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The Forgotten Entitlements: Reforming the Congressional Budget Process to Contain the Growth of Tax Expenditures

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The Forgotten Entitlements:

Reforming the Congressional Budget Process to Contain the Growth of Tax Expenditures

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INTRODUCTION

In 2007, most Americans read that the federal government spent about \$2.7 trillion dollars.¹ In fact, the government spent more than \$3.7 trillion.²

As the tremendous scope of the nation's coming fiscal crisis has become more apparent,³ scholars and experts from across the political spectrum have focused on developing reforms to maintain budgetary stability. But in focusing on the looming federal deficits and the need for reform, politicians and policy experts have by and large directed most of their efforts at proposing changes to Social Security, Medicare, and Medicaid.⁴ While the expected growth in these three programs due both to the retirement of the Baby Boom generation and the rapid pace of health care inflation make these programs undoubtedly the greatest driver of projected future deficits,⁵ another significant and disturbing fiscal trend has largely flown under the radar.⁶ Since the most recent major tax code rewrite in 1986, Congress has increasingly and stealthily used so-called "tax expenditures" to accomplish its policy objectives in lieu of annual appropriations.

¹ Congressional Budget Office, Historical Budget Data, <http://www.cbo.gov/budget/historical.shtml> (last visited February 24, 2009).

² See THOMAS L. HUNGERFORD, CONGRESSIONAL RESEARCH SERVICE, REPORT FOR CONGRESS, TAX EXPENDITURES: TRENDS AND CRITIQUES 22 (2008), available at <http://wikileaks.org/wiki/CRS-RL33641> (estimating the revenue losses from tax expenditures at \$1.034 billion). See also CHYE-CHING HUANG & HANNAH SHAW, CTR. FOR BUDGET & POL'Y PRIORITIES, NEW ANALYSIS SHOWS "TAX EXPENDITURES" OVERALL ARE COSTLY AND REGRESSIVE: FINDINGS HIGHLIGHT NEED TO RESTRAIN TAX SUBSIDIES AS PART OF SOLUTION TO LONG-TERM BUDGET PROBLEMS 1-2 (2009), <http://www.cbpp.org/cms/index.cfm?fa=view&id=2662> (estimating the total cost of individual tax expenditures only at over \$700 billion, when incorporating interaction effects). See *infra* Part II.A for a discussion on the practical challenges to estimating the costs of tax expenditures.

³ See, e.g., U.S. GOV. ACCOUNTABILITY OFFICE, THE NATION'S LONG-TERM FISCAL OUTLOOK, GAO-09-405SP (2009) [hereinafter "GAO FISCAL OUTLOOK"].

⁴ See, e.g., Ezra Klein, *How Entitlement Reform Became Health Reform*, AMER. PROSPECT, February 23, 2009, http://www.prospect.org/cs/articles?article=how_entitlement_reform_became_health_reform ("It's testament to how deeply the idea of an entitlement crisis has embedded itself in Washington that news that Obama planned a "fiscal accountability summit" was immediately taken as proof by *The Washington Post* that he was readying a frontal assault on Medicare, Medicaid, and Social Security.").

⁵ GAO FISCAL OUTLOOK, *supra* note 3, at 1.

⁶ See U.S. GOVERNMENT ACCOUNTABILITY OFFICE, GOVERNMENT PERFORMANCE AND ACCOUNTABILITY: TAX EXPENDITURES REPRESENT A SUBSTANTIAL FEDERAL COMMITMENT AND NEED TO BE REEXAMINED 47, GAO-05-690 (2005) [hereinafter "GAO TAX EXPENDITURES"].

A tax expenditure is an exclusion from gross income, a deduction, or a credit designed to accomplish a specific policy aim and which causes the government to take in fewer tax revenues than it would otherwise. Tax expenditures are familiar to every American taxpayer, even if they may not realize their budgetary significance. Among the largest tax expenditures are the deductions of home mortgage interest, the exclusion of employer-provided health insurance coverage from gross income, and deductions for charitable giving.⁷ But other tax expenditures are more obviously special interest giveaways, such as the complicated tax subsidies for the timber industry⁸ or percentage depletion allowances for natural resource extraction.⁹ While the mortgage and health insurance tax provisions are so familiar to average Americans that their existence may seem harmless, economists and commentators have long recognized that tax expenditures are in fact, if not in name, a form of budgetary entitlement.¹⁰ Just like Social Security, Medicare, and Medicaid, these provisions give direct financial benefits to certain Americans, cost the government money (in the form of forgone revenue), and do not require annual authorization or appropriation.

These silent spending programs account for the difference between true budgetary reality and the federal spending total reported on the front page of the newspaper. Make no mistake—subsidizing a particular taxpayer’s activity through a tax deduction is no different from a

⁷ HUNGERFORD, *supra* note 2, at 4, Table 1.

⁸ *See, e.g.*, I.R.C. §631(b) (2006); I.R.C. §194 (2006). *See also* THE CENTURY FOUND., BAD BREAKS ALL AROUND: THE REPORT OF THE CENTURY FOUNDATION WORKING GROUP ON TAX EXPENDITURES 23 (2002) (listing the timber subsidies as one of their “dirty dozen” tax expenditures that should be eliminated); Michael P. Ettlinger, *Our Bucket is Leaking: Tax Expenditures and Loopholes in the Federal Budget*, in BAD BREAKS ALL AROUND: THE REPORT OF THE CENTURY FOUNDATION WORKING GROUP ON TAX EXPENDITURES 131-33 (The Century Found. ed., 2002) (describing many timber tax breaks).

⁹ *See* I.R.C. §613 (2006). *See also* Ettlinger, *supra* note 8, 129-30 (describing the oil and gas tax breaks including percentage depletion).

¹⁰ Indeed, for this reason former Federal Reserve Chairman Alan Greenspan prefers to call tax expenditures “tax entitlements.” HUANG & SHAW, *supra* note 2, at 1. *See also* HUNGERFORD, *supra* note 2, at 2 (“[T]ax expenditures are another form of entitlement spending.”); ALLEN SCHICK, THE FEDERAL BUDGET: POLITICS, POLICY, PROCESS 172 (3d ed. 2007) (“Tax expenditures are a form of entitlement.”).

budgetary standpoint than writing that taxpayer a check.¹¹ And yet, because of the underlying structure of the tax code and because the federal budget process treats tax expenditures as hidden entitlements rather than as direct spending, the use of tax expenditures to advance social policy leads to deeply troubling consequences for both fiscal discipline and income inequality.

This paper begins in Part I by discussing trends in the use of tax expenditures to achieve policy objectives, and describes briefly how political incentives perversely encourage tax expenditures over direct spending. Part II surveys the many criticisms of tax expenditures, including their lack of transparency and accountability and their intrinsic regressivity. Part III discusses possible ways to define tax expenditures—a threshold question before any structural reform can be undertaken. Finally, Part IV contains a list of potential budget procedural reforms that can reduce the temptation for Congress to continually expand the size of the tax expenditure budget. Some of these proposals are new ideas tailored to the current political realities, and others are adopted from old or abandoned reform proposals that deserve a new life in the face of the nation’s pressing fiscal challenges.

I. TRENDS IN TAX EXPENDITURES

In fiscal year 2007, tax expenditures cost the federal government over \$1 trillion—or 7.6% of GDP—in forgone revenues.¹² If all these tax expenditures were eliminated, the

¹¹ Or, as Prof. Westmoreland explains, “whether taxes are collected and spent on widgets or whether widget-purchasers can deduct widget costs from their taxes, federal money is used to reduce or pay the costs of widgets.” Tim Westmoreland, *Standard Errors: How Budget Rules Distort Lawmaking*, 95 GEO. L.J. 1555, 1568 (2007). See also Eric J. Toder, *Tax Cuts or Spending – Does it Make a Difference?*, NAT’L TAX J., September 2000, at 361, 363 [hereinafter “Toder, *Tax Cuts*”], describing how it would be theoretically possible to structure the entire defense budget as a tax cut (i.e., by giving defense contractors a refundable tax credit for supplying weapons to the government for “free”) or to partially pay schoolteachers with a tax cut (as was once proposed in California).

¹² HUNGERFORD, *supra* note 2, at 22. Tax expenditures for individuals (i.e., excluding tax benefits for businesses) totaled \$760.5 billion in FY2007. HUANG & SHAW, *supra* note 2, at 1. *But see infra* Part II.A (describing potential complications with estimating tax expenditures).

government could cut all tax rates by about 37% with the added revenue.¹³ This growth has been fueled by an expansion in the number of tax expenditures from 60 in 1972 to 170 in 2007.¹⁴ Between 1980 and 2007, the share of total government support distributed through tax expenditures increased from 23% to 27%.¹⁵ Tax expenditures have grown faster than the economy in most years since data began being collected in 1967.¹⁶ But this modest percentage increase is misleading because the share of government support for health care delivered through tax expenditures has been decreasing due to the dramatic growth in the costs of government health care programs such as Medicare and Medicaid.¹⁷ In every other functional category of spending analyzed by the Congressional Research Service, the government is increasingly reliant on tax expenditures to accomplish its policy objectives.¹⁸

These trends are not surprising. Tax expenditures are politically attractive because they enable political leaders to “have their cake and eat it too”¹⁹ by “appear[ing] to reduce spending and taxes, while at the same time pursuing an activist policy that promotes popular programs.”²⁰ Alternatively, tax expenditures can be attractive means for accomplishing unpopular policy objectives because tax expenditures are less visible to the public.²¹

¹³ Ettliger, *supra* note 8, at 103. Note the rates could be cut by 37%, not by 37 percentage *points*.

¹⁴ STAFF OF J. COMM. ON TAXATION, 110TH CONG., A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS 4 (Comm. Print 2008), available at <http://www.house.gov/jct/x-37-08.pdf> [hereinafter “JCT RECONSIDERATION”].

¹⁵ HUNGERFORD, *supra* note 2, at 14-15.

¹⁶ Eric Toder, *Evaluating Tax Incentives as a Tool for Social and Economic Policy*, in BAD BREAKS ALL AROUND: THE REPORT OF THE CENTURY FOUNDATION WORKING GROUP ON TAX EXPENDITURES 39 (The Century Found. ed., 2002) [hereinafter “Toder, *Evaluating*”].

¹⁷ HUNGERFORD, *supra* note 2, 16.

¹⁸ *Id.* at 15, fig.2. In CRS’s “Commerce and Housing” category, for instance, virtually 100% of government support came through the tax code in 2007, up from about 90% in 1980. This category includes deductions for home mortgage interest and other tax subsidies for housing.

¹⁹ CENTURY FOUND., *supra* note 8, at 13.

²⁰ Toder, *Tax Cuts*, *supra* note 11, at 361.

²¹ See GAO TAX EXPENDITURES, *supra* note 6, at 69 (“Because tax provisions are not as visible in the budget as spending programs, there is an incentive for policymakers to use tax provisions rather than spending programs to accomplish programmatic ends.”).

II. CRITICISMS OF TAX EXPENDITURES

A. Transparency

As the opening statistic suggested, because tax expenditures do not appear in reported outlay totals, the true size of government and the true scope of the government commitment to various policy objectives is hidden.²² But even if an attempt were made to explicitly count tax expenditures in the annual budget outlays totals,²³ the cost of a tax expenditure is inherently uncertain. For example, while it is easy enough for the IRS to sum the total amount of special deductions claimed by the timber industry,²⁴ repealing the deduction would not result in the government collecting exactly this sum in revenue because the repeal of the deductions would, at least in theory, cause fewer companies to engage in lumber production and perhaps to find other means to shelter income.²⁵ By contrast, the cost of a discretionary spending program that directly subsidized lumber would be quite easy to calculate—simply the sum of all checks written by the treasury.

Additionally, eliminating two separate tax expenditures that cost the government \$100 million each would not necessarily generate \$200 million in additional revenue for two reasons. First, because taxpayers claim individual deductions only if the sum of such deductions exceeds the standard deduction, eliminating one tax expenditure may induce many taxpayers to instead claim the standard deduction, at which point those taxpayers would not see their liability reduced if a second deduction were also eliminated.²⁶ Second, eliminating the first deduction may push some taxpayers into a higher bracket, increasing the revenue that would be gained by eliminating

²² CENTURY FOUND., *supra* note 8, at 11.

²³ *See infra* Part IV.C.

²⁴ *But see infra* Part III.

²⁵ *See* JCT RECONSIDERATION, *supra* note 14, at 5.

²⁶ HUNGERFORD, *supra* note 2, at 7; GAO TAX EXPENDITURES, *supra* note 6, at 19.

the second deduction.²⁷ Without a definite understanding of the cost of a tax expenditure, it can be even more difficult to assess whether the provision is worth the benefits to society.²⁸

Tax expenditures also obscure the administrative costs of achieving a policy objective. Whereas in a direct expenditure program, administrative costs are typically directly accounted for as part of any appropriation, the costs of “administering” a particular tax expenditure is inextricably mixed with the overall cost of tax enforcement.²⁹ In other words, adding a new tax deduction to the Code does, at least in theory, incrementally increase IRS enforcement costs, either by directly requiring more IRS auditors or by causing the IRS to trade-off its limited enforcement resources to administer the new break.³⁰ But exactly how much a given tax expenditure costs to administer can never be known for certain, limiting the ability of Congress to assess whether the benefits of a tax provision are worth its costs.

Finally, tax expenditures also decrease the transparency of the tax code itself by increasing its complexity and requiring taxpayers to spend more time and effort preparing returns, and potentially increasing the risk of fraud. In 2007, taxpayers who filled out only forms 1040A or 1040EZ spent an average of 10.4 hours completing their returns.³¹ By contrast, taxpayers who filed form 1040, which is required to take advantage of the vast majority of tax expenditures, spent 33.5 hours on average preparing returns.³² Increased complexity also “endanger[s] the voluntary compliance on which tax administration depends” by creating

²⁷ HUNGERFORD, *supra* note 2, at 7; GAO TAX EXPENDITURES, *supra* note 6, at 19.

²⁸ See GAO TAX EXPENDITURES, *supra* note 6, at 21. Note that, though the exact cost to government is unknown, “the sum of tax expenditure revenue over time probably provides a good approximation of the *general trend* in the effect of tax expenditures on income tax revenue...[because] it is unlikely that the bias from simply summing tax expenditures estimates changes much from year to year.” HUNGERFORD, *supra* note 2, at 7 (emphasis added). See *supra* Part I for a discussion of general trends in tax expenditures.

²⁹ Toder, *Tax Cuts*, *supra* note 11, at 365.

³⁰ Toder, *Evaluating*, *supra* note 16, at 56.

³¹ HUNGERFORD, *supra* note 2, at 14.

³² *Id.*

taxpayer “frustration and resentment.”³³ Tax expenditures may also be more susceptible to fraud than direct spending programs because fraud in tax expenditures is only detected through random IRS audits, whereas direct spending programs involve individual eligibility assessments for each applicant.³⁴

B. Accountability

Because tax expenditures are not annually renewed in the appropriations process like ordinary spending, tax expenditure programs are rarely or never scrutinized for effectiveness.³⁵ Whereas most line items in the budget are defended in detail by the responsible agencies in lengthy “budget justification” documents, in oversight hearings, and performance audits, tax expenditure programs are not generally subject to such oversight.³⁶ Theoretically, the Administration is required by the Government Performance and Results Act of 1993³⁷ and OMB Circular A-11³⁸ to perform annual evaluations of tax expenditures, but the Clinton Administration confessed to being “unenthusiastic” about them and the Bush Administration never performed any at all.³⁹ This problem is compounded by the fact that many individual government agencies are reluctant to take responsibility for tax expenditures that arguably touch upon their policy spheres.⁴⁰

³³ CENTURY FOUND., *supra* note 8, at 12.

³⁴ *Id.* at 19.

³⁵ Westmoreland, *supra* note 11, at 1586.

³⁶ See GAO TAX EXPENDITURES, *supra* note 6, at 68-71.

³⁷ Pub. L. 103-63 (1993).

³⁸ OFFICE OF MGMT. & BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, OMB CIRCULAR NO. A-11§33.6, PREPARATION SUBMISSION AND EXECUTION OF THE BUDGET (2008), *available at* http://www.whitehouse.gov/omb/circulars/a11/current_year/a_11_2008.pdf. Notably, the OMB circular contains only about one-half of one page on guidance with respect to tax expenditures out of a 704-page document.

³⁹ HUNGERFORD, *supra* note 2, at 8.

⁴⁰ See GAO TAX EXPENDITURES, at 67 (“OMB officials told us that some agencies see tax expenditures as closely related to what they do and some do not, or agencies might not have enough knowledge about tax expenditures to consider them carefully.”).

Even if comprehensive analyses were rigorously conducted, the Congressional budget process does not place tax expenditures in direct competition with non-tax spending programs.⁴¹ Congress virtually never considers trading off a tax expenditure for a direct spending program (or, for that matter, vice-versa) because each type of spending takes a different path through Congress.⁴² If a performance evaluation concluded that a discretionary spending program would be preferable to an existing tax expenditure, in most cases a bill to make such a substitution would be required to move through multiple committees.⁴³ For example, first a tax writing committee would report (and Congress would have to pass) legislation repealing the expenditure. Then, an authorizing committee would have to authorize the new discretionary spending program. Finally, funds for the program would have to be included in an annual appropriation bill. By contrast, the appropriations committees can often directly trade-off funds between programs when fashioning annual appropriations legislation.⁴⁴

C. Progressivity

If a member of Congress proposed that the government write a check to all taxpayers to help pay for the cost of a mortgage, but stipulated that richer taxpayers with larger houses should receive bigger checks and less well-off taxpayers should receive smaller checks (or no checks at

⁴¹ See Westmoreland, *supra* note 11, at 1586.

⁴² JCT RECONSIDERATION, *supra* note 11, at n.9.

⁴³ SCHICK, *supra* note 10, at 172; HUNGERFORD, *supra* note 2, at 9. Each of the tax-writing committees do have jurisdiction over some spending programs, and so in theory a bill to trade-off a tax expenditure with spending on one of those programs might be simpler. HUNGERFORD, *supra* note, at 9. For example, the Senate Finance Committee has jurisdiction over both tax legislation and the Medicare program. See U.S. SENATE, 11TH CONGRESS, RULES OF THE SENATE, RULE XXV(1)(i) (2009), available at <http://rules.senate.gov/public/index.cfm?FuseAction=HowCongressWorks.RulesOfSenate>.

⁴⁴ *But see* Westmoreland, *supra* note 11, at 1582 (describing how subcommittee jurisdictional issues can “force choices between two worthy subcommittee priorities while leaving less worthy programs outside the jurisdiction unscathed”).

all), such a proposal would be “laughed out of Congress”⁴⁵ for its “upside-down”⁴⁶ subsidy. And yet, the Code achieves precisely that effect by providing a deduction for interest paid on home mortgages.⁴⁷ A similarly absurd example would be if Congress enacted a program that paid part of college tuition costs for families making between \$25,000 and \$100,000 per year, but gave no support to families making under \$25,000 per year.⁴⁸ Yet this very result is achieved through the HOPE scholarship tax credit.⁴⁹

More generally, tax expenditures like specialized deductions give greater benefits to wealthier taxpayers for two reasons. First, a deduction or exclusion is worth more to a taxpayer in a higher income bracket than it is to a taxpayer in a lower income bracket.⁵⁰ Second, deductions are only valuable to a taxpayer if that taxpayer itemizes (i.e., does not use the standard deduction). Richer taxpayers are far more likely to itemize than lower-income taxpayers.⁵¹ Finally, because most tax expenditure provisions are complex, they are most likely to be taken advantage of by more sophisticated taxpayers or taxpayers who can afford to hire an accountant.⁵²

⁴⁵ Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 722 (1970).

⁴⁶ Toder, *Tax Cuts*, *supra* note 11, at 6; Ettliger, *supra* note 8, at 102.

⁴⁷ See I.R.C. § 162(h)(2)(C) (2006).

⁴⁸ CENTURY FOUN., *supra* note 8, at 13. See also *id.* at 14 (describing how the revenues lost due to the HOPE credit could have instead been used to expand eligibility for Pell Grants); *infra* note 91 (describing then-candidate Barack Obama’s tax plans, including a proposal to make the HOPE credit refundable).

⁴⁹ See I.R.C. § 25A(d) (2006) (adjusted gross income limitation on HOPE credit).

⁵⁰ For example, a taxpayer in the 35% tax bracket who deducts \$10,000 in mortgage interest sees their tax liability decrease by \$3,500, while a taxpayer in the 15% bracket sees their liability decrease by only \$1,500.

⁵¹ See, e.g., ERIC J. TODER & CAROL ROSENBERG, THE TAX POLICY CENTER (URBAN INSTITUTE AND THE BROOKINGS INSTITUTION), THE SHARE OF TAXPAYERS WHO ITEMIZE DEDUCTIONS IS GROWING (2007), http://www.urban.org/UploadedPDF/1001054_Share_of_Taxpayers.pdf (explaining that the percentage of taxpayers who itemized grew to 35% in 2004, but that these taxpayers were overwhelmingly above the 50th percentile in income).

⁵² See HUNGERFORD, *supra* note 2, at 13.

Hard data confirm these general intuitions about the distributional implications of tax expenditures. Using the Suits progressivity index,⁵³ CRS calculated that many of the largest tax expenditures have severely regressive effects, with the worst offenders being the exclusion of interest on state and local government bonds, the deductibility of state and local government taxes, and the deductibility of charitable contributions.⁵⁴ For example, the average taxpayer making less than \$16,200 per year would realize only \$7.19 in tax savings as a result of the exclusion from income of employer-provided health insurance coverage, the average taxpayer making between \$16,200 and \$31,000 would realize about \$100 in savings, and the average taxpayer making over \$81,514 would realize \$1,482.17 in savings.⁵⁵ More generally, all tax expenditures combined increase after-tax income by 12.8% for taxpayers in the top 20% of the income distribution, but by less than 7% for taxpayers in the bottom 20% of the income distribution.⁵⁶

D. Benefits of Tax Expenditures

Despite these downsides, in certain circumstances a tax expenditure may be easier to administer than an ordinary spending program. Using the tax code to implement policy can obviate the need for an entirely new bureaucracy to distribute benefits—instead, the program merely piggybacks on the existing income tax reporting and refund system. Taxpayers are already required to file returns with the IRS, so tax expenditures do not require a “new point of

⁵³ The Suits index is calculated by drawing Lorenz curves that relate the cumulative percentage of tax benefits with the cumulative percentage of income and comparing the deviation from perfectly proportional benefits (i.e., taxpayers who collectively earn 50% of all taxable income receive 50% of all tax benefits from the deduction). The index ranges from -1 (all benefits go to the richest) to +1 (all benefits go to the poorest). See HUNGERFORD, *supra* note 2, at 23-24.

⁵⁴ *Id.* at 19-20.

⁵⁵ *Id.* at 21.

⁵⁶ HUANG & SHAW, *supra* note 2, at 2.

contact” between the government and a program’s intended beneficiaries.⁵⁷ Tax expenditures may be particularly efficient if eligibility for a particular benefit depends on information already provided to the government on a tax return or through the withholding system.⁵⁸ Eligibility for the EITC, for example, depends almost entirely on the income a taxpayer has earned over the course of the year. Thus, setting up the EITC as a separate government program with a separate administrative apparatus would be redundant and would needlessly require taxpayers to provide the government with the same information twice. The intended beneficiaries may also be more likely to claim a tax benefit than a direct spending benefit, because direct spending programs may require jumping through more bureaucratic hoops or may entail the stigma of being labeled a “welfare recipient.”⁵⁹

The key point that is emphasized throughout the literature and that underlies this paper is *not* that all tax expenditures are bad policy or that tax expenditures are never an appropriate policy tool.⁶⁰ Rather, the problem lies in the way the budget process and political dynamics incentivize using tax expenditures to achieve policy objectives even when an alternative method would be more fiscally responsible and less regressive.

III. DEFINITIONAL ISSUES

The Budget Act defines “tax expenditures” as

those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability....⁶¹

⁵⁷ CENTURY FOUND., *supra* note 8, at 20; Toder, *Tax Cuts*, *supra* note 11, at 368.

⁵⁸ Toder, *Tax Cuts*, *supra* note 11, at 369.

⁵⁹ CENTURY FOUND., *supra* note 8, at 20.

⁶⁰ *See, e.g.*, Toder, *Evaluating*, *supra* note 16, at 49 (“Labeling a program a tax expenditure does not itself say whether it is a good or a bad program.”).

⁶¹ 2 U.S.C. §622(3) (2006).

While many tax provisions clearly fit within this definition, the meaning of “special” is somewhat ambiguous. Historically, “special” was defined in reference to some baseline notion of federal revenues.⁶² That is, if the federal government was not “supposed” to be taxing a particular activity or source of income in the first place, the exclusion of tax on that income has not cost the government any forgone revenue. Thus, estimating the total level of tax expenditures required a comparison to some sort of “normal” tax system. Not surprisingly, defining what is the “normal” tax system, and thus what is a tax expenditure, has been a continuing source of controversy.⁶³ Some conservatives objected that the very concept of tax expenditures implied that all income intrinsically “belonged” to the federal government.⁶⁴ But most other critics accept the underlying analytical insights of tax expenditure analysis, but criticize the normative judgments necessary to design a “normal” tax baseline.⁶⁵

The Congressional Budget and Impoundment Control Act of 1974⁶⁶ requires the Joint House-Senate Committee on Taxation (JCT) to prepare an annual list of tax expenditures to Congress.⁶⁷ For years, JCT prepared an estimate of the federal tax expenditure budget (TEB)

⁶² JCT RECONSIDERATION, *supra* note 14, at 20-24.

⁶³ See Boris I. Bittker, *Accounting for Federal “Tax Subsidies” in the National Budget*, 22 NAT. TAX. J. 244 (1969), for the earliest academic criticism of the “normal” tax concept.

⁶⁴ SCHICK, *supra* note 10, at 172; JCT RECONSIDERATION, *supra* note 14, at 35 (describing the “every last penny” argument). See also JCT RECONSIDERATION, *supra* note 14, at 38, for a compelling rejoinder to this argument. Specifically, tax expenditure analysis does not require an income tax at all, much less specify any particular rate structure. Tax expenditure analysis takes as given the current system of progressive income taxation and the current rate structure, and simply identifies specially targeted deviations from that general scheme. If tomorrow the current income tax system were completely replaced with a straight national sales tax, with no special exceptions, the JCT would conclude that tax expenditures totaled \$0.

⁶⁵ Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Processes*, 43 B.C. L. REV. 863, 876 (2002) (“Although the [tax expenditure] concept itself is not especially controversial, arriving at a mutually acceptable definition of what constitutes a tax expenditure has proven quite intractable.”). See JCT RECONSIDERATION, *supra* note 14, at 29-33 for a summary of academic criticisms of the traditional normal tax base.

⁶⁶ Pub. L. 93-344 (1974).

⁶⁷ Technically the Budget and Impoundment Control Act of 1974 requires the Congressional Budget Office to prepare those estimates, but subsequent provisions have required CBO to rely on the JCT’s figures due to that Committee’s special expertise on taxation issues. See 2 U.S.C. §61(f); STAFF OF J. COMM. ON TAXATION, 110TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2008-2012 n.2 (Comm. Print 2008), available at <http://www.house.gov/jct/s-2-08.pdf>.

based on its own concept of a “normal” income tax. The JCT, as a nonpartisan committee, kept this baseline consistent over the years.⁶⁸ Over the same period, the Department of Treasury has also estimated a tax expenditure budget, but its methodology has changed from Administration to Administration.⁶⁹ Lamenting being “[d]riven off track by seemingly endless debates about what should and should not be included in the ‘normal’ tax base,” the JCT staff has recently developed an innovative new conception of tax expenditures that captures the same information but does not require comparison to a hypothetical baseline tax system.⁷⁰

The JCT’s new approach abolishes the idea of a “normal” tax baseline without losing any analytical power. The JCT now identifies two types of tax expenditures: tax subsidies and tax-induced structural distortions.⁷¹ Under the JCT’s definition, a tax subsidy is a provision of the tax code that is “deliberately inconsistent with an identifiable general rule of the present tax law (and not some hypothetical “normal” tax).”⁷² Thus, identifying a tax subsidy does not require a normative judgment about what the tax system “should” be or what tax rules are “normal,” but is defined solely by reference to the provisions of the tax code itself.⁷³ However, this new category does not capture all of items the JCT had previously identified as tax expenditures.⁷⁴ JCT’s second tax expenditure category of “tax-induced structural” distortions is defined not by reference to any baseline, but includes any tax rule that creates economic allocative efficiency losses.⁷⁵ This definition encompasses any inconsistency within the tax code that distorts

⁶⁸ HUNGERFORD, *supra* note 2, at 2.

⁶⁹ *Id.* See also Linda Sugin, *Sustaining Progressivity in the Budget Process: A Commentary on Gale & Orszag’s An Economic Assessment of Tax Policy in the Bush Administration, 2001-2004*, 45 B.C. L. REV. 1259, 1274-82 (2004) (accusing the Bush Administration of manipulating the TEB baseline so as to make tax expenditures appear less regressive than they actually are).

⁷⁰ JCT RECONSIDERATION, *supra* note 14, at 1.

⁷¹ *Id.* at 9-10.

⁷² *Id.* at 9.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.* at 10.

economic incentives, but does not specify which method of resolving the inconsistency is “correct.”⁷⁶ Most tax expenditures that present the most troubling accountability and equity concerns are “tax subsidies” under the JCT’s new definition.⁷⁷ The JCT’s new definition in practice makes little difference in terms of what tax provisions are counted as tax expenditures,⁷⁸ but hopefully the new definition will attract less criticism because it is based on more objective criteria.

While critics may still quibble with the JCT’s approach, the key point is that the concept of a tax expenditure is useful even without universal agreement as to what tax policies are normatively superior. As the JCT correctly notes, the concept of tax expenditures is not, as some conservatives charge, a philosophical commentary about the nature of the tax system—it is merely an analytic tool for assessing the government’s fiscal commitment to various programmatic objectives. Having a clear, consistent definition—any definition—is far more important than the exact contours of any definition.⁷⁹ Once identified, tax expenditures can then be assessed on their own merits.⁸⁰

For the purposes of the rest of this paper, I implicitly assume the JCT’s definition of tax expenditures, but the reforms listed in the next section would be useful under any reasonable

⁷⁶ *Id.* at 42. For example, the deferral of earnings of foreign subsidiaries is a distortion because of its effect on firm behavior, but defining this provision as a structural distortion does not necessarily imply that the optimal solution is either a territorial tax regime or a “full inclusion” regime (which would be the “polar opposite” resolution). *Id.*

⁷⁷ *Id.* at 42, 47.

⁷⁸ *Id.* at 47.

⁷⁹ See CENTURY FOUND., *supra* note 8, at 8 (“[M]ost tax expenditures on the OMB/JCT lists would be counted as tax breaks under any reasonable definition.”).

⁸⁰ I do not mean to suggest that the choice of definition is completely irrelevant. Indeed, as the examples above show, the choice of definition may impact which tax provisions are characterized as expenditures and which are not. But, as JCT writes, the debate over the definition of tax expenditures is ultimately a distraction from the core point that a variety of tax code provisions routinely escape the rigorous review that other budgetary provisions are subjected to as a matter of course. The mere fact that setting a definition requires a normative judgment to some degree does not make the whole exercise worthless. If Congress makes a deliberate decision that a particular category of tax provision is analytically distinct from a tax expenditure, and that therefore that provision should be privileged from the reforms I propose below, then at least some accountability has been achieved for that provision through the initial setting of the definition.

definition as long as it remains consistent and is not manipulated for short-term political gain. Alternatively, the reforms I propose below could apply only to the “tax subsidies” category developed by the JCT. That category is likely to capture the vast majority of items which are troubling for equity or transparency reasons anyway,⁸¹ and the “tax subsidy” category may prove to be less politically controversial than the “tax-induced structural distortion” category (if only because it is easier to understand).

IV. REFORM PROPOSALS

The reforms I propose below vary in their degree of current political viability. For the most part, the more politically contentious proposals would also be the most effective at curbing the growth of tax expenditures or increasing their transparency, accountability, and equity. But the most viable proposals can still be very useful. Additionally, even a failed push for the more aggressive proposals can help bring attention to the problems inherent in the use of tax expenditures, and might spur greater self-discipline by Congress.

A. Default Refundability

Many of the most glaring downsides of tax expenditures described above⁸²—notably lack of transparency, accountability, and equity—are mitigated if the provisions are structured as refundable tax credits rather than deductions or exclusions. First, refundable credits do not grant a disproportionate benefit to higher income taxpayers because they are unaffected by marginal rates and because credits may be taken advantage of by taxpayers who do not itemize. Additionally, even the one-third of taxpayers who have no federal income tax liability can

⁸¹ JCT RECONSIDERATION, *supra* note 14, at 42, 47.

⁸² See *supra* Part II.

benefit from refundable credits.⁸³ For example, a deduction for the cost of installing home solar panels would be worth more for a taxpayer in the 35% bracket than a taxpayer in the 25% bracket, and would be worth nothing at all to taxpayers who do not itemize or who do not have any income tax liability. But a refundable tax credit for 25% of the cost of solar panels would be worth the same to every taxpayer regardless of circumstances. Additionally, the cost of refundable tax credits to the government is more transparent. Unlike deductions and exclusions, the repeal of which might push a taxpayer into a higher bracket or might cause a taxpayer to begin claiming the standard deduction,⁸⁴ refundable credits will not otherwise affect a taxpayer's situation. In essence, a refundable credit is just a direct cash subsidy from the government—the rest of the tax code is completely irrelevant to its implementation.

The use of refundable tax credits instead of more traditional tax devices like exclusions and deductions has been growing, albeit slowly. The most important credit of this kind today is the Earned Income Tax Credit (EITC), which provides tax benefits to lower-income workers as they increase their wages and thereby reduce their entitlement to government social services programs. Until 1975, there were no refundable tax credits,⁸⁵ and between 1975 and 1997, the EITC was the only refundable credit.⁸⁶ As of the 2008 tax year, the tax code contained only three refundable tax credits: the EITC, the Child Tax Credit (only partially refundable), and a small refundable health insurance credit.⁸⁷ The American Recovery and Reinvestment Act of 2009 (more commonly known as the “stimulus bill”) created a new “Making Work Pay” refundable

⁸³ Lily L. Batchelder, Fred T. Goldberg, Jr., & Peter Orszag, *Efficiency and Tax Incentives: The Case for Refundable Credits*, 59 STAN. L. REV. 23, 52 (2006).

⁸⁴ See *supra* Part II.A (describing interaction effects between tax deductions).

⁸⁵ Batchelder, Goldberg & Orszag, *supra* note 83, at 25.

⁸⁶ Toder, *Tax Cuts*, *supra* note 11, at 366.

⁸⁷ Batchelder, Goldberg & Orszag, *supra* note 83, at 33.

tax credit that takes effect for the 2009 tax year.⁸⁸ But although the total number of refundable tax credits still remains small, Congress has dramatically expanded the refundability of the EITC and the Child Tax Credit over the past two decades,⁸⁹ and politicians from both parties have proposed various refundable credits recently.⁹⁰ Indeed, in the 2008 Presidential Campaign, refundable credit proposals were a centerpiece of the domestic agendas of both major party candidates.⁹¹

Despite these trends and the bipartisan support for refundability,⁹² some strenuously object to the refundability of tax credits because of the potential that individuals with no current federal income tax liability could end up receiving a check from the government.⁹³ In response to this criticism, Batchelder, Goldberg, and Orszag defend the refundability of tax credits on grounds other than distributional equity, which they fear is subject to “deep partisan divides.”⁹⁴ Instead, Batchelder, Goldberg, and Orszag show that, in the vast majority of cases, refundable credits are the most economically efficient means of subsidizing particular behavior through the

⁸⁸ I.R.C. §36(A) (West 2009); Internal Revenue Service, “The Making Work Pay Tax Credit,” <http://www.irs.gov/newsroom/article/0,,id=204447,00.html> (last visited April 20, 2009).

⁸⁹ Batchelder, Goldberg & Orszag, *supra* note 83, at 38-39. Refundable credits have also been expanding at the state level. *Id.* at 38.

⁹⁰ *See id.* at 40-41 (describing Bush Administration proposals to create various refundable credits). *See also infra* note 91.

⁹¹ *See* Tax Policy Center, Major Provisions of the McCain and Obama Tax Plans, http://www.taxpolicycenter.org/tpccontent/tax_plan_matrix_0908.pdf (last visited April 2, 2009). Sen. John McCain proposed a refundable credit to replace the current exclusion from income of employer-provided health insurance. Then-Sen. Barack Obama proposed making several existing credits refundable, including the Child and Dependent Care Tax Credit, the Saver’s Credit, and the HOPE Credit, and proposed a number of entirely new tax provisions that would be structured as refundable credits, including the “Making Work Pay” credit. *Id.* The “Making Work Pay” credit was passed into law in 2009. *Supra* note 88. President Obama’s preference for refundable credits is also evidenced in his selection of Dr. Peter Orszag, a proponent of refundable credits, to serve as Director of the Office of Management and Budget. *See* Batchelder, Goldberg & Orszag, *supra* note 83.

⁹² *See supra* notes 91-92. *See also* Batchelder, Goldberg & Orszag, *supra* note 83 (supporting refundable credits as a “default”). Notably, Mr. Goldberg was an Assistant Secretary of the Treasury under President George H.W. Bush, so the support for refundable credits is by no means confined to the political left. Indeed, the idea of refundable tax credits is traceable to Milton and Rose Friedman (economists who remain icons of the conservative movement), who created the idea of the “negative income tax.” *See id.* at 32.

⁹³ *See, e.g.,* Peter Ferrara, *Obama’s Tax Plan is Really a Welfare Plan*, WALL ST. J., August 19, 2008, at A17, available at <http://online.wsj.com/article/SB121910303529751345.html>.

⁹⁴ Batchelder, Goldberg & Orszag, *supra* note 83, 25-26.

tax code.⁹⁵ Specifically, because the benefit from a refundable credit is not dependent on a taxpayer's overall tax situation, a refundable credit perfectly mimics the classical economic idea of a "Pigouvian subsidy" for an individual to engage in socially beneficial behavior.⁹⁶ Indeed, even if the underlying activity subsidized is actually *bad* for society, a refundable credit ends up less wasteful than a deduction or exclusion.⁹⁷

Thus, even with the potentially polarizing distributional issues of tax expenditures set aside, the combination of efficiency and transparency justifications for refundable credits creates a unique opportunity to expand the existing bipartisan support for this approach. Batchelder, Goldberg, and Orszag argue that these justifications show that a refundable credit should be the default for all tax incentives.⁹⁸ Batchelder, Goldberg and Orszag do not propose any particular mechanism to enforce such a default, but the procedural rules of each house of Congress could be modified to build the preference for refundable credits directly into the budget process. For example, a rule could be passed in the House and Senate stating

It shall not be in order to consider any bill, joint resolution, amendment, or conference report which includes a new tax expenditure, unless that tax expenditure is structured as a credit against tax imposed without any limitation based on the amount of regular tax liability.⁹⁹

⁹⁵ Batchelder, Goldberg & Orszag, *supra* note 83. *Accord* CENTURY FOUND., *supra* note 8, at 20 ("...if there are to be explicit subsidies through the tax code, they should generally be designed as credits that provide the same subsidy rate to all taxpayers.").

⁹⁶ Batchelder, Goldberg & Orszag, *supra* note 83, at 44-45.

⁹⁷ *Id.* at 47-49. For example, given the recent troubles in the housing market, the advisability of subsidizing home mortgages through the tax code at all might seem questionable. But as Batchelder, Goldberg, and Orszag show, even if it were generally economically inefficient to subsidize home mortgages, it would be less wasteful for the government to spend \$1 billion subsidizing mortgages with refundable credits than with deductions. This result holds because, absent any evidence that consumer demand elasticity for the subsidized activity is different across income groups, a uniform subsidy minimizes the expected economic distortion and deadweight loss. Readers more interested in the microeconomic logic of this argument are advised to see Batchelder, Goldberg & Orszag's paper, which illuminates the key effects and assumptions very clearly.

⁹⁸ *Id.* at 24.

⁹⁹ *Cf.* U.S. HOUSE OF REPRESENTATIVES, 111TH CONGRESS, RULES OF THE HOUSE OF REPRESENTATIVES RULE XXI(10), Jan. 28, 2009, *available at* <http://www.rules.house.gov/ruleprec/111th.pdf> (the House pay-as-you-go or "PAYGO" rule).

Such a provision would also require a rule defining “tax expenditure,” either based on the JCT’s definition or some other definition.¹⁰⁰ Again, a variety of possible definitions would be acceptable. A definition based on the JCT’s “tax subsidy” concept might read something like “A tax expenditure is a provision providing for a new deduction, exclusion from income, or credit against income tax due that is inconsistent with the current Internal Revenue Code.”¹⁰¹ Such a definition would necessarily require the parliamentarian to exercise some degree of judgment on close calls, but this is already true with respect to enforcement of budget reconciliation rules, for example.¹⁰² Additionally, classifying a new provision as a tax expenditure is likely to be a much less controversial exercise than discriminating between existing provisions, since there is a clear baseline for comparison (i.e., the existing code).

This rule could then be enforced by any member on the floor with a point of order. The effectiveness of a point of order as an enforcement mechanism is mitigated to the extent that a point of order may be waived, either by a vote of the entire body or through a special rule passed by the House Rules Committee.¹⁰³ Although budget rules can be circumvented relatively easily by the majority in the House, rules typically have more bite in the Senate where a three-fifths majority is required to waive most points of order,¹⁰⁴ and so these mechanisms can still provide a meaningful constraint on the temptation to enact policy through the tax code. Even though such budget rules have certainly been manipulated over the years,¹⁰⁵ they have provided a net positive force for fiscal discipline,¹⁰⁶ and thus the use of these familiar procedural tools holds some

¹⁰⁰ See *supra* Part III.

¹⁰¹ See JCT RECONSIDERATION, *supra* note 14, at 9.

¹⁰² See, e.g., SCHICK, *supra* note 10, at 146-49, Box 6-2.

¹⁰³ Block, *supra* note 65, at 881.

¹⁰⁴ See *id.* at 881, 885, 933-34.

¹⁰⁵ See, e.g., *id.* at 888-924.

¹⁰⁶ *Id.* at 919 (“Despite the gimmicks, most commentators agree that the modern legislative budget process has provided valuable restraints and imposed an element of self-discipline on Congress....”).

promise for constraining the temptation to enact more and more federal policy through the tax code.

In some cases, making a tax expenditure refundable may be infeasible, either politically or practically. But in those cases, the procedural rules proposed here will create an incentive for designing such programs as direct or discretionary spending rather than as a tax break, as they ordinarily should be absent an independent efficiency justification.¹⁰⁷

B. Limited Deductibility for Top Brackets

A less dramatic, but also less effective, means of limiting the expansion of tax expenditures than default refundability would be to create default rules which limit the extent to which any deduction or exclusion can be claimed by a taxpayer. For instance, President Obama's first budget proposed limiting the extent to which wealthier taxpayers could claim certain itemized deductions.¹⁰⁸ Under the proposal, certain deductions would count only as if the taxpayer were in the 28% tax bracket, in essence making the deductions function a little bit more like non-refundable credits. Applying these same ideas to future tax expenditures would limit their costs and their regressive effects to some degree, albeit less than if the expenditures were instead structured as refundable credits.¹⁰⁹ This weaker measure could be enforced in the same manner as the default refundable credits option. For example, the rule might instead state "It shall not be in order to consider a bill, or an amendment to any bill, adding any new tax deduction, unless the tax deduction is limited such that no taxpayer may claim the deduction as if

¹⁰⁷ See CENTURY FOUND., *supra* note 8, at 22 ("But the very need to make these programs refundable is a strong argument for keeping them out of the tax system altogether and moving them to the spending side of the budget.").

¹⁰⁸ Jackie Calmes & Robert Pear, *To Pay for Health Care, Obama Looks to Taxes on Affluent*, N.Y. TIMES, Feb. 25, 2009, at A1, available at <http://www.nytimes.com/2009/02/26/us/politics/26budget.html>.

¹⁰⁹ Limiting deductibility does not fully replicate refundable credits because deductions would still have no utility to taxpayers who do not itemize or who pay no income taxes.

their marginal rate were greater than 28%.” The applicable percent could instead be replaced with a more flexible reference like “as if they were subject to the third highest marginal rate,” to accommodate future marginal rate changes.

Even this proposal is likely to be somewhat controversial. Congress and the charitable organization community reacted particularly coolly to the Obama Administration’s proposal to limit the deductibility of charitable deductions,¹¹⁰ in spite of evidence that suggested that the proposal would have a negligible effect on charitable giving rates.¹¹¹ An amendment opposing the change for charitable deductions passed the Senate 94-3,¹¹² and the final fiscal year 2010 budget resolution did not include the proposal.¹¹³ But the proposal would likely engender much less opposition if it only applied to new tax credits rather than existing credits which have already built up strong constituencies. Even with this limitation, the proposal would still serve as an effective check on the future proliferation of tax deductions.

C. Inclusion in the Outlay Totals

Perhaps the simplest measure to constrain the growth of tax expenditures would be to include tax expenditures in the annual budget as part of total outlays rather than as decreases to revenues. A more modest change supported by the GAO would be for OMB to include tax

¹¹⁰ See, e.g., Stephen Dinan & David R. Sands, *Charity Tax Limits Upset Many*, WASH. TIMES, Feb. 27, 2009, available at <http://www.washingtontimes.com/news/2009/feb/27/charity-tax-challenged-by-political-friends/>.

¹¹¹ PAUL N. VAN DE WATER, CTR. FOR BUDGET & POL’Y PRIORITIES, PROPOSAL TO CAP DEDUCTIONS FOR HIGH-INCOME HOUSEHOLDS WOULD REDUCE CHARITABLE CONTRIBUTIONS BY ONLY 1.9 PERCENT, WOULD HELP TO FINANCE UNIVERSAL HEALTH COVERAGE 1 (2009), available at <http://www.cbpp.org/files/3-3-09bud.pdf>.

¹¹² U.S. Senate, Roll Call 00138, S.Amdt. 103 to S.Con.Res. 13, April 2, 2009, available at http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=111&session=1&vote=00138.

¹¹³ E.g., Janet Hook, *Congress’ Budget shorts Obama plans to shift wealth*, L.A. TIMES, April 30, 2009, available at <http://www.latimes.com/news/la-na-budget30-2009apr30,0,5614049.story?page=1>.

expenditure revenue losses alongside outlay totals in the President’s budget.¹¹⁴ OMB actually began taking this approach for the fiscal year 1998 budget, but the policy was discontinued for the fiscal year 2002 budget.¹¹⁵ While in some sense such a change would be entirely cosmetic—just moving a number from the revenue to the spending side of the ledger—it would have important political implications. First, more accessible information about the scope and nature of tax expenditures might deter their overuse.¹¹⁶ Second, since tax expenditures would be counted as spending, no longer would a member of Congress be able to claim credit for both cutting taxes and cutting spending merely by shifting more federal spending to the tax code.

Including all tax expenditures in the outlay totals would also remove the disincentive in current law to structuring tax expenditures as refundable credits. Presently, most tax expenditures are reflected in the budget totals only through decreased projected revenues. However, the refundable portion of refundable credit provisions appears in the budget as an outlay.¹¹⁷ Thus, a member who structures his or her program as a refundable credit can be derided for “increasing spending,” while a member who structures his or her subsidy proposal as a less transparent and more regressive tax deduction is championed as a tax cutter.

D. Sunset Rules

Unlike discretionary appropriations and authorizations, which typically last a definite period of time such as one year, a tax expenditure remains until repealed or until it “sunset” by its own provisions. If a tax expenditure does not contain a sunset, then Congress has no set

¹¹⁴ GAO Tax EXPENDITURES, *supra* note 6, at 59, 73. The Bush Administration OMB was very cool to this proposal, reiterating its objections to the very concept of tax expenditures. *Id.* at 82-87.

¹¹⁵ *Id.* at 59.

¹¹⁶ CENTURY FOUND., *supra* note 6, at 28. *See also* GAO TAX EXPENDITURES, *supra* note 6, at 59 (“Integrating tax expenditure costs in the annual budget presentation is crucial to providing a comprehensive picture of federal resources to facilitate reexamining the base.”)

¹¹⁷ Toder, *Evaluating*, *supra* note 16, at 56.

opportunity to revisit the provision to assess its effectiveness. If Congress must renew a tax provision, it at least has an opportunity to reconsider the law “in light of increasing fiscal concerns, renewed caution, or other relevant post-enactment developments.”¹¹⁸ To encourage more tax expenditures to be subject to this constant renewal process, yet another House and Senate rule could be created that prohibits consideration of any tax expenditure that lasts longer than a specified length of time.

However, adding sunsets to tax expenditures creates many additional problems. First, sunsets may complicate tax planning, and thus reduce the benefit of any expiring tax provision.¹¹⁹ Second, sunsets can allow politicians to continuously extract political rents from constituencies that benefit from tax expenditures since these groups must constantly lobby for renewal.¹²⁰ Additionally, in practice many tax expenditures are routinely extended again and again despite their sunset provisions. As of 2006, only two tax “extender” provisions have ever been allowed to expire.¹²¹ In practice, many extremely popular provisions that Congress has every intention of extending repeatedly are given sunsets not to increase accountability, but in order to comply with PAYGO rules.¹²² Because a permanent repeal would require too many offsets, it is often more politically expedient for Congress to only extend a provision for a few years at a time.¹²³ Because the CBO is required to assume current law when making its long-term fiscal projections, this strategy can have the consequence of reducing budgetary

¹¹⁸ Sugin, *supra* note 69, at 1269.

¹¹⁹ Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335, 368-69 (2006); Sugin, *supra* note 69, at 1271 (describing in particular the burden on lower-income families of unpredictability in the tax code).

¹²⁰ Kysar, *supra* note 199, at 362-68, 393-94.

¹²¹ *Id.* at 358, n.163. Occasionally, a provision expires but then Congress applies an extension retroactively. *Id.*

¹²² *Id.* at 359-62.

¹²³ *Id.*

transparency and hiding the true long-term fiscal impact of tax cuts.¹²⁴ Piecemeal sunsets also make it politically easier to allow tax benefits for low-income families to slowly disappear.¹²⁵

In practice, PAYGO and the Senate’s Byrd Rule already create strong incentives for tax expenditures to sunset.¹²⁶ Given these existing structural incentives, and given the fact that many tax expenditures are routinely extended anyway,¹²⁷ an additional rule requiring sunsets would probably not be particularly effective by itself in reducing tax expenditures or increasing their accountability, and could bring other downsides.¹²⁸ However, even if a structural solution is not appropriate here, when enacting new tax expenditures Congress should carefully consider the transparency and accountability implications of adding sunsets. If a provision is designed as a short-term or experimental replacement for a discretionary program, sunsets can make tax expenditures receive a level of accountability and oversight more on par with their discretionary spending cousins. But if the expenditure is clearly intended to become a permanent feature of the tax code, sunsets only obscure the true long-run fiscal impact of a provision.

E. Require Prior Authorization by Authorizing Committees

The solution to the growth of tax expenditures that would require the most revolutionary change to the budget process would be to require that tax expenditures be “authorized” before being passed by a tax-writing committee, in much the same way that discretionary spending must be authorized before being appropriated by the appropriations committees. This approach in

¹²⁴ See William G. Gale & Peter R. Orszag, *Sunsets in the Tax Code*, TAX NOTES 1553, June 9, 2003. See also SCHICK, *supra* note 10, at 178-79, Box 7-2 (describing the political strategy for including sunsets in the Bush tax cut packages).

¹²⁵ Sugin, *supra* note 69, at 1270-71.

¹²⁶ Kysar, *supra* note 199, at 359-62; SCHICK, *supra* note 10, at 178-79, Box 7-2.

¹²⁷ See *supra* note 121.

¹²⁸ In fact, for these reasons Gale & Orszag argue that rules should be created that *discourage* sunsets. Gale & Orszag, *supra* note 124, at 1559.

essence treats tax expenditures like any other spending, requiring a two-step approval process before a tax expenditure can become law. For example, Rule XXI(2)(a)(1) of the Rules of the House states “An appropriation may not be reported in a general appropriation bill, and may not be in order as an amendment thereto, for an expenditure not previously authorized by law....”¹²⁹ A parallel rule for tax expenditures might state “A tax expenditure may not be reported in any bill, and may not be in order as an amendment, unless previously authorized by law.” Again, this rule would also need to be accompanied by a rule defining tax expenditures.¹³⁰

Requiring tax expenditures to be authorized would have a number of important advantages. First, it would place tax expenditures on an equal procedural footing with ordinary spending, thus eliminating an artificial political incentive for a member to use the tax code rather than the appropriations process to achieve a particular policy objective. Second, authorizing committees may have greater (or, at the very least, different) substantive expertise regarding the policy objective at issue. The members of the tax-writing House Ways and Means Committee, for instance, could benefit from the insight of members on the House Energy and Commerce Committee (which has jurisdiction over health care programs) when it comes to the policy merits of tax expenditures for health insurance. Requiring authorization of each tax expenditures would give the authorizing committees ownership of each provision, and would create an additional point for oversight and accountability. Presumably, an authorizing committee would hold oversight hearings over the administration of tax expenditures within their jurisdiction before re-authorizing them, just as those committees hold hearings before re-authorizing direct spending programs.

¹²⁹ U.S. HOUSE OF REPRESENTATIVES, 111TH CONGRESS, RULES OF THE HOUSE OF REPRESENTATIVES 34, Jan. 28, 2009, available at <http://www.rules.house.gov/ruleprec/111th.pdf>.

¹³⁰ See *supra* text accompanying notes 100-102.

Most importantly, the authorization process would also facilitate direct consideration of whether a particular policy objective is most efficiently achieved through a tax expenditure or a direct expenditure. Currently, even if either a tax writing committee or an authorizing committee believed a tax expenditure would be better structured as discretionary spending, a bill to replace the tax expenditure with an appropriation would be required to move through multiple committees.¹³¹ This hurdle adds inertia to the system, and incentivizes proponents of a particular policy objective to leave well enough alone and not challenge whether a goal is best achieved through the tax code or through discretionary spending. Requiring all tax expenditures to be authorized periodically would force authorizing committees to explicitly consider the trade-off between tax expenditures and annual appropriations. An authorizing committee that chooses not to re-authorize a tax expenditure within its jurisdiction would then free up funds that could be used to support other programs under its umbrella instead.

Requiring all tax expenditures to be authorized before passage by the tax writing committees might also eliminate an implicit disincentive for the tax writing committees to use refundable credits rather than more regressive methods. Although Congress agreed in the 1970s that the EITC should be solely within the jurisdiction of the tax writing committees, those committees may remain fearful that other oversight committees would demand jurisdiction over any new refundable credit provisions.¹³² If all tax expenditures, regardless of form, required authorization by other committees anyway, perhaps the tax writing committees would feel more freedom to structure such provisions optimally, rather than in a way that preserves their “turf.”

¹³¹ HUNGERFORD, *supra* note 2, at 9; *supra* text accompanying notes 42-44. *Cf.* Westmoreland, *supra* note 11, at 1582 (describing how subcommittee jurisdictional issues can “force choices between two worthy subcommittee priorities while leaving less worthy programs outside the jurisdiction unscathed”).

¹³² Toder, *Tax Cuts*, *supra* note 11, at n.12 and accompanying text.

The most glaring downside to this proposal is that the tax writing committees can be expected to strenuously resist any effort to dilute their authority over tax expenditures.¹³³ On the other hand, every other committee is likely to be pleased by the added lever they would gain over tax policy. To make the proposal more palatable to the tax writing committees, the tax writing committees could be granted authorizing authority over some subset of existing tax expenditures. For instance, the House Ways and Means Committee could be given authorizing jurisdiction over deductions for charitable giving. If this were the case, the Ways and Means Committee would be responsible for both authorizing the charitable giving deduction and enacting it into the tax code. More comprehensively, all existing tax expenditures could be grandfathered into the new system by giving the tax writing committees jurisdiction over all of them. Only new tax expenditures would be subjected to authorization by other committees of jurisdiction. This compromise would also please constituencies that benefit from existing tax expenditures. Of course, this compromise eliminates the advantages of the proposal for each tax expenditure for which the tax writing committees retain authorizing jurisdiction.

Even if the tax committees successfully shoot down this proposal, perhaps a concerted assault on their jurisdiction will at least inspire those committees to be more thoughtful about the future proliferation of tax expenditures. Alternatively, even a failed battle for this more comprehensive solution may pave the way for some of the less dramatic solutions proposed herein.

F. Distribution-Weighted PAYGO

¹³³ See Kysar, *supra* note 119, at 362-65 (2006) (arguing that tax expenditures for special interests create enormous political rents for politicians).

Although tax expenditures are not included as outlays in the budget, their growth is constrained to a degree by PAYGO rules. But because tax expenditures tend to have a regressive effect,¹³⁴ and because tax expenditures are likely to be offset by decreasing spending programs which have progressive effects,¹³⁵ Linda Sugin argues that PAYGO rules are insufficient to protect the poor from regressive policy shifts.¹³⁶ She proposes that to compensate for this effect, Congress adopt a PAYGO system that is weighted for distributional impacts. In Sugin’s proposal, “[t]ax cuts that decrease inequality could be subject to lower procedural hurdles than tax cuts that increase inequality.”¹³⁷

Sugin argues that “details are not crucial to this idea,” and only very generally outlines how her proposal might be structured.¹³⁸ Implementation would obviously require some benchmark for progressivity, but these sorts of analyses are routinely conducted using measures such as the Suits progressivity index¹³⁹ or calculations of changes in after-tax income for high-income and low-income taxpayers.¹⁴⁰ It is true that implementation would require CBO to project these distributional impacts before floor consideration of any proposed tax change, but the CBO scorekeeping already requires substantial guesswork, and as long as the estimate is not tainted by political considerations the process can still provide some measure of fiscal discipline.¹⁴¹ If the measure chosen shows that the proposed change in tax law would be

¹³⁴ See *supra* Part II.C.

¹³⁵ See HUNGERFORD, *supra* note 2, at 17-18 and Table 3 (showing that the Suits the progressivity index for various social welfare spending programs is uniformly positive (i.e., social spending has progressive effects)).

¹³⁶ Sugin, *supra* note 69, at 1262-66.

¹³⁷ *Id.* at 1264.

¹³⁸ *Id.* at n.26 and accompanying text.

¹³⁹ HUNGERFORD, *supra* note 2, at 23; see also *supra* notes 53-54 and accompanying text.

¹⁴⁰ See William G. Gale & Peter R. Orszag, *An Economic Assessment of Tax Policy in the Bush Administration, 2001-2004*, 45 B.C. L. REV. 1157, 1186-89 (2004) (defending the use of change in after-tax income as the proper basis for assessing progressivity); HUANG & SHAW, *supra* note 2, at 2 (analyzing the distributive impact of tax expenditures based on change in after-tax income).

¹⁴¹ See Westmoreland, *supra* note 11, at 1574-75 (explaining that even though CBO scores of legislation are merely an “educated best guess” that “no one is under any illusion... will prove to be correct,” the CBO score is still a

regressive (for example, if the Suits progressivity index for the change is negative, or if the projected change in after-tax income is lower for the bottom quintile of taxpayers than the top quintile, etc.) then the measure would require a supermajority for passage. Although she does not explicitly propose this, Sugin's proposal could also be applied to tax cuts for businesses, thus requiring a supermajority to pass tax breaks that disproportionately benefit big corporations at the expense of small businesses. This PAYGO rule could still exclude any change, even if progressive, that increases the deficit. The key is that even strictly deficit-neutral legislation should require a supermajority for passage if it is particularly regressive.

This solution is not attractive solely for its distributional impacts. Distribution-weighted PAYGO would create a strong incentive for members to structure their tax proposals as refundable credits rather than deductions or exclusions because a refundable credit would be more likely to pass through the progressivity screen.¹⁴² Still, as the most explicitly equity-based reform proposal here, this proposal is the most unlikely to attract wide bipartisan support and to thus create an enduring political norm against tax expenditures. But even if a distribution-weighted PAYGO system adopted by the current Democratic congress were to be summarily reversed down the line by a Republican congress, its use in the interim could cause politicians and the voters they serve to re-think their knee-jerk preference for targeted tax cuts for enacting social policy. Additionally, a push for such rule changes could bring to the fore the distributional biases in the budget process and make equity concerns more explicitly part of the annual budget battle.

“necessary fiction for budgeting and legislating”). But see Block, *supra* note 65, for a description of how CBO scores can be manipulated, a problem that would have to be carefully monitored under a distribution-weighted PAYGO system as well.

¹⁴² See *supra* Part IV.A for a discussion of the equity, efficiency, and transparency implications of refundable credits vis-à-vis other types of tax expenditures.

CONCLUSION

As the debate over the Nation's long-term fiscal health rages on, controlling tax expenditures must be part of the conversation. Tax expenditures represent an increasingly large portion of federal commitments, and the current budget rules create strong incentives for elected officials to spend money through the tax code rather than through the appropriations process. This trend is disturbing not only because of the part it plays in the projected long-term federal deficits, but also because tax spending is inherently more regressive and subject to less transparency and accountability. A single-minded focus only on reform of entitlement spending programs like Medicare, Medicaid and Social Security to the exclusion of the need for tax expenditure reform will not only miss a key component of the fiscal dilemma, but will also leave us with a government that is less transparent and accountable and less attentive to the needs of the most vulnerable in society.

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