defends the Democratic Administrations he served. *See generally* Stanley S. Surrey, FEDERAL TAX POLICY IN THE 1960S, 15 BUFF. L. REV. 477, 477–500 (1966).

18. Tax Reform Act of 1969, Pub. L. 91-172, 83 Stat. 487 (1969).

19. *See* Paul M. Dodyk, *The Tax Reform Act of 1969 and the Poor*, 71 COLUM. L. REV. 758, 786 (1971) (describing the studies that led to the Act).

the Treasury.[20] Surrey's impact highlights the strength of the OTP during his time and its power in policymaking. While the integrity of the office has remained intact, its influence over policy has waxed at times but also waned, particularly after the tax base expansions that comprised a significant part of the deficit reductions efforts in 1982, 1984, 1990 and 1993, and the tax reform in 1986.

After significant expansion in the Depression and World War II, the executive branch initiated many tax and spending policies. Gradually, Congress expanded its own reach and staff.[21] Congress in recent years has become ever more reluctant to let presidents take the lead on the tax agenda. At the same time, the White House increasingly has taken control over the tax policy debate by cutting back on what we might call the Treasury's "power of the first draft"—its ability to lead in preparing drafts of tax legislation according to its understanding of tax policy principles and the president's broader goals. Similarly, the office has not prepared any comprehensive tax reform analysis since studies in 1977 and 1984.

Still, as Eric Toder—who served for many years as a senior executive in the Office of Tax Analysis—relates, its influence was still strong in the sense that

> We could still prevail if we could show that a policy could not be administered or, through control over the revenue-estimating process, whether it cost too much. (In the latter, we were helped by the fact that JCT scoring was the official metric used by Congress, so trying to subvert the revenue-estimating process would have been counter-productive.)[22]

The goal of this White House centralization of policy making was to ensure that communication would be limited—including on issues that needed to be addressed but that the White House saw public revelation as having no political gains.[23]A related factor has been increased partisanship in policymaking, as evidenced by the pressure on each member of Congress to vote in near or total unanimity with a party position. That partisanship makes it difficult to put out studies and reports that would be interpreted as anything but political. It is doubtful that these developments have reduced the level of fighting over tax reform or led to better tax policy.

20. Robert Goulder, *Stanley S. Surrey – The Greatest U.S. Tax Scholar*?, FORBES (Jun. 8, 2022), https://www.forbes.com/sites/taxnotes/2022/06/08/stanley-s-surrey—-the-greatest-us-tax-scholar/?sh=7db44352c598 [https://perma.cc/E2ZB-4NQY].

21. *See* Part III below on the creation of the Congressional Budget Office and the requirement for it also to publish a tax expenditure budget.

22. E-mail from Eric Toder, Former Senior Exec. in the U.S. Off. of Tax Analysis to C. Eugene Steuerle, Inst. Fellow & Richard B. Fisher Chair, Urb. Inst., and Assaf Harpaz, Visiting Assistant Professor, Drexel Univ. Thomas R. Kline Sch. of L. (Mar. 1, 2023, 2:55 P.M.) (on file with the authors).

23. At least two other Assistant Secretaries of the Treasury, one Democratic and one Republican, reflect this view. Donald Lubick, who served during three Democratic administrations, quipped that each time he served was "better than the next." C. Eugene Steuerle, *Donald Lubick: Public Servant*, TAX POL'Y CTR. (Apr. 6, 2018), https://www.taxpolicycenter.org/taxvox/donald-lubick-public-servant [https://perma.cc/CW77-X2X6]. John E. (Buck) Chapoton has discussed with Steuerle at various times his assessment of the weakening of the influence of the office.

III

TAX EXPENDITURES

Surrey is credited for propelling the Treasury to publish its first tax expenditure budget in 1968.[24] However, publication of the tax expenditure budget became mandatory only following the Congressional Budget and Impoundment Control Act of 1974.[25] Under the Act, the Office of Management and Budget is required to publish an annual tax expenditure budget, though the cost estimates are performed by the Office of Tax Analysis of the Treasury. Eventually these estimates were projected ten years forward. The Act also created the Congressional Budget Office and required it to produce its own annual tax expenditure budget, though it has deferred the Congressional version of the analysis to the Joint Committee on Taxation (JCT). The listed tax expenditures differ slightly between the Treasury and JCT reports, but for the most part they tell a similar story and are of similar magnitude.[26]

Adding to Surrey's lasting influence, the reporting of tax expenditures has extended at some level to eighty countries, promoted in part by the Fiscal Affairs Department of the International Monetary Fund. That department's publications explain and define tax expenditures and note the nuances in the U.S. measure. Its goal often centers less on some exact definition of tax expenditures and more on encouraging governments to recognize subsidies hidden in taxes, bolster transparency, encourage fiscal management around tax expenditures, and come to a better recognition of tradeoffs among tax expenditures and direct spending programs.[27]

Dan Shaviro traces the idea of examining tax subsidies as similar to direct outlays at least back to Germany in the 1950s.[28] Surrey, however, is widely known

24. U.S. DEP'T OF THE TREASURY, ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FOR THE FISCAL YEAR ENDED JUNE 30, 1968, at 339 (1969); Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept: Current Developments and Emerging Issues*, 20 B.C. L. REV. 226, 226 (1979).

25. Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, §§ 2(2), 3(a)(3) 88 Stat. 297 (1974).

26. *See id.* at §§ 101(c)(3), 102(a)(2)(C). *See also* SARAH CALAME & ERIC TODER, TAX POL'Y CTR., TRENDS IN TAX EXPENDITURES: AN UPDATE 3 n.2 (2021), https://www.urban.org/sites/default/files/publication/104124/trends-in-tax-expenditures-an-update_1.pdf [https://perma.cc/KGK4-S83M] (noting that "JCT only projects tax expenditure costs forward for 5 years, while OMB shows them for 10 years").

27. *See generally* CHRISTOPHER HEADY & MARIO MANSOUR, INT'L MONETARY FUND, TAX EXPENDITURE REPORTING AND ITS USE IN FISCAL MANAGEMENT: A GUIDE FOR DEVELOPING COUNTRIES (2019); SEBASTIAN BEER, DORA BENEDEK, BRIAN ERARD & JAN LOEPRICK, INT'L MONETARY FUND, HOW TO EVALUATE TAX EXPENDITURES (2022); Emil Sunley, *Tax Expenditures in the United States: Experience and Practice*, *in* TAX EXPENDITURES—SHEDDING LIGHT ON GOVERNMENT SPENDING THROUGH THE TAX SYSTEM: LESSONS FROM DEVELOPED AND TRANSITION ECONOMIES 155, 155–72 (Hana Polackova Brixi, Christian M.A. Valenduc & Zhicheng Li Swift eds., 2004).

28. According to Daniel Shaviro, "by 1959, the German government had begun reporting on subsidies in the federal budget, including those supplied through the tax system." *See* Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX L. REV. 187, 199 (2004) (describing the origins

for coining the term "tax expenditures." He first used it publicly in a November 15, 1967, speech in New York before the Money Marketeers[29] titled "The United States Income Tax System: The Need for a Full Accounting."[30] However, Surrey started working on tax expenditures several years before assuming his position at the Treasury. In an unpublished 1961 manuscript, Surrey considers whether an "objective should be reached by a tax technique or by an expenditure technique,"[31] though the term, "tax expenditure," was not used.[32] Surrey considered tax expenditures to be special tax preferences, incentives, or subsidies, which are departures from the *normal* tax structure of raising revenue. These come in various forms of deductions, exclusions, credits, deferrals, or special rates, and represent government spending for favored activities through the tax system.[33]

To understand some of Surrey's tax expenditure analysis, consider his view of the *normal* income tax base. Surrey held that the tax base itself is not defined by the Haig–Simons definition of economic income[34] nor that there is a normative concept of that base.[35] Instead, the choice for how to apply a tax is a broader policy issue indicating a country's attitudes towards social behaviors and activities. Similarly, the rate schedules are not a normative concept, but are instead matters determined by fiscal policy.[36] Surrey held that once the rate structure has been established, a variation from that rate intended to provide a

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and reception of tax expenditure analysis). It is unclear to what extent the tax expenditure concept was noticeable outside Germany at the time. It gained notable popularity when introduced (and perhaps re-invented) by Surrey in the U.S. in 1967. *See id.* at 200. For more on tax expenditure analysis in Germany, see generally Harry A. Shannon III, *The Tax Expenditure Concept in the United States and Germany: A Comparison*, 33 TAX NOTES 201 (1986).

29. The Money Marketeers are a New York group which provide a "forum for engaging, meaningful and substantive dialogue with U.S. policymakers, senior Federal Reserve officials, and other distinguished speakers." *See* MONEY MARKETEERS OF NEW YORK UNIVERSITY, INC., https://moneymarketeers.org/ [https://perma.cc/5RWP-W63P] (last visited Feb. 6, 2023).

30. Stanley S. Surrey, *The United States Income Tax System: The Need for a Full Accounting*, 125 J. ACCT. 57, 58 (1968); Stanley S. Surrey & William F. Hellmuth, *The Tax Expenditure Budget — Response to Professor Bittker*, 22 NAT'L TAX J. 528, 528 (1969).

31. Stanley S. Surrey, Agenda for Consideration of Tax Research Topics Possessing a Significant Legal Orientation 7 (1961) (unpublished manuscript) (on file with The Stanley S. Surrey Papers, Harvard Law School Library, Modern Manuscript Division Box 23, Folder 7).

32. In 1961, Surrey was a part of President-Elect Kennedy's Pre-Presidential Taxation Task Force. The task force was responsible for designing tax policy during the Kennedy administration. The report on this task force was not made public and was even withheld from Congress. *See President's 1961 Tax Recommendations: Hearings Before the H. Comm on Ways and Means*, 87th Cong. 1971 (1961). The report may be accessed at the John F. Kennedy Presidential Library. *See* TAX'N TASK FORCE, TAX POLICY FOR 1961: CONTENTS, LISTING OF MATTERS COVERED, BRIEF SUMMARY OF RECOMMENDATIONS, DETAILED DISCUSSION OF RECOMMENDATIONS (Dec. 31, 1960) (on file in Taxation Task Force, Box 1072, Task Force Reports, Pre-presidential Papers, John F. Kennedy Presidential Library).

33. *See generally* Surrey & Hellmuth, *supra* note 30, at 528.

34. The Haig-Simons definition of income provides that income equals consumption plus change in net worth.

35. Stanley Surrey, Address at the International Institute of Public Finance, Subsidies, Tax Reliefs, and Prices: The Concept of Tax Reliefs—Its Relation to Tax Policy and Budget Policy (1977).

36. *Id.*

special tax benefit becomes a departure from a normal structure. Thus, the *normal* income tax with reference to tax expenditures can be identified by imposing the general schedule against a taxable unit's net income base. That base includes all items of gross income, from which costs related to the production of income are deducted.[37]

Professor Boris Bittker attacked the relatively undefined concept of a normal tax. Emil Sunley notes that one reason that Surrey developed a concept of a normal tax was that he felt that using Haig-Simon's income as the standard would get him laughed out of the room. He did not want imputed income of owner-occupied housing or the deferral of capital gains until realization to be considered tax preferences.[38]

Surrey treated corporate and individual taxes in their own boxes. Once a government determines its corporate-to-individual-income tax relationship, any departures from that decision can be tax expenditures.[39] Thus, the choice to exempt certain items from either the individual or corporate income tax base, due to economic or social objectives, becomes a tax subsidy because the tax base has been eroded.[40]

Today both the Treasury and the Joint Committee on Taxation indicate that their estimates on tax expenditures are largely based on special exceptions to taxing all income. They even use the term Haig–Simons income. Although they have made many additions over the years, differences remain here as well. For instance, imputed income from housing has been added by Treasury but not by the Joint Committee on Taxation. In the end, however, both their publications adopt many of the exceptions set out by Surrey, such as treating capital gains on a realization and not accrual basis.[41]

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37. *Id.*

38. Boris I. Bittker, *Accounting for Federal Tax Subsidies in the Budget*, 22 NAT'L TAX J. 244, 247–49 (1969); E-mail from Emil Sunley, Former Deputy Assistant Sec'y of the Off. of Tax Analysis, to C. Eugene Steuerle, Inst. Fellow & Richard B. Fisher Chair, Urb. Inst., and Assaf Harpaz, Visiting Assistant Professor, Drexel Univ. Thomas R. Kline Sch. of L. (Nov. 23, 2022, 7:20 P.M.) (on file with the authors).

39. Bittker, *supra* note 38.

40. Surrey & McDaniel, *supra* note 24, at 232.

41. U.S. DEP'T OF TREASURY, TAX EXPENDITURES, FISCAL YEAR 2024, at 1–2 (2022), https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2024.pdf [https://perma.cc/8K8A-FT8Q]; J. COMM. ON TAX'N, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2020-2024, at 4 (2020), https://www.jct.gov/getattachment/ec4fb616-771b-4708-8d16-f774d5158469/x-23-20.pdf [https://perma.cc/VGK3-XUC8]. Treasury now indicates up front that "tax expenditure estimates presented in this document are patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time," "using two methods of accounting: current tax receipt effects and present value effects," and including a "normal tax baseline and the reference tax law baseline." U.S. DEP'T OF TREASURY, *supra* note 41, at 1. The Joint Committee, in turn, presents estimates off of a "normal tax baseline" and indicates that the determination of whether a provision is a tax expenditure is made on the basis of a broad concept of income that is larger in scope than "income" as defined under general U.S. income tax principles." J. COMM. ON TAX'N, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2022-2026, at 3 (2022), https://www.jct.gov/getattachment/46c5da1a-424b-4a6f-bf6e-e076845b168d/x-22-22.pdf [https://perma.cc/R2MZ-RZVD]. Thus, both agencies come close to defining the baseline for tax

Surrey was clear that any special exception to the general rules of a baseline tax system—rather, than, say, lower tax rates or personal exemptions that serve as zero-rate brackets—has the same net effect on the budget as direct government spending. He argued that the use of a tax expenditure can create the illusion of lower government spending even when higher "spending" occurs nonetheless.[42]

Of course, tax purity can compete with other legitimate policy objectives. Peter Barnes notes that in negotiating a tax treaty with Bermuda, Colin Powell insisted that getting a treaty "was critical to national security, so that the U.S. could retain two naval bases. . .[for] surveillance of Russian submarines."[43]

A. Progressivity and Refundable Credits

Surrey's line of critique included progressive justifications. Surrey held that wealthy taxpayers do not pay effective tax rates at the levels prescribed by the tax rate schedules, almost exclusively due to the tax expenditure budget and its benefits.[44] According to Surrey, tax expenditures in the form of deductions and exclusions—which vary by the marginal income tax bracket—can create a regressive upside-down subsidy.[45] These upside-down subsidies benefit taxpayers in the higher-marginal tax brackets over lower-income taxpayers.[46]

Some of these distributional considerations need historical context. In 1960, Aid to Families with Dependent Children (AFDC) was the only major federal means-tested program, and Social Security was modest in size. But with the vast expansion of domestic policy, paid for in no small part by a decline in the relative importance of the defense budget, came many new program enactments and expansions, including Medicare, Medicaid, and food stamps (now SNAP). Some exclusions of direct spending from the tax base, such as military housing and Social Security benefits, have been added over time to the formal publications of tax expenditures. Some have not.[47]

The IRS became a major distributor of refundable benefits for those with little or no tax liability with the enactment of the Earned Income Tax Credit (EITC) in 1975 and its subsequent expansions, especially in 1986, 1990, and 1993; a partially refundable child tax credit was later to follow.[48] Before the addition of

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expenditures as economic income or the Haig-Simons definition of income. But then they, too, establish many exceptions, often for reasons of practicality.

42. Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679, 697–98 (1976).

43. E-mail from Peter Barnes, *supra* note 16.

44. Surrey & McDaniel, *supra* note 24, at 254.

45. *Id.* at 255.

46. Stanley S. Surrey, *Government Assistance: The Choice Between Direct Programs and Tax Expenditures*, 8 TAX NOTES 507, 509–10 (1979).

47. Some are included in the tax base: the exclusion of the benefit of subsidies for military housing and the exclusion of some Social Security benefits. *See also* Part III Subsection D on the "outlay equivalent" tax expenditure budget.

48. Significant expansion occurred during both the George H.W. Bush and Bill Clinton administrations, beginning with their expansions of the Earned Income Tax Credit. *See generally* ERIC

these individual tax credits, most individual income tax expenditures were in the form of deductions and exclusions, though the investment tax credit for businesses began in 1962. Since those deductions and exclusions are of higher value to taxpayers with the highest tax rates and the most expenses, many still are of little value to low and moderate-income taxpayers. Connecting a tax base reform with progressive increases in revenues tends to give it a liberal interpretation but does not account for Congress's ability to use the revenues to lower tax rates and maintain progressivity, an issue discussed further below.

Surrey, of course, recognized that tax expenditures represented spending in disguise, and because of regressivity and their hidden nature, he generally portrayed them as bad. However, another tailwind behind the growth in tax expenditures likely was the desire of the tax-writing committees to share in the credit that appropriators enjoyed for giving away money to individuals. Ever less was the role of the tax-writing committees to provide "ways and means"—that is, to raise revenues. Indeed, the largest direct expenditure programs of the federal government—Social Security and health—are largely under the jurisdiction of the tax-writing committees, which deal with direct spending, tax expenditures and revenues associated with those programs.

B. Surrey's Continued Involvement

Surrey supported repealing most tax expenditures. He proposed that tax-favorable treatments should generally be replaced by direct government spending or terminated altogether.[49] He believed not only that repealing most tax expenditures would create a more equitable, progressive, and transparent tax system.[50] He also thought that *enormous* tax simplification could be accomplished by eliminating all tax expenditures present in the income tax system.[51] Surrey, however, recognized that an all-or-nothing approach would be nearly impossible.[52] If, however, tax expenditures were replaced by direct government programs, an ensuing question arises: would the direct program be more complex, equitable, efficient and administrable than the tax expenditure it replaced?

Many of Surrey's positions were expressed during an hour-long interview with William F. Buckley Jr. in a 1974 episode of the public affairs television show *Firing Line*.[53] In the interview, Surrey explains that the government should

TODER, URB. INST., THE CHANGING COMPOSITION OF TAX INCENTIVES: 1980–1999 (1999), https://www.urban.org/sites/default/files/publication/69911/410329-The-Changing-Composition-of-Tax-Incentives.pdf [https://perma.cc/G73H-4E6L].

49. *See generally* Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352 (1970).

50. Stanley S. Surrey and Paul R. McDaniel, *The Tax Expenditure Concept: Current Developments and Emerging Issues*, 20(2) B.C. L. REV. 225, 255 (1979).

51. *Id.* at 276.

52. *Id.* at 277.

53. Firing Line with William F. Buckley, Jr., *Tax Reform*, YOUTUBE (Jan. 27, 2017), https://www.youtube.com/watch?v=wq3qC-C_r-8 [https://perma.cc/87JM-F7F9].

eliminate most tax expenditures in favor of direct expenditures, but he refrains from speaking in absolutes.[54] Among his important contributions on the tax expenditure concept was *Pathways to Tax Reform: The Concept of Tax Expenditures,* published in 1973.[55]

Surrey's continued efforts remind us of Robert Ball, long associated with the development of Social Security legislation. The men not only helped direct legislative policy while in government but for years afterward acted as major guardians of a systematic, almost canonical, approach to policy, whether in tax or Social Security. One can debate how systematic and consistent those systems were, as we do below, but they provide a baseline against which different policies and policy proposals can be assessed. Anyone familiar with the random ways that most policy is enacted—with interest groups fighting with limited appeal to principle—knows that an imperfect standard or baseline almost always trumps no standard at all.

Two anecdotes reveal that intense level of engagement. When an Office of Tax Analysis paper on tax expenditures for healthcare was published, it suggested that a deduction for extraordinary health costs might be justified as an adjustment for ability to pay.[56] As an example, someone with $50,000 of income and $50,000 of health care expenses might have no ability to pay tax—though the paper left open the question of whether this was a well-designed subsidy. Surrey contacted the authors by phone to convey in no uncertain terms that this analysis was incorrect. The tax code was no place to consider this or any other type of expenditure.[57] In another case, Surrey objected to the Treasury's addition to the tax expenditure budget of the exclusion from taxation for employer-provided educational expenses, as these expenses were allowed by regulations interpreting "ordinary and necessary" business expenses, which were not a tax expenditure. The Treasury should not take the position that regulations interpreting the law create a tax expenditure. The non-taxation of these benefits, however, might be a tax expenditure, but that was not Surrey's issue.[58]

While anecdotal, these examples also demonstrate one of the debates over the appropriate tax base. Adjustments for ability to pay may not reflect economic income or Surrey's sense of a normal tax base, but whether they are bad cannot be assumed automatically just because they are tax expenditures. Perhaps he was thinking that they could not easily be replaced by some direct spending program.

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54. *Id.* at 4:25.

55. *See generally* STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973).

56. *See* C. Eugene Steuerle & Ronald Hoffman, *Tax Expenditures for Healthcare* (Office of Tax Analysis Paper No. 38, Apr. 1979), https://home.treasury.gov/system/files/131/WP-38.pdf [https://perma.cc/T4VB-EWEP].

57. *See generally id.*

58. E-mail from Emil Sunley, Former Deputy Assistant Sec'y of the Off. of Tax Analysis, to C. Eugene Steuerle, Inst. Fellow & Richard B. Fisher Chair, Urb. Inst., and Assaf Harpaz, Visiting Assistant Professor, Drexel Univ. Thomas R. Kline Sch. of L. (Nov. 23, 2022, 7:20 P.M.) (on file with the authors).

C. Capital Income

Work within the OTP continued after Surrey's departure. More tax expenditures were added to the published list not simply because of new congressional legislation, but also because the prior work had been incomplete.

Many debates also ensued. Those emphasizing the merits of a consumption tax—or a consumed income tax—over an income tax would suggest that preferences for capital income should not be treated as tax expenditures. To the extent that tax expenditures are thought of as inherently bad, one can see why consumption tax advocates would object to the message conveyed by including those capital-related items. Capital income items are always among the most complex issues of taxation.

In the Budget for Fiscal Year 1983, the debate over capital income items was resolved in part when the Treasury created a second tax expenditure budget: the reference law baseline. The Joint Committee continued to publish only one tax expenditure budget.

Speaking generally, most capital income subsidies began to be included as tax expenditures in the normal baseline, as it had developed over time, but many would now be excluded from the reference baseline. These exclusions included depreciation in excess of straight-line depreciation, preferential rates for capital gains, and corporate rates below the maximum statutory rate. In some ways, this allowed those favoring income taxes over consumption taxes, or vice-versa, to choose the tax expenditure budget they wanted to use.

There are some ways in which the "normal" tax expenditure budget, as promoted by Surrey, fell between these two expenditure budgets. As noted, Surrey also would not have listed accelerated depreciation as a tax expenditure. In the reference baseline, tax preferences that represented substitutes for a defined spending program were to be included, while preferences that reflected an arguably flawed income tax rule but for which there is no clear spending analogy would be excluded.

Near the end of the Reagan Administration, the Treasury also developed—and OMB published—an *estate* tax expenditure budget. It was soon dropped, and the Office of Management and Budget no longer publishes it along with budget appendices that contain the income tax expenditure budget. This was almost assuredly a political position built largely around opposition to the tax itself. That estate taxes may or may not be meritorious in the aggregate—for example, they could involve double taxation of some income—does not mean that separate provisions favoring, say, farmers and family-owned businesses, still should not be examined regularly for their cost and effect on the distribution of estate taxes. A similar analysis can be applied to Social Security taxes.[59]

The controversies continued over time. The Office of Management and Budget in 2002 argued that the norm for taxation should be consumption or

59. Jonathan Barry Forman, *Comparing Apples and Oranges: Some Thoughts on the Pension and Social Security Tax Expenditures*, 5 EMPLOYEE RIGHTS AND EMPLOYMENT POL'Y J. 297 (2001).

consumed income and stated that "the concept of a tax expenditure is of questionable analytic value."[60] Of course, the Administration then was in the midst of proposing a number of tax reductions for capital income that would show up as higher tax expenditures in the normal tax expenditure budget.[61]

D. The Outlay Equivalent Budget

Seymour Fiekowsky, one of the finest minds ever to work in the OTP, at the same time worked on another permutation. Fiekowsky emphasized that many tax expenditures were nontaxable, which meant that the tax expenditures should be grossed up often by dividing the direct tax expenditure estimate by *one minus the marginal tax rate applying to those expenditures*. For instance, someone receiving a tax credit of $100 and in a fifty percent tax bracket would receive a benefit equivalent to $200 in taxable earnings. To account for these additional subsidies, Fiekowsky developed, and the Treasury published, an "Outlay Equivalent" budget. As was true for other tax expenditures, the analysis was not always complete. That is, many outlays themselves are nontaxable and excluded from the tax expenditure budget. To the extent they are included, adding together the direct spending cost of a provision and its nontaxability comes close to the outlay equivalent for tax expenditures developed by Fiekowsky.[62]

These permutations on a budget that itself was occasionally revised to include more items often added to confusion. Surrey vigorously disagreed with Fiekowsky on this alternative budget. Emil Sunley, Deputy Assistant Secretary of the Office of Tax Analysis when the budget was first published, has commented to us that the confusion that resulted may not have been worth the effort, and, indeed, the outlay equivalent budget is no longer published.

Among the most useful of analyses for categorizing different types of tax expenditures have been those of Eric Toder, at times with his colleagues Allison Rogers and Sarah Calame. They classify tax expenditures into four categories: (1) individual versus corporate; (2) personal versus business; (3) tax structure provision versus spending substitute provision (note the close relationship to the outlay equivalent discussion); and (4) form of incentive (deferral, exclusion, deduction, special rate, or credit). They also attempt to trace the aggregate size of tax expenditures from 1985 onward.[63]

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60. OFF. OF MGMT. & BUDGET, ANALYTICAL PERSPECTIVES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 2002, at 61 (2001), https://www.govinfo.gov/content/pkg/BUDGET-2002-PER/pdf/BUDGET-2002-PER.pdf [https://perma.cc/NU3Z-4YR8].

61. *See generally* U.S. DEP'T OF TREASURY, OFF. OF MGMT. & BUDGET, TAX EXPENDITURES (2002), https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2002.pdf [https://perma.cc/984C-NFQN].

62. Technically, the value of nontaxable direct expenditures included in the normal tax expenditure budget understates their value, since there is a multiplier effect due to extra tax benefits themselves being taxable. That is, the value can be calculated by dividing the spending by $(1 - t)$, then subtracting the direct spending, as opposed to multiplying by t, where it is the average marginal tax rate.

63. CALAME & TODER, *supra* note 26, at 2; ALLISON ROGERS & ERIC TODER, URB. INST. & BROOKINGS INST. TAX POL'Y CTR., TRENDS IN TAX EXPENDITURES, 1985-2016 (Sept. 16, 2011), https://www.urban.org/sites/default/files/publication/27561/412404-Trends-in-Tax-Expenditures---.PDF

IV

TAX EXPENDITURES AND THE TAX REFORM ACT OF 1986

In his State of the Union address in 1984, President Reagan called for a tax reform study to be conducted by the Treasury Department and released after the presidential election. Congress—or at least the Democratic members—broke out in laughter, in part because the 1981 tax legislation had engaged in a large number of giveaways and erosions of the tax base and in part because the issuance of the study was to occur only after the 1984 election. In fairness to the President when it comes to tax expenditures, he had proposed only one major tax base erosion in 1981—a system of cost recovery that essentially greatly accelerated depreciation mainly for equipment. Congress, however, proceeded to add many new giveaways in what was widely viewed as a Christmas tree bill. Republican Senators like Bob Dole (R-Kansas) and Pete Domenici (R-NM) later led efforts to cut back on some of those items and to expand the tax base in deficit-reducing bills in 1982 and 1984.

The Treasury's effort followed upon examples in *Blueprints for Basic Tax Reform*—a Treasury study issued in 1977 and led by David Bradford—and various bills in Congress, the most well-known of which was put forward by Senator Bill Bradley (D-NY) and Representative Dick Gephardt (D-MO) ("Bradley-Gephardt").[64] Unlike Bradley-Gephardt, these other Congressional bills, usually failed to maintain revenues. The most significant of those alternatives was put forward by Representative Jack Kemp (R-NY) and Senator Robert Kasten (R-WI), thus providing some bipartisan movement toward reform.

The Treasury responded with a proposal that was far more comprehensive than any of these and, for that matter, any proposal since then.[65] Hundreds of provisions of the tax code were examined, some for the first time.[66] Because the White House did not want this task to enter the presidential election debate, Treasury staff were left alone with the Secretary of Treasury to construct a reform plan. Taking advantage of the window of opportunity, they investigated items

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[https://perma.cc/LHK8-8D4A]. *See also* DONALD MARRON & ERIC TODER, URB. INST. & BROOKINGS INST. TAX POL'Y CTR., TAX POLICY AND THE SIZE OF GOVERNMENT (2012), https://www.urban.org/sites/default/files/publication/23741/412850-Tax-Policy-and-the-Size-of Government.PDF [https://perma.cc/43YE-SSJW].

64. Bill Bradley & Richard Gephardt, *Fixing the Income Tax with the Fair Tax*, 3 YALE L. & POL'Y REV. 41, 41–57 (1984); U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977), https://home.treasury.gov/system/files/131/Report-Blueprints-1977.pdf [https://perma.cc/M4NV-TYPR].

65. Full disclosure: Steuerle served as economic coordinator and original organizer of the Treasury effort under John E. (Buck) Chapoton (Assistant Secretary) and Charles E. McLure (Deputy Assistant Secretary for Tax Analysis).

66. A much fuller assessment of successes and failures of the overall project can be found in C. EUGENE STEUERLE, THE TAX DECADE: HOW TAXES CAME TO DOMINATE THE PUBLIC AGENDA (1992); and, in a shorter form, within C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY (2d ed. 2008).

that had long been ignored or not fully analyzed, even including issues as narrow or sensitive as parsonage allowances, the right depreciation rate for permanent tunnel bores, and completed contract timing issues. It was far more than an academic treatise and contained a second how-to volume that provided a detailed rationale for each of a very large number of proposals. That volume then outlined roughly how such provisions might be drafted. The study examined exclusions and not just the itemized deductions—most tax reform studies emphasized the latter because they were visible on tax returns and data on them was more readily available. The study tackled each itemized deduction in detail and did not accept simple fixes like just proposing some overall cap on the rate of subsidy for all of them, as in Bradley–Gephardt and proposals to this day.

Beyond revenue and distributional neutrality, the Treasury was constrained to deal only with provisions in the Tax Code and under the purview of the tax-writing committees. That meant that a tax expenditure could not be proposed in exchange for a direct expenditure, even if the latter were considered better. Some staff members had to remove suggestions that a provision should be replaced with a direct expenditure from their drafts.[67] The tax provision might be proposed for elimination or paring, but the primary exchange had to be for another tax provision or lower tax rates.

One reform the Treasury undertook was to exchange a group of purportedly inefficient tax subsidies for low-income housing tax credit that help finance housing construction for low-income households. In testimony before the Ways and Means Committee on this issue soon after the reform, it was noted that direct spending vouchers might be superior to the credit. Charles Rangel (D-NY), then chair of the Committee, leaned across the dais and said something to the effect of "[w]hen our committee has jurisdiction over housing vouchers, we can discuss them. For now, let's stick with the credit."[68] This example shows how the formal division of the budget into direct and tax expenditures can reinforce jurisdictional problems in reforming them together, particularly when Congress undertakes tax and expenditure reform separately and through different committees.

As part of its efforts in preparing the 1984 study, the Treasury staff often did turn to the tax expenditure budget. The staff had a leg up on both the revenue and distributional consequences of many of the provisions within that budget, as it had already been prepared for many years. But as a guide to broad policy reform, it had many limits that extend beyond jurisdictional issues, as summarized in the subparts below.

67. Author's recollection.

68. *Low-Income Housing Tax Credits and the Role of Tax Policy in Preserving the Stock of Low-Income Housing: Hearings before the H. Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 100th Cong. (1988) (statement of Charles Rangel, Chairman, Subcomm. on Select Revenue Measures). Though we can find no record of this discussion in the record, it may have been deleted in the editing of the transcript. It provides a good example of the limitations of pure tax reform, regardless.

A. Tax Rates and Tax Base

Broad tax reform often deals with both the tax rate schedule and tax base at the same time. In anticipating what could be done to respond to President Reagan's request, and given his concern over tax rates and revenues, the Treasury decided to propose a broad reform that was both revenue and distributionally neutral. This puts almost the entire focus of reform on the efficiency and equal justice—horizontal equity or equal treatment of equals—of different provisions which are largely associated with how the tax base is defined.

B. Progressivity

Closely related, once tax rates are changeable and designed to hit a certain target—in the case of Treasury's 1984 study, to sustain overall progressivity—then there is no argument about the regressivity or progressivity of repealing or adding any particular tax provision. After all, rates would be adjusted to restore roughly the same overall progressivity of the tax system. In fact, staff had to be told that it could not argue against a particular tax expenditure because of its regressivity. They could suggest that the allocation of a particular subsidy failed to meet its objective—for example, more universal home ownership—by concentrating benefits among those with higher incomes and higher tax rates. Staff could not suggest, however, that eliminating, reducing or expanding it would affect progressivity or revenues in the package as a whole.

C. From Tax Expenditures to Economic Income to Ability to Pay . . . With Caveats

In the end, the baseline against which many choices were made—that is, the North Star guiding reform—was an attempt to measure the correct tax base according to some measure of ability to pay. Ability to pay, in turn, was largely but not entirely based on economic income. To move along the project in the midst of a debate over a consumption versus income tax, the first modules sent to the Secretary for examination concentrated on equal treatment of those with equal incomes *and* equal consumption, thus deferring decisions over what to do about capital income.

D. The Value of Some Tax Expenditures

Some tax expenditures were deemed worthy of retention as a matter of good policy. Unlike many other deductions, the charitable deduction was viewed as providing positive externalities, not negative ones. It was viewed as justifiable both on the basis of ability to pay—after contributions were made—and its incentive effect. The EITC was deemed worthy of both retention and increase as a wage subsidy. Also, taxpayer eligibility for the EITC was confirmable based mainly on W-2 reports on wages to the IRS, and, hence, likely more easily administered by the IRS than another agency when dealing with taxpayers.[69] The Research and Development Tax Credit was accepted as a way to support research and also an item more easily administered by the IRS when dealing with business filing. Put another way, many tax expenditures might represent bad budget accounting—or be better measured as outlays than tax reductions—but their programmatic merit had to be judged by the same standards as direct expenditures and the place of administration by whether the IRS or another agency would be the better administrator.

E. Negative Tax Expenditures and Double Taxation of Income

The Treasury effort groped with ways in which the tax base not only excluded some income from tax, but excessively included other income. Most relevant, the corporate and individual taxes were treated together, and a proposal was made to further integrate them. Once economic income was accepted as the main—but not complete—base through which to define who had equal ability to pay, there was no need to double tax the same income. At the same time, the Treasury recognized that corporations served as useful tax collectors for corporate earnings. This led to much discussion about how to administer an integrated system.

As can be seen by this short list, no matter how purely one tries to define the tax base, whether relative to tax expenditures, economic income, consumption, or ability to pay, conflicting principles allow for alternative choices. Should state and local taxes be treated as an adjustment for ability to pay federal tax or as payments for services received? What should be done about unrealized income due to accrued gains that are often not measured? What about pension plans, which effectively allow a type of consumption tax treatment within an income tax?

V
FURTHER NOTES ON THE EVOLUTION OF THE TAX EXPENDITURE DISCUSSION

The tax expenditure discussion goes beyond what might or might not be included in an appropriate tax base. Three are discussed here: when tax expenditures appeal less to elected officials than direct expenditures or the higher tax rates they induce, refundable credits that are treated partly as outlays and partly as tax expenditures, and the implications for tax expenditure analysis by the replacement of the dependent exemption with child credits.

69. Not to understate its problems of administration, it has proven difficult to define who is an eligible child and who is the parent or guardian who can claim credit for the child. Also, tax noncompliance has always been a major issue for the self-employed; the traditional problem of detecting understated income becomes expanded with the EITC, when some taxpayers can obtain additional credits by overstating income. Whether the EITC is worse or better than direct expenditures for low-income individuals requires multiple calculations beyond just whether it is a tax expenditure.

A. Flipping of the Tax Expenditure Debate

The advantage to policy makers in spending through the Tax Code is well understood. However, bipartisan majorities supporting both the Tax Reform Act of 1986 and a report produced by the National Commission on Fiscal Responsibility and Reform showed the flip side. Democrats could at times get behind tax expenditure reform when faced with an opportunity to reduce them in exchange for rate reduction than on net increased progressivity. Republicans could get behind tax expenditure reform as an alternative to rate increases as part of budget reform or in exchange for lower rates in tax reform. If tax expenditures hide spending, the removal of tax expenditures hide the reduction in spending.[70]

B. Refundable Credits

The EITC makes apparent the somewhat arbitrary issue of whether to treat a tax credit as a tax expenditure or a part of direct spending. Today's budget convention requires treating it as a tax expenditure to the extent that it reduces taxes otherwise due and as an outlay (direct spending) to the extent that it entails refundable credits over and above any income tax due. The tax expenditure and outlay costs are even counted separately in the Treasury's tax expenditure budget publications, and the alert reader must look to footnotes to figure out how they add up. In the JCT publication, the footnote separates out the two components. The investment tax credit and the research and development tax credit have at times also raised issues of whether they should be available as outlays to nontaxpayers.

C. Dependent Exemptions and Child Credits

The dependent exemption, like the taxpayer exemption, has long been recognized as creating a zero-bracket amount, with differences based on household size.[71] A household of four has less ability to pay tax than a household of one or two, even if the incomes are the same. The child credit came along much later and has been at least partially refundable. Surrey did not feel that tax expenditures should include the bracket rate structure, including the zero-bracket amount created by dependent exemptions. But the child credit now can be viewed as both a subsidy for raising children and an adjustment for ability to pay based on household size. Illustrating the somewhat arbitrary nature of any tax expenditure definition, it makes little sense to believe that tax expenditures

70. THE WHITE HOUSE, THE MOMENT OF TRUTH: REPORT OF THE NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM (2010), https://www.ssa.gov/history/reports/ObamaFiscal/TheMomentofTruth12_1_2010.pdf [https://perma.cc/FDT8-J3ZZ]. Again, some of this evidence is anecdotal, but I was the only person asked to testify on tax reform and was told afterward that it was a turning point in finding an area of agreement.

71. In 2017, Congress replaced both exemptions with an expanded standard deduction and expanded child credit. We do not engage here the further issue of whether a standard deduction operates as a zero-bracket amount or a simplified allowance for itemized deductions when it too, serves more than one purpose.

suddenly rose to the extent that the child credit simply displaced the dependent exemption.

D. Present Value and the Timing of Tax Expenditures

Unlike revenue estimate, tax expenditure estimates are based on change in liability and not change in receipts. Accordingly, the revenue cost of a tax expenditure for a given year is often not the same as the revenue that would be gained if the tax expenditure were repealed going forward. Nor does it often represent the long-term cost of the new preferences declared in a given year. Consider deferral preferences such as for equipment purchases or for employee compensation put into a retirement account. Nonetheless, in the Budget for Fiscal Year 1996, the administration first provided present value estimates for some tax expenditures that involved deferral.

E. Dynamic and Static Analysis and Incidence

Tax expenditure estimates do take account of behavioral adjustments, including portfolio decisions such as the reduction in capital gains realizations when tax rates on those gains are raised. Changes in aggregate economic output, however, are not included, in part because a budget generally must be presented based on one level of economic income, not income that would change with every action of Congress. There is one exception: when the Office of Management and Budget puts forward the president's budget, the economic assumptions (at least in theory) represent the economy that would occur if that budget were enacted in its entirety, including feedback effects from dynamic scoring. Similarly, tax expenditure estimates generally do not take account of some ultimate incidence of each provision.

VI

CONCLUSION

Within the United States government, the OTP still stands out as a premier institution. Its analysis is top notch, even when insufficiently appreciated by elected officials. That development owes much of its evolution to Stanley Surrey and the many people he influenced, including those who knew him as students, colleagues, or through his work.

The practice of providing annual lists of tax expenditures and their costs, which was one of his most important innovations, remains an extremely useful way to call attention to many provisions of the Tax Code. Further, by tracking their revenue and sometimes distributional impact each year, the OTP and Joint Committee on Taxation are better prepared to provide advice and analysis on those provisions. Regardless of somewhat narrow debates over what to count in the budget, the very listing of these items calls elected officials to give them attention. The power and usefulness of these budgets is reflected in the work now done in at least eighty countries to examine tax expenditures.

Still, while many tax reform efforts attempt to cut back on tax expenditures as a way to expand the tax base and raise revenues, such efforts are incomplete and imperfect in trying to assess the merits of the overall tax structure. Assessment of the appropriate tax base must allow for other approaches like ability to pay, and there is no reason to accept or reject tax expenditures because they are progressive or regressive in and of themselves, when rates and other alternatives can deal with progressivity.

None of this mitigates the contributions made through the evolving development of the tax expenditure concept. Policy making is always better when individuals like Surrey stand up for the integrity of institutions of policy making or set up a useful baseline against which to measure a policy's costs and achievements. Surrey did both extraordinarily well.