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**THE TAX EXPENDITURE CONCEPT
AND THE BUDGET REFORM ACT OF 1974***

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AND

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The Budget Document of the United States for fiscal year 1976 issued in January 1975 contained for the first time a Special Analysis entitled "Tax Expenditures."¹ This material was included pursuant to the Congressional Budget Act of 1974,² which contains a number of other provisions relating to "tax expenditures" as well as a definition of that term. This Act represents the most concrete recognition taken by any country³ that tax subsidies constitute a form of government spending and thus are essentially linked to the methods of government spending traditionally covered in budget documents.

I. THE TAX EXPENDITURE CONCEPT IN GENERAL

Essentially, the tax expenditure concept, as applied to an income

*Some of the material in this article is based on a paper delivered by Professor Surrey at the International Tax Conference, Nairobi, Kenya, January 1976.

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¹ BUDGET OF THE UNITED STATES GOVERNMENT, 1976, Special Analysis F at 101 (1975). The 1977 Budget has a similar analysis, Special Analysis F at 116 (1976), containing an extended description of the tax expenditure concept and the various tax expenditure items. See also the 1977 Budget, at 58, for an introductory discussion of tax expenditures in Part 5, The Federal Program By Function, and also page 15.

² Act of July 12, 1974, Pub. L. No. 93-344, 88 Stat. 297 [hereinafter cited as Budget Act].

³ Apparently only West Germany has recognized the propriety and utility of quantifying tax subsidies on a systematic basis. West Germany has since 1966 published information concerning expenditures—called "tax aids"—through its tax provisions. The German experience is discussed in Ault, *Steuervergünstigungen in der Bundesrepublik Deutschland und den USA*, 5 *STEUER UND WIRTSCHAFT* 335 (1974) [hereinafter cited as Ault]. A discussion of tax incentives in other nations will appear in General Report, *Tax Incentives as an Instrument for Achievement of Government Goals*, Vol LXIa, *CAHIERS DE*

tax, regards such a tax as composed of two distinct elements. The first element contains the structural provisions necessary to the application of a normal income tax, such as the definition of net income; the specification of accounting periods; and the determination of the entities subject to tax, the rate schedule and exemption levels. These provisions compose the revenue raising aspects of the tax. The second element consists of the special preferences found in every income tax. These special preferences, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favor a particular industry, activity, or class of persons. They partake of many forms, such as permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates. Whatever their form, these departures from the "normative" income tax structure essentially represent government spending for the favored activities or groups made through the tax system rather than through direct grants, loans, or other forms of government assistance.

Put differently, whenever government decides to grant monetary assistance to an activity or group, it may elect from a wide range of methods in delivering that assistance. A direct government grant or subsidy may be made; a government loan may be made, perhaps at a special interest rate; a private loan may be guaranteed by the government; and so on. In contrast, the government may use the income tax system and reduce the tax otherwise applicable, by adopting a special exclusion, deduction or the like for the favored activity or group. Examples are investment credits, special depreciation deductions, deductions for special forms of consumption, low rates of tax for certain activities, and so on. These tax reductions, in effect, represent monetary assistance provided by the government.

In looking at these tax preferences, one is tempted to ask such questions as: Why have an assistance side to the tax system at all? If we have a properly constructed revenue-raising income tax, why ask the tax system to do anything more? Why ask it to provide assistance to businesses or individuals or activities when we already possess a budget process of direct expenditures for that purpose? The answers are mixed. Depending on the particular item, they lie in both ancient tax history and in recent events; in both a lack of realization of the assistance being provided by technical tax provisions when initially adopted and in a deliberate effort to provide assistance; in both the inexperience and mistakes of tax technicians and in the lobbying of strong pressure groups; in both the yielding to the demand, often idiosyncratic, of a strong-minded influential Congressman and in the yielding to the emotions of large congressional majorities; and, in recent years, especially in 1971, to the desire of the Republican Treasury Department to utilize tax incentives in contrast to the desire of the previous Democratic Treasury to stress direct assistance programs.

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But whatever the origin of these preference items, their continued presence today in the tax system lies in their defense by those who benefit from their existence.

These "spending" provisions engrafted onto the normative income tax have been given the name of "tax expenditures" in the United States. The congressional recognition in the Budget Reform Act of 1974 of this tax expenditure process has opened the way to a study of that process and its implications both for tax policy and budget policy.

II. DEVELOPMENT OF THE TAX EXPENDITURE CONCEPT

The legislative recognition in the Budget Reform Act of the tax expenditure process was prompted by two developments. In 1968, the Treasury Department published the first "tax expenditure budget."⁴ That Department in the 1960's had taken a general position against the use of tax incentives to advance acceptable social policy goals, and had instead urged the use of direct programs to provide the needed assistance. Its study of tax incentives disclosed that nowhere in government was there any comprehensive analysis of the existing tax incentives or of the amounts they involved. As a result, the Treasury undertook that analysis and drew up a list of tax expenditures together with an estimate of the revenue lost—*i.e.*, the amount spent—for each item. The list was arranged in accordance with direct budget categories and a comparison made between direct programs and tax expenditure programs.⁵ Similar lists were published in later years, principally by the tax staff of the Congress pursuant to a legislative direction in 1971.⁶ Although the Treasury had shifted its position and ultimately disfavored the use of tax expenditure analysis, tax reform studies began to focus on the concept.⁷ All this represented one strand of the tax expenditure concept, having its roots in an analysis of the tax structure and a comparison of the tax incentives with direct assistance.

The second strand grew out of the considerations involved in the Congressional Budget Act of 1974.⁸ At various times, the Congress had had serious disagreements with different Presidents with

⁴ ANNUAL REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES FOR FISCAL YEAR 1968, 326-40 [hereinafter cited as 1968 ANNUAL REPORT].

⁵ *Id.*

⁶ CONFERENCE REPORT ON THE REVENUE ACT OF 1971, H.R. REP. NO. 708, 92d Cong., 1st Sess. 49 (1971). For comparative purposes, the tax expenditure budgets for fiscal years 1968-1976 have been compiled in 1 S. SURREY, W. WARREN, P. MCDANIEL & H. AULT, FEDERAL INCOME TAXATION 242-45 (1972), and 1975 Supplement 101-05 (1975).

⁷ The tax expenditure concept and its uses were most fully developed in S. SURREY, PATHWAYS TO TAX REFORM (1973) [hereinafter cited as SURREY]. For a brief general statement see Surrey, *The Sheltered Life*, N.Y. Times, April 13, 1975, Magazine at 50.

⁸ Act of July 12, 1974, Pub. L. No. 93-344, 88 Stat. 297.

regard to the appropriate level of government spending.⁹ These disagreements intensified in 1972 and 1973.¹⁰ As these disputes developed, however, it became clearly evident that the Congress itself possessed no mechanism to shape its own overall view of government spending. Instead, it would pass a series of separate budgets for the various government departments without any specific overall target in mind. Further, the level of spending was not directly coordinated with the revenue figures, since different committees handled these items and there was no coordinating mechanism between them.

As a consequence of these experiences, Congress in 1974 developed a procedure designed to give overall direction to its budgetary actions and to directly relate those actions to its revenue decisions. In the process of designing that procedure, the legislators came to recognize the relationship between control of government spending and tax expenditures.¹¹ For example, if an overall figure is established for direct programs in the education or housing fields, those advocating more government aid in those fields would thus be blocked from obtaining direct assistance. These advocates could, however, turn to the tax committees and seek the same amount of assistance through special deductions for education or housing. If the tax committees adopted these tax expenditures, the control over direct spending would clearly be undercut. In effect, two spending processes existed in the Congress: one using traditional appropriations through authorizations initiated by the legislative committees and consequent appropriations initiated by the appropriations committees; the other using the tax system and reductions in tax liabilities initiated by the tax committees. In recognition of this duality, the Congress included in the Budget Reform Act of 1974 a number of provisions designed to identify existing and new tax expenditures and to coordinate the tax expenditure route with the direct spending route.

III. DEFINITION OF TAX EXPENDITURE

The identification in the Budget Reform Act of tax expenditures and their relationship to the budget process required a definition of

⁹ For example, the Congress in the Revenue and Expenditure Control Act of 1968, Act of June 28, 1968, Pub. L. No. 90-364, 82 Stat. 251, imposed an overall spending ceiling because of its concern that federal expenditures, fueled by the Viet Nam War, were not being kept under adequate control by President Johnson. *Id.* § 202, 203. *See, e.g., Hearings on President's 1967 Tax Proposals Before the House Ways and Means Comm., 90th Cong., 1st Sess. 1-217 (1967).*

¹⁰ The disagreements had by this time also expanded to include congressional dissatisfaction with the refusal of President Nixon to expend funds appropriated by Congress. For an historian's view of the "Impoundment" dispute, see A. SCHESLINGER, JR., *THE IMPERIAL PRESIDENCY* 397 (1973).

¹¹ *See Panel Discussions (Discussion on the Budgetary Process) Committee Organization in the House, House Select Comm. on Committees, 93d Cong., 1st Sess. 125 (1973) (statement of Stanley S. Surrey).*

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the term "tax expenditure." The Act provides the following definition:

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 liability¹²

The legislative history of the Act indicates that the quality of "special" relates to a "deviation from the normal tax structure for individuals and corporations."¹³ The legislative history also indicates that in using the term "tax expenditures," Congress had in mind the type of items included in the lists previously drawn up by the Treasury Department and the congressional tax staffs.¹⁴ In turn, the origin of the basic Treasury Department list shows that the list was derived from carefully considered criteria. As a guide, the process of identifying tax expenditures began with "widely accepted definitions of income,"¹⁵ here having in mind the general economic definition of income, *i.e.*, increase in net economic wealth between two points of time plus consumption during that period. However, the Treasury tempered that criterion by also referring to the "generally accepted structure of an income tax."¹⁶ Thus, it excluded as tax expenditures unrealized appreciation in asset values and imputed income from houses or other assets, since in the United States, and largely elsewhere, these items are not commonly regarded as income for tax purposes, though they fall within the economic definition of income. As another criterion, the Treasury referred to widely accepted "standards of business accounting" used to determine income for financial reports.¹⁷ With regard to expenses, it followed the economists' approach and considered as tax expenditures those provisions allowing deductions for personal consumption items or other items not incurred in the earning or production of income.¹⁸

Essentially, the concept of a normal (or normative) income tax structure was one of applying a rate schedule against the taxable unit's net income base—ascertained by including all items of gross income and deducting all expenditures associated with the production

¹² Budget Act, *supra* note 2, § 3(a)(3).

¹³ The quoted language is from the Senate version of the Act. S. 1541, 93d Cong., 2d Sess. § 3 (1974). Although this language was not included in the definition ultimately contained in the Act, the Conference Committee Report explained: "The Senate definition of 'tax expenditures' has been simplified although no change in meaning is intended." H.R. REP. NO. 1101, 93d Cong., 2d Sess. 50 (1974).

¹⁴ *E.g.*, 120 CONG. REC. S. 4107-14 (daily ed. March 21, 1974) (statement of Senator Javits); 120 CONG. REC. S. 4317 (daily ed. March 22, 1974) (statement of Senator Muskie). See note 6 *supra* for prior lists.

¹⁵ 1968 ANNUAL REPORT, *supra* note 4, at 327.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 327-28.

of that income, with capital expenditures allocated over time in accordance with generally accepted accounting practices—less personal exemptions. Departures from that norm—"special" provisions—were tax expenditures.¹⁹ The analysis extended to both the corporation income tax and the individual income tax, with the present separation of the two taxes accepted as a permissible facet of the normative structure in the United States.²⁰ The analysis also accepts the present approach of basing the definition of income and related computations on nominal amounts, that is constant dollars—and thus disregards the effect of inflation. This present approach does involve a choice as to the basic character of the income tax in this regard. A country could choose to base its income tax on real values and real dollars and hence adjust its definition of income and computations for inflation. Such a decision, however, should be a clean one. Thus, an approach that would adjust the cost of an asset for inflation in computing gain or depreciation but fail to make an adjustment for the decline in the real cost of funds borrowed to buy that asset would be effecting only a partial or preferential change to reflect inflation and would thus involve a tax expenditure.²¹

The enumeration of tax expenditures—the tax expenditure budget—like any budget enumeration is not concerned with the wis-

¹⁹ See *id.* at 327, 329-30; SURREY, *supra* note 7, at 4, 15 *et seq.* However, minor departures from the norm were disregarded to avoid too cumbersome a list. The economic definition is that developed in H. SIMONS, *PERSONAL INCOME TAXATION* 50 (1938).

The description of tax expenditures in the 1976 Special Analysis F, *supra* note 1, speaks in terms of whatever tax rates or exemption levels may exist from time to time as the "normal" rates or levels. *Id.* at 102. This view is not necessarily required. All that need be said is that a normal or normative income tax would of course contain rate schedules and exemption levels. Since these matters are politically determined and must essentially vary from country to country and from time to time, any particular set of rates or levels cannot be said, and need not be said, to be "normal." Such aspects, like the unit of taxation and the separation of the corporation and individual income taxes, in this sense, lie outside tax expenditure analysis. See also STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, *ESTIMATES OF FEDERAL TAX EXPENDITURES, PREPARED FOR THE COMMITTEE ON WAYS AND MEANS AND THE COMMITTEE ON FINANCE 4* (Comm. Print March 15, 1976) [hereinafter cited as *ESTIMATES OF FEDERAL TAX EXPENDITURES*], stating that items such as the rate schedules and personal exemptions are not a part of tax expenditure analysis.

²⁰ For a discussion of the competing considerations involved in employing a dual versus an integrated individual-corporate income tax structure see National Tax Association—Tax Institute of America Symposium, *The Taxation of Income from Corporate Shareholding*, 28 *NATL TAX J.* 257 (1975).

²¹ For discussions of indexing the definition of both individual and business income for inflation, and the related aspect of restating financial statements, see the forthcoming Brookings Institution volume on this subject.

The tax expenditure list does not include the last-in, first-out inventory method since that method has been a long-recognized acceptable method of inventory accounting and since its use for tax purposes is conditioned on its being used for book purposes. *INT. REV. CODE OF 1954* § 472(c).

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dom of the items included. Rather, the goal is simply the identification and quantification of the tax expenditure items, and the illustration of their relationship to the items and classifications of the direct budget.²² As a whole, given the concept of a tax expenditure, there is not much dispute over the composition of the current list being used by the Congress.²³ Usually an examination of the defense made for a

²² There appears in some quarters to be misconception regarding the significance to be attached to the presence of an item in the tax expenditure list. Some assume that this listing is an automatic statement that the tax expenditure is bad per se and a "loophole" in the popular usage. The listing, however, is not pejorative, but only descriptive of the included items as "spending" and not "taxing" provisions. The spending programs embodied in the listing may be helpful or harmful, necessary or unnecessary. The answers to these queries, however, lie not in the listing but in a careful analysis of the programs represented in the items listed. This is of course equally the situation for each item listed in the direct budget.

Another misconception regarding tax expenditures is the view that those who utilize the tax expenditure concept are implying, through the very listing of these various items, that the items should simply be eliminated from the tax system and that all else should remain the same. Clearly this is a misconception and quite foreign to a sensible approach to the tax expenditure concept. As stated in the text, the listing does not inform us as to whether the spending involved in an item is useful. In many cases it is not. In other cases, if spending through the income tax system were dropped it would be necessary or appropriate either to add the increased revenues to existing direct programs or to substitute a direct spending program (though not necessarily in the same amount or with the same design). Moreover, while a critical examination of the tax expenditure list could well result in the elimination of some items and a reduction of the amount involved in others, it does not follow that the remaining tax structure would remain unaltered. On the contrary, any significant increases in revenue resulting from changes in tax expenditures could be applied to alterations in the tax rate or exemption structure. Moreover, since a large number of the tax expenditure items provide incentives to savings and investment, many might urge that a general lowering of tax rates, with a goal of encouraging savings and investment through that course, should complement the elimination of tax expenditure incentives. Of course others might prefer using the funds so freed to increase or add direct budget programs. The point is, contrary to the misconceptions, that answers to these questions do not flow automatically from the step of utilizing the tax expenditure concept and list of tax expenditures.

²³ Critics of the tax expenditure approach often appear to proceed from the premise that the list is some sort of indiscriminate or haphazard listing of tax provisions, or else state that the term "special" in the Budget Act definition can have no helpful meaning in itself. See, e.g., MORGAN GUARANTY TRUST COMPANY, WHAT YOU GET TO KEEP MAY BE A "TAX EXPENDITURE," (December 1975) (Morgan Guaranty Survey), where the author styles the tax expenditure concept as a "semantic ploy," states, in effect, that the listing is "capricious and arbitrary," and then advances the observation that "the very concept of a tax expenditure remains fuzzy—and debatable." *Id.* at 9, 10. (Is it possible the writer of the piece desires to "fuzz" up the topic?) Such unsupported statements neglect the careful analysis that was used in the original approach and in the subsequent examinations of the list since 1968. Considering the various governmental units and persons who have worked in the area since 1968, the differences over the composition of the lists are indeed few. There can always be borderline questions but the clear items presenting no conceptual issue far outweigh the borderline questions that may arise and require further analysis.

Professor Carl Shoup, in Surrey, *Pathways to Tax Reform, A Review Article*, 30 J. FIN. 1329 (1975) [hereinafter cited as Shoup], though he cautiously concludes that a valid tax expenditure list can be drawn, seems to struggle with the problems he believes are raised in Professor Bittker's approach to tax expenditures through the path of a

particular provision discloses whether its supporters are treating it as a tax incentive and are arguing in those terms, or instead are really urging that the provision is needed to overcome a structural distortion in the proper tax structure that would otherwise exist.²⁴ The list used in the President's 1976 and 1977 Budgets does omit a few items which had appeared on previous lists and which appear on the present congressional list, but that omission is largely due to an overemphasis on certain policy positions of the current Treasury Department that impeded coherent analysis.²⁵

comprehensive income tax. See, e.g., Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NATL TAX J. 244 (1969) [hereinafter cited as Bittker]. However, like Professor Bittker's discussion, though considerably less so, Shoup's discussion does not separate the areas with which tax expenditure analysis is involved from the areas which lie outside that analysis, such as general rate schedules, personal exemption levels, determination of the taxable unit, and the relationship of the corporation tax to the individual tax. Once that separation is perceived, then a view that sees the tax landscape as one vast panorama without any distinctions is not relevant.

As another aspect of classification, Professor William Andrews, while accepting the validity of the tax expenditure concept, has demurred to inclusion in the list of the deductions for charitable contributions and medical expenses. See INT. REV. CODE OF 1954 §§ 170, 213. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972). To reach this conclusion, Professor Andrews in effect converts the normative structure of the tax system from one based on the production of income to one based on the expenditure or consumption of economic resources, excluding savings. He then argues that in a consumption-type tax, deductions for charitable contributions and medical expenses should not be regarded as tax expenditures. Professor Andrews' conclusions may be open to question even if the United States were to adopt a consumption tax. However, in an income tax system, the threshold question must be whether expenditures for charitable contributions and medical expenses are costs of producing income. Professor Andrews does not address himself to this issue. See SURREY, *supra* note 7, at 19-23 for further analysis of this aspect and for discussion of the "ability to pay" justification for the medical expense deduction. Indeed, critics of the definitions and criteria used to determine the tax expenditure list usually refer to items of medical expenses, INT. REV. CODE OF 1954, § 213, and casualty losses, INT. REV. CODE OF 1954, § 165(c)(3), as examples, and stop there, giving the impression that there are other numerous illustrations, but really focussing exclusively on these two situations involving loss of wealth and physical well-being.

²⁴ For example, the charitable contributions deduction was most recently analyzed by Congress in connection with the Tax Reform Act of 1969, Act of Dec. 30, 1969, Pub. L. No. 91-172, 83 Stat. 487. One searches in vain in the hearings by the tax committees for any argument or analysis by supporters of the deduction that charitable contributions represent costs of producing income and hence are proper offsets to gross income to arrive at taxable net income.

²⁵ The 1976 Budget list (in January 1975), *supra* note 1, omitted the exclusion of capital gains at death, deferral of income of controlled foreign corporations, and asset depreciation range—items which were included in previous Treasury and congressional lists. The 1975 congressional lists included these items and also the "maximum tax on earned income." See, e.g., STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES, PREPARED FOR THE COMMITTEE ON WAYS AND MEANS AND THE COMMITTEE ON FINANCE, (Comm. Print, July 8, 1975); H.R. REP. NO. 145, 94th Cong., 1st Sess. 53-55 (1975) (House Budget Committee). The 1975 Budget list (in January 1976), *supra* note 1, omitted these items, but they were included in the 1976 congressional list, which also added "cooperatives: deductibility of non-cash patronage dividends and certain other items." See ESTIMATES OF FEDERAL TAX EXPENDITURES, *supra* note 19. See also CONGRESSIONAL BUDGET OFFICE, FIVE YEAR BUDGET

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There are, of course, those who disagree with the tax expenditure concept itself, essentially on the rhetorical ground that the concept implicitly and erroneously asserts all income belongs of right to the government and that what the government decides not to collect, by exemption or otherwise, constitutes a subsidy. They add that while a subsidy used to mean a government expenditure for a certain purpose, it now also is said to mean a generous decision by government not to take your money.²⁶

One would think it obvious, however, that a decision to employ net income as a tax base—thus including all items of gross income and subtracting the costs of producing that income—does not in any way assert that all income belongs to the government. Once the tax base is properly determined, it is then the function of the rate structure to effect an appropriate allocation of each person's income for public needs. The tax expenditure concept does not dictate the adoption of a 100% flat rate of tax on net income—the rate implicitly necessary to support the argument advanced by the above critics of the concept. In practical life, of course, the rates adopted are determined by a complex set of factors including revenue needs, effects on labor and investment, political considerations, and so on.

Fortunately, practical legislators were not as bemused by form and rhetoric and did recognize that a tax preference can constitute a subsidy that produces monetary assistance to the same degree as the traditional direct subsidy. Others have difficulty in visualizing any such concept as a normative income tax structure and instead see the income tax as only the composite or jumble of statutory provisions resulting from numerous ad hoc legislative decisions.²⁷ Such an anarchistic view of the tax structure has the consequence of making tax

PROJECTIONS, FISCAL YEARS 1977-81, 49 *et. seq.* and Table 19 (January 26, 1976); CONGRESSIONAL BUDGET OFFICE, BUDGET OPTIONS FOR FISCAL YEAR 1977: A REPORT TO THE SENATE AND HOUSE COMMITTEES ON THE BUDGET 381 (March 15, 1976) (the Table at 384 is Appendix A of this article) [hereinafter cited as BUDGET OPTIONS FOR FISCAL YEAR 1977]. The 1977 Budget Special Analysis on Tax Expenditures, *supra* note 1, while excluding the above items, does contain descriptive material on them including estimates of the amounts involved and some indication the items could well have been included in the Budget list.

For descriptive summary material on each tax expenditure, see SENATE BUDGET COMM., TAX EXPENDITURES, 94th Cong., 2d Sess. 1 (March 17, 1976).

²⁶ See, e.g., Kristol, *Taxes, Poverty and Equality*, 37 THE PUBLIC INTEREST 3, 14 (1974), quoted in WHAT YOU GET TO KEEP MAY BE A "TAX EXPENDITURE," *supra* note 23, at 9; Coheen, *Is Private Philanthropy "Government Money"?*, 60 UNIVERSITY: A PRINCETON QUARTERLY 14, 16 (Spring 1974); exchange of letters of Kristol and Surrey in *Letters*, N.Y. Times, June 1, 1975, Magazine, at 61-63; Will, *The Non-Spending of Non-Taxes*, Wash. Post, April 22, 1976, at A-17, and letter of Senator Kennedy in response thereto, Wash. Post, May 2, 1976.

²⁷ This view has on occasion seemed to have been espoused by Professor Boris Bittker, although his writings in some instances appear to accept the utility of the tax expenditure concept. Compare Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244 (1969), with, Bittker, *The Tax Expenditure Budget—A Reply to Professors Surrey & Hellmuth*, 22 NAT'L TAX J. 538, 542 (1969).

policy formulation a task to be performed without criteria, guidelines, or standards, and any policy official who has tried to approach the tax conscientiously would reject that view. Moreover, the worldwide dialogue that continuously takes place among those who shape legislative tax developments—officials, theoreticians, tax professionals, and taxpayers—does assume a generally understandable set of concepts and norms representing the income tax. The speakers in that dialogue do have understandings of a normative tax structure in their minds, and while there may be some differences in those understandings, the degree of commonness about the understandings clearly overshadows those differences. It is that basic commonness of concepts that gives the dialogue rationality and vitality.²⁸

IV. THE ESTIMATES OF TAX EXPENDITURES

The estimates for the amounts spent through tax expenditures are stated in terms of the revenue losses attributable to the various items. The procedure for making these estimates is carefully explained in the Special Analysis F of the 1976 Budget.²⁹ Each item is estimated separately by assuming that the item were deleted and all else, including the rate schedule, remained the same. In the case of deferrals of tax liability, the estimate is based on the *current* revenue loss. Since most deferrals are likely to be lengthy or even indefinite and in a growing economy to increase over time, and since even a limited deferral involves a significant revenue loss (and corresponding benefit to the taxpayer) especially at an appropriate discount rate, this method of estimation is a reasonable approach for such deferrals. More significantly, the estimates for the various items assume that taxpayer behavior and general economic conditions would remain unchanged even though the particular item—be it incentive or subsidy—were eliminated.³⁰

²⁸ Thus, the proceedings of the International Fiscal Association, the membership of which is composed of government officials, lawyers, economists, academics, accountants, executives and investment advisors from many countries, reflect the generalized acceptance of normative income tax rules. See the annual *CAHIERS* published by the Association. Also in the absence of such widespread agreement, the task of formulating tax treaties between countries would be rendered virtually impossible. Tax treaties entered into by the United States by and large reflect this understanding, and deviations from the norm that are accepted by either or both of the treaty partners are generally clearly identifiable as such.

²⁹ See note 1 *supra*.

³⁰ As the discussion in the 1976 Special Analysis F, *supra* note 1, indicates, the estimates show the difference between budget receipts under the current tax law and budget receipts which would have been raised had a different tax law always been in effect. If the change in the tax expenditure involved a transitional approach to its elimination, then, as the Analysis states at 105-06, the estimate in the tax expenditure list would show more revenue than would be obtained in the transition years.

The discussion in Special Analysis F states that tax expenditure items cannot simply be added together for functional areas or for a grand total. The principal reason assigned for this view is a technical one derived from the estimating process: if two tax

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Mention should be made of some comments directed to this estimating approach. Thus, it is said, that if a number of items were eliminated, revenue rates generally might well be changed. This of course may be true, but to measure the present revenue loss it is necessary to use the present rate schedule.³¹ These comments focus more sharply, however, on the second assumption—that taxpayer behavior or economic conditions would remain unaltered—and it is said that this assumption is clearly erroneous and the estimates are therefore inaccurate because they fail to take into account taxpayer reaction to changes in tax expenditures. The comments point out that the consequently altered taxpayer behavior might lead to revenue losses in other areas (so that no net gain might occur if the tax expenditure were dropped) or result in such other taxpayer action as to require an increase in direct government expenditures.³²

The criticism, however, essentially overlooks the fact that all

expenditure exclusions from income were to be dropped, the combined effect would be greater than the addition of the two separate effects since that combined effect could push the taxpayer into a higher bracket than would a single change. Furthermore, with respect to itemized deductions which are included as tax expenditures, the Analysis states that the elimination of multiple tax expenditures could push taxpayers into the standard deduction, thus limiting the resulting revenue gain. (This assumes, probably incorrectly, that the standard deduction, which is a proxy for average itemized deductions, would remain unchanged despite major changes in itemized deductions; the low income allowance might be changed.) However, these effects of multiple changes would not appear to be a sufficient reason for not totaling the tax expenditures either by functional category or overall. Indeed, under the above reasons, the totals would probably underestimate the amounts actually involved. Another reason given for not aggregating the estimates is that if several tax expenditures were changed the assumption of no change in economic behavior or other aspects of the tax system would have little validity. This aspect is discussed in the text of the article at notes 31-33 *infra*. It should be noted that while these tax expenditures estimating considerations are also involved in estimates of direct expenditure programs, we are accustomed to using totals for those programs. See BUDGET OPTIONS FOR FISCAL YEAR 1977, *supra* note 25, at 382, where it was observed: "A similar measurement problem often is present with direct outlay programs as well. For example, if veterans' college benefits were ended, outlays would probably rise in the basic educational grant program."

³¹ See also note 22 *supra*.

³² Graetz, *Assessing the Distributional Effects of Income Tax Revision: Some Lessons from Incidence Analysis*, 4 J. LEGAL STUDIES 351 (1975) [hereinafter cited as Graetz], appears to take somewhat this view by stressing the importance of determining the precise economic effects in the economy if a tax expenditure were granted or dropped, *i.e.*, the ultimate consequences in terms of who benefits and who loses under the tax expenditure and under an elimination of that expenditure. He then describes a long trail of taxpayer and economic reactions that must be followed in order to answer these questions. Of course, some such analysis should be made when one is considering the wisdom of the item—the program—involved, but one need not require such an analysis to answer the initial question: What is the present revenue cost of the item or program—what is the Government now spending? Whether even to determine the wisdom of a particular program one must indulge in the full extent of the analysis Graetz suggests and follow his long trail is still another issue. There is some skepticism that economists and others have the sufficient knowledge of the various possible taxpayer behavior reactions and economic consequences to enable one to pursue that trail as far as he would like. See also note 52 *infra*.

Treasury estimates follow the approach taken in formulating the estimates in the tax expenditure budget.³³ This is because, as the critics themselves acknowledge, it is very difficult to predict taxpayer reaction to changes in revenue provisions. Consequently, the Treasury and the Congress have thought it safer in most situations involving the estimation of revenue loss or gain from a tax change to use a "first order" estimate that is in effect a "snapshot" of the present world with this one change made. Indeed, data regarding the direct budget essentially proceed on this "first order" basis—it will be said that \$X can be saved if a direct program is dropped, with the calculation based on the present program cost and no conjecture made as to any ripple effect in behavior if the direct program is dropped. While it is surely worthwhile to attempt to learn more about such "ripple effects" of taxpayer behavior incident to tax law changes, the consideration of those effects is a proper subject in connection with the analysis, in cost-benefit terms or otherwise, of the wisdom or effectiveness of a particular tax expenditure. As far as the tax expenditure estimates are concerned, however, it should be recognized that such estimates follow the presently accepted course used by the Treasury and Congress with regard to both revenue estimates in general, and direct expenditure programs.

V. LIST OF TAX EXPENDITURES

The present list of tax expenditures used by the Executive Branch and the Budget and Tax Committees of the Congress is set forth in a Report of the Congressional Budget Office in 1976.³⁴ It includes tax expenditures resulting from the Tax Reduction Act of 1975 and several other additions.³⁵ Two aspects stand out at once on

³³ See BUDGET OPTIONS FOR FISCAL YEAR 1977, *supra* note 25.

³⁴ BUDGET OPTIONS FOR FISCAL YEAR 1977, *supra* note 25, at 384-87. This list is set out in Appendix A. The differences in the Budget list and the congressional list are described in note 25, *supra*. The revenue estimates in Appendix A assume that the tax changes effected by the Revenue Adjustment Act of 1975, Act of Dec. 23, 1975, Pub. L. No. 94-164, 89 Stat. 970, are made permanent. The 1976 Joint Committee Staff Estimates, *supra* note 25; assume that these tax changes are allowed to expire according to their terms. As a result, the JCIRT staff estimates are somewhat lower than the Congressional Budget Office figures for 1977-81 in several instances. The figures given in the two estimates for the maximum tax on earned income also vary, but the difference in this instance appears to have resulted from the different mechanical estimating procedures employed.

³⁵ The additions are: exclusion of interest on state and local government pollution control bonds (under "Natural Resources, environment and energy") and interest on state and local industrial development bonds (under "Commerce and transportation"), both being separated from the item exclusion of interest on general purpose state and local bonds (under "Revenue Sharing and general purpose fiscal assistance")—formerly all three were grouped together; the earned income credit (1975) and the exclusion of special benefits for disabled coal miners (under "Income Security"); the exclusion of rental value of parsonages and housing allowances of ministers (now included in excluded "Meals and lodging" under "Income security"); deferral

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an examination of this list. The first is the variety of categories and items involved.³⁶ The list is arranged by direct budget classifications and shows that the tax expenditures approach covers nearly every budget category in the United States. A second aspect of the list is that the overall total is quite large—almost \$106 billion for fiscal 1977. The direct budget outlays for that fiscal year may total \$419 billion. Thus, it is clear that tax expenditures are a sizeable amount in relation to direct programs. In some budget functions, more government funds are provided through the tax system than are spent directly, as in Commerce and Transportation (notably Housing). In some other areas, tax expenditures constitute the largest program under a particular function, as in Agriculture. Indeed, in the case of Government subsidy payments, the tax expenditures or tax subsidies far exceed the total of all direct subsidies. The \$106 billion in expenditures effected through the income tax system in fiscal 1977 may also be compared to the estimated yield of the income tax—\$234.5 billion in that period.³⁷

VI. USES OF THE TAX EXPENDITURE CONCEPT

A. Budgetary Aspect

The recognition that government assistance is being provided through the tax system and that the consequent tax expenditures are a very large and important segment of government spending has many implications. One way of putting the matter is to inquire into

of interest on U.S. savings bonds (under "Interest"); excess first-year depreciation and expensing of construction period interest and taxes (under "Commerce and transportation"); and cooperatives (under "Agriculture"). The exemption of credit unions has been placed under "Commerce and transportation."

The descriptive material in the 1976 Special Analysis F, *supra* note 1, states that the exclusion of appreciation on assets contributed to charitable and educational organizations is included in the estimates for contributions to those organizations.

The earned income credit item in Special Analysis F, *supra* note 1, includes only credits offsetting tax liabilities; the refundable credits are included in direct budget outlays. The Congressional Budget Office list set out in Appendix A includes both aspects.

The list may contain a few significant gaps. Thus, more study should be given to the possible existence of tax expenditures in the various accounting provisions, *e.g.*, installment accounting and completed contract method of accounting; in the tax exempt organization area, *e.g.*, to what extent would income be present if these organizations were tested by rules applicable to entities subject to income taxation; in the various rules exempting from income tax the benefits of in-kind governmental financial assistance, *e.g.*, food stamps, rent subsidies, and the like. The Budget Analysis does discuss in-kind governmental benefits and provides an estimate for the exclusion of food stamps. It also discusses the tax treatment of various types of cooperatives, also giving estimates. Cooperatives are included in the congressional list.

³⁶ There are a number of very minor tax expenditure items whose inclusion would only obscure the research and attention that should be paid to the significant items in the present list, or to significant items that may have been omitted. Thus, at the present, the search need not be for a complete list covering every single tax preference in the Internal Revenue Code.

³⁷ BUDGET OPTIONS FOR FISCAL YEAR 1977, *supra* note 25, at 14-15.

the uses of a tax expenditure concept. In considering this matter we may start with the *budgetary aspect*. Certainly a government should know how much it is spending and for what purposes. A tax expenditure budget provides this essential and elementary knowledge with respect to the spending channelled through the tax system. It is interesting to observe that a country that gathers as much detailed government statistics as the United States did not have this knowledge until 1968, and that perhaps only one other country presents these data officially. In all likelihood, the data are not available in other countries.³⁸

Once the knowledge exists, appropriate analysis becomes possible. The presence of an item in the tax expenditure table does not tell us whether the assistance given is desirable as a national goal or not.³⁹ Here, as with any direct expenditure, we must weigh the particular assistance against competing claimants, and reach a judgment based upon our view of the national priorities involved. Even if the goal is appropriate, the presence of an item in the tax expenditure table does not tell us whether the particular assistance is being provided in a rational, equitable, and efficient way. Here also, just as with direct expenditure items, we need to analyze the particular situation, understand who is receiving what, and then weigh the costs and benefits in the light of the priority of the goal, and the effectiveness of the means chosen to achieve that goal.

To do so we can ask the usual question relevant to any budgetary matter: Does the tax expenditure item represent a priority goal of the government, as respects those assisted and the amount involved? A useful, initial way to test a tax expenditure in this regard is to ask if government would directly spend such funds for the purpose at hand. If not, then why should the money be spent through the tax system?⁴⁰

³⁸ See note 3 *supra*. A great deal more information on the practice in other countries will be made available through the September, 1976 Jerusalem Congress of the International Fiscal Association (IFA), which has chosen as one of its subjects "*Tax Incentives as an Instrument for Achievement of Government Goals: Their Role in Income Taxation and a Comparison with Alternative Instruments Regarding Both Economic and Social Goals*." The General Report for that subject, *supra* note 3, presents a summary description of the data on, and attitudes towards, tax incentives in about twenty countries, and the separate National Reports provide further detail. The picture that emerges is that only the United States and West Germany provide official data on tax expenditures. See Ault, *supra* note 3. The relation of tax expenditures or tax incentives to the fiscal process is not considered in other countries and both qualitative and quantitative data on such items are relatively or almost absolutely non-existent. In effect, nearly every country lacks knowledge and control regarding this significant aspect of its tax policy and budget policy. But we must remember that the same could be said of the United States less than ten years ago. The IFA discussion is likely to stimulate at least academic thinking in some countries. Also, as the General Report describes, the OECD is beginning to explore ways of achieving some internationally comparable data on this subject.

³⁹ See note 22 *supra* and accompanying text.

⁴⁰ For example, for a discussion of the tax expenditures for farm operations, considered as direct farm programs, see *Hearings on Tax Reform Before the House Ways and Means Comm.*, 94th Cong., 1st Sess. 1362 (1975) (statement of Paul R. McDaniel).

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This last question takes us to the next level of consideration. Assuming that government assistance in the particular area is a priority goal, then should the assistance be in the form of a direct program or through the tax system? It is the experience in the United States that until recently little thought was given to this aspect of the inquiry and thus there were no criteria developed to govern the choice since no analysis had been made of the factors involved in the choice.⁴¹ Gradually, however, various factors that are involved in a choice of the tax system are being recognized.⁴² Thus, it is now realized that a tax expenditure in the form of an exemption, exclusion, or deduction provides the greatest assistance to the wealthiest taxpayers and to the large corporations, in view of the progressive individual tax rates and the higher rate for large as opposed to small corporations. Tax expenditure assistance is usually "upside-down" assistance. Moreover, the choice of the tax system automatically excludes from the assistance non-taxpayers, such as individuals below taxable levels, loss proprietorships and loss corporations, exempt organizations, and governmental units. This exclusion exists even where the aspect of upside-down assistance is alleviated by using a credit against tax instead of an exemption or deduction.⁴³

It is clear that no direct program would be structured in such an upside-down or exclusionary fashion. Thus, in the United States the

⁴¹ The IFA General Report, *supra* note 3, indicates that this question is scarcely being asked in any other country when the tax route is used to provide government assistance.

⁴² For a discussion of the factors involved in the choice between tax assistance and direct assistance, see SURREY, *supra* note 7, at 126-74.

⁴³ It is sometimes said that use of a tax credit mechanism avoids the upside-down aspects of tax expenditures effected through deductions, exemptions, or exclusions. This is not necessarily so. If the tax credit itself should be taxable, then failure to include the amount of the credit in income will mean that the credit is of greater value to a wealthy taxpayer than it is to a lower-income taxpayer. To avoid the upside-down effect where a tax credit is employed, one must ask whether amounts paid under a direct financial assistance program structured like the tax credit would, under normal tax principles, be includible in gross income. If these principles would require the inclusion of direct payments in the recipient's income, then a tax credit in the same amount should also be treated as taxable income. Failure to do so will result in an upside-down tax expenditure, although the range of the benefits from upper to lower income recipients will be considerably narrower under a tax credit than under a deduction or exemption.

For example, in 1975, Congress approved changes in the child care deduction to allow its benefits to be obtained by higher income individuals. Act of March 29, 1975, Pub. L. No. 94-12, § 206, 89 Stat. 27, 32. For a family of four (two children) with \$35,000 adjusted gross income, the benefit of this tax expenditure will be approximately \$1728 (assuming marginal tax bracket of 36% times the maximum qualifying child care expenditures of \$4800). On the other hand, a family of four with \$15,000 adjusted gross income receives a maximum benefit of only \$1056 (22% times \$4800). The House Tax Reform Bill, H.R. 10612, 94th Cong., 1st Sess. (1975), would have converted the child care deduction to a tax credit of 20% of child care expenses up to a maximum of \$2000 of expenses for one dependent (or \$4000 for 2 or more dependents). The amount of the credit, however, was not required to be included in income. (Query, does Congress have to tell the Internal Revenue Service whether each tax expenditure constitutes taxable income under § 61, even though it leaves this determina-

tax deduction for home mortgage interest means that the government pays \$700 of each \$1,000 of mortgage interest for a wealthy homeowner in the 70% bracket—and does so for his residence and his summer vacation home and his winter vacation home—but pays only \$140 for the homeowner in the 14% bracket, and zero for the least well-off of homeowners because they are not taxable. This is equally so for the property taxes on the home. Even though the encouragement of home ownership is presumably a priority goal in the United States, it does not take much intuition to understand that no direct assistance program for home ownership with this upside-down distribution of benefits would ever be voted, and the few direct programs we do have (though our tax program is the largest housing program) such as mortgage interest assistance,⁴⁴ are not upside-down.⁴⁵ Similarly, deferrals of tax liability gained through the expens-

tion to the IRS in the case of direct expenditure programs?). Assuming that proper tax principles would require a recipient of a direct governmental subsidy for child care to include these amounts in income, failure to include the amount of the proposed child care credit in income would provide a maximum benefit of \$560 for a 70 percent bracket taxpayer ($20\% \times \$4000 \times 70\%$), \$112 for a 14% bracket taxpayer, and zero to a poverty level taxpayer. See generally, H.R. REP. NO. 658, 94th Cong., 1st Sess. 146 (1975). It has been urged that the proposed child care credit be made refundable. 122 CONG. REC. S. 3755, 3764 (daily ed. March 18, 1976) (statement of Senator Kennedy before the Senate Fin. Comm.).

The treatment of a credit under income tax principles does not necessarily require a direct inclusion in income. Thus, a direct subsidy similar to the investment credit might be viewed as a contribution to capital requiring a corresponding reduction in the basis for depreciation. Compare INT. REV. CODE OF 1954 § 118, with § 362(c). The tax credit voted in the Senate January 29, 1976, 122 CONG. REC. S. 822-877 (daily ed. Jan. 29, 1976) for organizations providing child care (equal to 20% of the first \$5,000 of wages paid each welfare recipient employed in the provision of child care) if structured as direct assistance would presumably be includible in taxable income as a direct subsidy for operations. The credit as passed by the Senate was refundable, in order to make the assistance available to public and non-profit child care centers. See H.R. REP. NO. 9803, 94th Cong., 1st Sess. (1975), as reported by the Senate Finance Committee and passed in the Senate, and S. REP. NO. 592, 94th Cong., 2d Sess. (1976): The bill was, however, vetoed by the President.

⁴⁴ 12 U.S.C. § 17152-1 (1970).

⁴⁵ While there are some who would quarrel with the text statement and say that we cannot be sure that Congress would not favor upside-down direct programs, they are not explicit in giving examples of upside-down programs they believe Congress would approve. A group coming closest here is the Filer Commission Report, REPORT OF THE COMMISSION ON PRIVATE PHILANTHROPY AND PUBLIC NEEDS, GIVING IN AMERICA 106-14, 127-34 (1975), which offers a defense of the upside-down charitable deduction. Yet one can be skeptical that this Commission would risk a congressional vote on a direct program allocating to individuals, on an upside-down basis, funds earmarked for distribution by them to charitable organizations of their choice.

Some offer the defense for the upside-down aspect of tax expenditures that such effect is merely the reflection of the progressive individual rate structure. See, e.g., Morgan Guaranty Survey, *supra* note 23, at 13: "Inescapably, of course, if Congress wishes to achieve an economic or social goal by means of 'tax expenditure,' it must rely most heavily on those most able to finance that goal: those with the most discretionary funds, i.e., those in upper-income brackets." This is quite a sentence. It can either merely be explaining the upside-down character of tax expenditures, though it neglects to point out that the funds made available are government funds involved in the tax

ing of items that are properly capital expenditures also operate in an "upside-down" fashion, resulting in interest-free, nonsecured loans of the deferred tax liability, with the size of the loan increasing as the benefitted individual's or corporation's income increases.⁴⁶ The interesting, perhaps sad, fact is that until recently, legislators never really understood the implicit upside-down aspect involved in granting assistance through the tax system by these special deductions or exclusions.

The Congress has recently released tables showing the distribution of tax expenditures assistance for individuals by income classes.⁴⁷ Partly because of the upside-down aspect and partly because many of the activities assisted represent expenditures or activities of the well-to-do, *e.g.*, capital gain transactions and exemption of state and local bond interest, the tables show that the overwhelming amount of tax expenditure assistance goes to upper-income groups. Thus, for 1974, of the \$58 billion in tax expenditures for individuals, over 23 percent went to individuals with incomes over \$50,000, who constituted only 1.2 percent of all taxpayers.⁴⁸ On the other hand, the 46.9 percent of taxpayers with adjusted gross incomes of less than \$10,000 received only 16.6 percent of these tax expenditures.⁴⁹ Seen as an average, the 160,000 taxpayers with adjusted gross incomes over \$100,000 received an average of \$45,662 each in tax benefits, while the approximately 9.9 million taxpayers with adjusted gross incomes of between \$15,000 and \$20,000 received \$901 each.⁵⁰ (Obviously, the precise assistance for each taxpayer in the group would involve a wide range, and the figures illustrate only the general upside-down character of the assistance.) There is thus one set of generalizations that can be made about the choice of the tax system to provide government assistance—the assistance is likely to be provided in an upside-down manner and to be skewed to favor those already well-off.

This discussion of the relationship of the techniques used to the

expenditure. Or it can be saying that because we have a progressive income tax it is only right that those who pay the largest taxes should have the largest control over the spending of government funds—a view that seems a complete non-sequitur to say the least.

While it is not necessary at this point to maintain that no direct program would be structured in an "upside-down" manner, it is proper to assert that those who defend "upside-down" tax expenditures should recognize openly that the programs are indeed "upside-down" and should be required to bear the burden of proof as to the appropriateness of such a result.

⁴⁶ See Statement of Paul R. McDaniel, *supra* note 40, for a description of the loan programs for farm operations that are contained in present tax expenditure provisions.

⁴⁷ See Appendix B. The table is taken from 121 CONG. REC. S. 9174-77 (daily ed. June 2, 1975) (statement of Senator Mondale) and is based on Treasury Department data. Similar distributional data for each tax expenditure are contained in SENATE BUDGET COMM., TAX EXPENDITURES: COMPENDIUM OF BACKGROUND MATERIAL ON INDIVIDUAL PROVISIONS, 94th Cong., 2d Sess. (Comm. Print, March 17, 1976).

⁴⁸ See Appendix B.

⁴⁹ *Id.*

⁵⁰ *Id.*

objectives sought to be achieved also points to the various ways in which the beneficiaries of the tax expenditures may be described or classified. At the first level, there is the overall or broad initial target category of beneficiaries, *e.g.*, the aged, homeowners, consumers, certain categories of employees, certain categories of investors, and so on. The next level involves an analysis of the income groups within this overall target category which actually benefit initially from the tax expenditure and the extent of the benefit, *i.e.*, the tax reduction. As a result of the "upside-down" effect of the technique usually adopted, the actual distribution of the tax benefits will in the main usually accrue disproportionately to only a small portion of the intended beneficiaries and this small group will be the persons who are already better off and who have the least need for assistance.

A third level of description of beneficiaries would seek to discover the ultimate economic beneficiaries of the tax expenditure as its consequences ripple throughout the economy. Tax expenditures for home ownership will aid the construction industry; tax expenditures for investors in residential real estate will aid the construction industry and perhaps tenants; tax expenditures for the interest on state and local bonds will aid state and local governments; tax expenditures for students will aid schools; and so on. The opposite is also true, in that the removal of the tax expenditure will have its own set of economic effects. The construction industry may suffer; tenants may have their rents raised; state and local governments may resort to higher taxes on some groups; schools may lose students; and so on. Obviously this analysis of ultimate economic beneficiaries is related to the earlier discussion of the estimates beyond "first order" estimates,⁵¹ and involves the difficult, almost endless task of tracing the effects of the tax expenditure through the economy. Essentially, this task becomes an analysis of the desirability of the tax expenditure itself—what does the expenditure really accomplish and is the accomplishment worth the cost in revenue and tax equity?⁵²

⁵¹ See discussion at note 33 *supra*.

⁵² Essentially, it is this third level of description discussed in the text that is the subject of Graetz, *supra* note 32. A difficulty with this analysis is that one is tempted to push it too far, where the imponderables of the various choices available begin to defeat an understanding of the effects of the tax expenditure or its removal. Thus, it is well and good to point out that a wealthy investor in a state tax exempt bond may not gain as much as one might expect from the exclusion of the interest on the bond, because, if the exclusion were eliminated, the state, in order to meet its added interest costs, might have to resort to taxes which might have an effect on the investor, but this needlessly distracts attention from the very real benefits now being obtained by that investor because of the tax expenditure.

It also distracts attention from the fact that the "first order" recipients of tax expenditure items extract a high commission for delivering the benefits of the tax expenditure to those ultimate beneficiaries whom Congress really intended to assist. These "messengers," so to speak, who carry the tax expenditure checks to those ultimate beneficiaries are well paid, which is but the mirror image of the inefficiency of tax expenditure assistance. See, *e.g.*, as to tax exempt bonds, *Hearings on Alternatives to Tax-Exempt*

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There is another set of generalizations that can be made about the efficiency of using the tax expenditure assistance process rather than direct programs. Generally, and certainly until recent years, these tax expenditures were rarely examined. They lay hidden in the tax structure, often worded and looking like any normal structural provision since the technical tax jargon appeared the same. Furthermore, they did not have to be voted on each year. Whatever may be the weaknesses in our direct budget programs, they usually do have to endure more scrutiny. Thus, the Joint Economic Committee in commenting in 1974 on increases in government spending said: "The largest absolute increase has occurred in tax subsidies. Tax expenditures are not included in any budget and therefore they are not reviewed on a systematic and regular basis."⁵³ With the advent of the tax expenditure budget, this absence of scrutiny may be redressed. But the items are still in the tax laws and as such are usually permanent unless changed. On the other hand—and equally irrationally—the amounts involved in many tax expenditure programs are changed, automatically and without discussion, each time Congress changes rates, exemption levels, or the standard deduction. Moreover, the "tax reform" struggles to change or remove tax expenditure items take place within the tax committees. These committees are often uninformed on the real issues involved and on the other programs that relate to the tax assistance. A look at the titles in the tax expenditure list will reveal at once that many other congressional committees have as their principal areas of expertise the items in that list—housing, education, agriculture, commerce, labor, and so on. The presence of an item in the tax expenditure budget is generally a sign of lack of study and coordination within the executive departments and the Office of Budget and Management.

There are basic issues of efficiency and rationality in government spending. Cost-benefit and other forms of analysis are now customarily applied to direct government spending programs. They can and should be applied equally to tax expenditure programs. If experience in the United States is any guide, many tax expenditure programs would be found lacking any priority status. Moreover, those that do represent appropriate goals would be found lacking in fairness and

State & Local Bonds Before the House Ways and Means Comm., 94th Cong., 2d Sess. 153 (1976) (statement of Stanley S. Surrey). As to other commissions to "messengers," see McDaniel, *Tax Shelters and Tax Policy*, 26 NATL TAX J. 353 (1973) [hereinafter cited as McDaniel] and SURREY, *supra* note 7, at 244. The analysis in the Graetz article, *supra* note 32, seeks to pursue the trail further, but the assumptions are likely to become too hard to control and if pursued too far, are likely to distract us from the main effort.

It may be observed that an analysis of levels of beneficiaries similar to that in the text should be used for direct expenditures as well, though presumably in such an analysis there should not be a difference, as there is in the case of tax expenditures, between the category of intended beneficiaries and that of the groups within that category caused by the "upside-down" effect of the tax technique.

⁵³ JOINT ECONOMIC COMMITTEE, FEDERAL SUBSIDY PROGRAMS, STAFF STUDY FOR SUBCOMM. ON PRIORITIES AND ECONOMY IN GOVERNMENT, 93d Cong., 2d Sess. 4 (1974).

efficiency.⁵⁴ Economy and efficiency in government spending would thus be served by a careful re-examination of items in the tax expenditure list.⁵⁵

B. Tax Reform Aspect

1. Effective Rates Paid by United States Taxpayers

Returning to the central matter of the uses of the tax expenditure concept, we may shift our attention from the budgetary aspect to the *tax reform aspect*. There is considerable concern in the United States over those well-to-do individuals and large corporations who pay little or no income tax year after year.⁵⁶ The key to an under-

⁵⁴ Congress is beginning to be made aware of the fact that one useful way of understanding the effects of a tax expenditure provision is to compare it to an existing direct expenditure program. For example, if one is analyzing the tax expenditures for agriculture as government spending programs, the structure of direct spending programs for farm operations would appear highly relevant to determining whether the tax expenditure program is furthering our overall national agricultural policy. Preliminary work in this area indicates that, in fact, tax expenditures for agriculture may be operating in a manner that is directly counter to the objectives of direct federal financial programs for farmers. See Statement of Paul R. McDaniel, *supra* note 40, at 1377-82. The task of comparing existing direct and tax expenditure programs has only just begun, but the technique appears to offer a fruitful method of assisting Congress in understanding and evaluating decisions to use the tax expenditure route.

The insistence in the text of the need for examining both routes for government assistance, the tax expenditure route and the direct route, and the belief that many tax expenditures would come off second best in such a comparison does not, as some seem to assert, mean that this view is but an "idealization of the appropriations process;" see Shoup, *supra* note 23, at 1337, quoting Bittker, *supra* note 23. The belief is expressed with the full understanding that the appropriations process is far from ideal—but certainly this does not detract from the proposition that the tax expenditure process is even further from that ideal.

⁵⁵ Shoup, *supra* note 23, raises the interesting question of whether government subsidies should be given to a business that is currently not operating at a profit. Apparently this question has not been much discussed by economists in considering subsidies. It is raised, however, by proposals to make the investment credit refundable. See, e.g., 122 CONG. REC. S. 3765 (daily ed. March 18, 1976) (statement of Senator Kennedy). The question is also linked to tax shelters, since tax expenditures that cannot be directly used by a business currently not operating at a profit are made available to such business through the tax shelter device, e.g., bank equipment leasing. See McDaniel, *supra* note 52. If government assistance is to be given only to profit-generating enterprises, then this factor must be injected into the criteria to be considered in choosing between the tax route and the direct route—the issue here would be which route can more readily distinguish between losing ventures and profitable ventures. Professor Shoup also mentions the aspect of promptness of paying the government assistance, and here also studies would be required on the promptness with which direct subsidies can be paid compared with tax subsidies, as well as the consequences of subsequent checks, through audits, under both routes.

S. 2925, 94th Cong., 2d Sess. (1976), would establish a so-called "zero-base" review and evaluation procedure to require that all direct budget programs be examined each four years to determine if the programs should be continued or terminated. Senator Glenn introduced an amendment to the bill that would subject tax expenditure programs to the same zero-base review. See 122 CONG. REC. S. 4768 (daily ed. April 1, 1976).

⁵⁶ See, e.g., 121 CONG. REC. S. 16564 (daily ed. Sept. 24, 1975) (statement of

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standing of this situation is the tax expenditure list. It is this list that explains why some of the wealthiest individuals in the United States pay little or no income tax and why some businesses on *Fortune Magazine's* list of the largest corporations also pay little corporate tax. The list also explains why, with individual tax rates stated in the law to rise to 70 percent, the actual rate of tax paid overall by the group of individuals with over \$100,000 income is between 30 and 40 percent, with some in this group paying far less or even zero.⁵⁷ It explains why, with a corporate tax rate stated in the law to be 48 percent, the average real rate is around 35 percent, with some corporations paying far less. Furthermore, the real corporate tax rate varies erratically both *among* industries and *within* any particular industry depending on the effects of the tax expenditure list.⁵⁸ Put another way, this list is the key to the present income tax escape by the wealthy and by corporations. It is the key to why some individuals and corporations are favored by the tax system and therefore pay far lower taxes than others alongside them with the same income or profits.

In the case of individuals, the Treasury, except for studies in 1968, has been unwilling to describe the extent of individual tax escape and the causes of those escapes. Yet enough is known from the 1968 Treasury studies and from some scant data released by the tax committees⁵⁹ to conclude that the causes lie in the tax incentive assistance represented by items in the tax expenditure list. The special treatment of capital gains (excluding one-half of capital gains on lifetime sales and the exclusion of all capital gains at death) is the most significant factor, followed by the exemption of state and local bond interest, and the use of "tax shelters."⁶⁰ These "tax shelters" in turn are built on the tax incentives granted to general business investment and to particular industries, such as the investment credit, very accelerated depreciation, special five-year amortization of capital expenditures in certain industries (a current favorite of the tax committees), the expensing of certain construction costs for residential housing and other buildings, oil depletion and the expensing of drilling costs, and favorable farm accounting rules.⁶¹ Some escapes are built around the

Senator Kennedy) (as regarding wealthy individuals); 121 CONG. REC. H. 9755 (daily ed. Oct. 7, 1975) (statement of Representative Vanik) (regarding corporations).

⁵⁷ J. PECHMAN & B. OKNER, WHO BEARS THE TAX BURDEN? 49 (1974).

⁵⁸ See TAX NOTES NO. 46, at 26-36 (Nov. 17, 1975).

⁵⁹ See 121 CONG. REC. H. 79 (daily ed. Jan. 14, 1975) (statement of Representative Corman). See also Tax Shelter Investments: Analysis of 37 Individual Income Tax Returns, 24 Partnership and 3 Small Business Corporation Returns. Prepared for the use of House Comm. on Ways and Means, Sept. 3, 1975.

⁶⁰ See Appendix B.

⁶¹ For descriptions of the operation of the tax shelters built around these various tax incentives, see S. SURREY, PATHWAYS TO TAX REFORM 92 *et seq.* (1973); Panel Discussions on the Subject of General Tax Reform Before the House Ways and Means Comm., 93d Cong., 1st Sess., pls. 4-6 (1973); Hearings on the Subject of Tax Reform Before the House Ways and Means Comm., 94th Cong., 1st Sess. 1360-1608 (1975); McDaniel, *Tax Shelters and Tax Policy*, 26 NAT'L TAX J. 353 (1973); McDaniel, *Tax Reform and the Revenue Act of*

generous deductions for personal consumption expenses.⁶²

In the case of corporations, while a similar Treasury reluctance to provide data exists,⁶³ a rule of the Securities and Exchange Commission⁶⁴ has enabled tax reform groups to compile reasonably accurate data concerning the effective rates paid by corporations.⁶⁵

1971: *Lesions, Lagniappes and Lessons*, 14 B.C. IND. & COMM. L. REV. 813 (1973); Kurtz, *Tax Incentives for Real Estate Have Failed*, 3 REAL ESTATE REV. NO. 2, at 66 (1973); H. AARON, *SHELTER AND SUBSIDIES: WHO BENEFITS FROM FEDERAL HOUSING POLICIES?* (1972); JOINT ECONOMIC COMMITTEE, *THE ECONOMICS OF FEDERAL SUBSIDY PROGRAMS, A COMPENDIUM OF PAPERS* (1972-74); pamphlets on tax shelters prepared for the House Ways and Means Committee during its consideration of H.R. 10612, 94th Cong., 1st Sess. (1975); discussion in H.R. REP. NO. 658, 94th Cong., 1st Sess. 25-130 (1975).

⁶² The Treasury's "Minimum Taxable Income" (MTI) proposal in 1973 recognized this fact by computing the proposed minimum tax on "expanded adjusted gross income" which would have had the effect of subjecting itemized personal deductions to the minimum tax. See *Hearings on General Tax Reform Before the House Ways and Means Committee*, 93d Cong., 1st Sess. 6873, 6985 (1973) (statement of Hon. George P. Shultz, Secretary of the Treasury). See also H.R. 10612, 94th Cong., 1st Sess. (1975) adding as a preference under the minimum tax, itemized deductions in excess of 70% of adjusted gross income.

⁶³ There is some Treasury data on effective corporate rates contained in the *Joint Hearings on Small Business Tax Reform Before the Select Comm. on Small Business and Subcomm. on Financial Markets of the Senate Finance Comm.*, 94th Cong., 1st Sess. 1423, 1430 (1975). This data, however, significantly omits some of the differences between taxable income and corporate book income and hence overstates effective corporate rates.

⁶⁴ 17 C.F.R. § 210.3-16(a) (1975).

⁶⁵ The data are published periodically by Tax Analysts and Advocates in TAX NOTES. For a summary of 1974 data, see Kaplan, *Disparity in Corporate Rates Raises Questions About Underlying Tax Policy*, 3 TAX NOTES No. 46, at 13-36 (Nov. 17, 1975). For a discussion of the technique used to obtain corporate effective rates from the S.E.C. data, see Kaplan, *Effective Corporate Tax Rates*, 2 J. CORP. TAX. 187 (1975).

Professor Bittker, in *Effective Tax Rates: Fact or Fancy*, 122 U. PA. L. REV. 780 (1974) discusses what he perceives to be problems in determining effective rates of tax. As he correctly observes, one must define the base or measure of income against which the actual tax paid is applied, in order to obtain the ratio which is the effective rate. He also observes that various presentations have used varying measures of income. In large part, however, the variations in the case of those who understand the proper technique involved are traceable to the lack of adequate data, especially as to individuals. Furthermore, the extent of this data gap changes from time to time. Essentially, for individuals, one could use taxable income plus tax expenditures plus personal exemptions as the base; for corporations, corporate book income, i.e., S.E.C. data, may be used. The problem of achieving agreement on the proper technique is not as difficult as the Bittker article seems to indicate.

Moreover, the utility of proper effective tax rate analysis is considerably greater than the above article indicates. It may of course be true that if a number of tax expenditures were eliminated, the present progressive rate structure might be altered downwards. But the fact remains that the present rate structure is in the law, and people generally believe that because of it the well-to-do pay reasonably high income taxes. Effective tax rate analysis shows that in fact this is not the case—many well-to-do individuals are in fact escaping the income tax. This is in itself an indication that something is seriously amiss and an explanation of the causes of this escape is required. Thus, effective tax rate analysis is a useful key to the issues to be examined: why the escapes from tax; why the large disparities between effective tax rates and statutory rates; why large disparities among individuals with the same economic income and among corporations with the same book income. After all, it is an income tax that is involved—a tax

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This rule requires public corporations to indicate why their provision for taxes varies from 48 percent of their financial or book income, and to indicate the amounts attributable to each significant factor in that variation.⁶⁶ The factors, of course, turn out to be the items in the tax expenditure list in the categories involving business activity. The principal general factors are the investment credit, accelerated depreciation, and deferral of taxes on foreign subsidiaries. The principal industry factors are: for *oil*, depletion and expensing of intangible drilling costs;⁶⁷ for *banks*, exemption of state and local bond interest, excessive deduction for bad debt reserves, and tax shelters;⁶⁸ for *utilities*, expensing of construction interest and other capital costs,⁶⁹ for *retailers*, the use of installment accounting;⁷⁰ for some *drug*, and other manufacturers, the exemption of income earned in the United States possessions such as Puerto Rico;⁷¹ for *timber*, the capital gain treatment applied to the value of cut timber;⁷² for some *exporters*, the use of DISC.⁷³

The overall effective rate for eight leading industrial companies in *Fortune Magazine's* list for 1974 was 34.6 percent.⁷⁴ However, the

which is supported by the public because it believes it to be a fair tax which is geared to the taxpayer's ability to pay. Thus, there is something seriously wrong with such a tax where a wealthy person pays the same or less tax on his economic income than a skilled worker pays on his economic income. The same serious question is raised by the disparities between corporate effective tax rates and the statutory 48% rate.

⁶⁶ 17 C.F.R. § 210.3-16(a) (1975).

⁶⁷ 3 TAX NOTES No. 16 at 5 (April 21, 1975); *Id.* No. 25 at 14 (June 23, 1975); *Id.* No. 28 at 7 (July 14, 1975).

⁶⁸ 3 TAX NOTES No. 17 at 16 (April 28, 1975).

⁶⁹ 3 TAX NOTES No. 29 at 14 (July 21, 1975).

⁷⁰ 3 TAX NOTES No. 34 at 14 (Aug. 25, 1975).

⁷¹ 3 TAX NOTES No. 31 at 20 (Aug. 4, 1975); *Id.* No. 42 at 13 (Oct. 20, 1975).

⁷² 3 TAX NOTES No. 22 at 14 (June 2, 1975).

⁷³ 3 TAX NOTES No. 32 at 8 (Aug. 11, 1975).

⁷⁴ 3 TAX NOTES No. 46 at 26 (Nov. 17, 1975). This average is unweighted for company size. The largest company, Exxon, had an effective United States tax rate on domestic income of 32.7%; its worldwide effective tax rate of 71.3% on worldwide income (and its effective rate on foreign income of 79.6%) is affected by the aspect of the "non-income tax" components of foreign income taxes, *i.e.*, royalties or excise taxes paid to foreign governments that are labeled "income taxes," included in the latter figures. (For this reason, the text considers only the leading industrial companies and does not include the leading oil companies.) The Exxon Company estimated its U.S. rate on domestic income for 1975 at around 41%, reflecting the 1975 change in percentage depletion; the worldwide rate was estimated at 74.4%. 4 TAX NOTES No. 8 at 11, 13 (Feb. 23, 1976).

Sunley, *Effective Corporate Tax Rates: Toward a More Precise Figure*, 4 TAX NOTES No. 9 at 15 (March 1, 1976), using national income and products account data and applying adjustments explained in the article, found a worldwide effective corporate tax rate on worldwide profits of 32.7% for 1972 and 1973 and 34.1% for 1974 (the 1974 increase is attributed to a significant increase in foreign source oil income and the impact of inflation), and a domestic effective corporate rate on domestic profits of 31.7% for 1972, 31.2% for 1973 and 31.1% for 1974 (the difference from the worldwide rate is attributed to high-taxed foreign source oil income). The worldwide figure for 1960 was 40.5%; the domestic figure for 1960 was 40.6%. The divergence between the two

variation in effective tax rates for different industries and also the variation among companies in the same industry is quite startling. Thus, the following shows the variation in effective corporate income tax rates among various industries in 1974:⁷⁵

Tobacco	46.1%
Personal Care Products	44.1%
Chemical	39.4%
Electronics	37.9%
Paper	37.1%
Beverage	36.6%
Drugs	35.8%
Non-Food Retail	35.4%
Aerospace	34.1%
Conglomerates	34.1%
Metals and Mining	30.8%
Office Equipment	30.6%
Banks	17.0%
Utilities	9.2%

The intra-industry variation in effective tax rates can be demonstrated by a few examples: aerospace companies ranged from 7.7 percent to 47.5 percent; drug companies, from 16.2 percent to 46.6 percent; non-food retailers, from 6.5 percent to 46.0 percent; conglomerates, from 22.1 percent to 43.1 percent. The top eight major industrial firms varied in effective rates from 16.1 percent to 46.5 percent.⁷⁶

These wide variations demonstrate the effect that tax expenditure assistance has on the fairness of the tax system. They also show the extreme unevenness that results from using the tax system as a vehicle for government spending. A tax-and-budget-system that produces these wide swings would seem to be *prima facie* suspect and ground for concern.

2. Effective Rate Analysis—The Aspect of "Foregone Income"

Where a tax expenditure is involved, the result is to lower the effective rate of income tax below the rate that would otherwise exist under the statutory rate schedule without the tax expenditure. Thus, for example, if an individual received only tax exempt income, then his effective tax rate would be zero. The customary effective tax rate determination compares actual tax paid to total actual income (as de-

figures appeared to commence in 1971.

⁷⁵ 3 TAX NOTES NO. 46 at 26-33 (Nov. 17, 1975). The figures represent worldwide rates on 1974 pre-tax worldwide income as reported to shareholders. For an interesting discussion of the "subsidy" aspects involved in including foreign taxes paid in the determination of the effective tax rate, see BIEDERMAN & TUCCIO, *THE TAXATION OF FINANCIAL INTERMEDIARIES: SUMMARY REPORT 19-23* (1975) (National Savings & Loan League).

⁷⁶ 3 TAX NOTES NO. 46 at 26-33 (Nov. 17, 1975).

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fined in tax expenditures analysis). However, the individual directly enjoying the tax expenditure benefit may be receiving a lower pretax gross income than he would have received from a transaction in which no tax expenditure were involved. Should this lower gross income be reflected in the determination of the effective tax rate? In other words, should the *loss* of gross income be considered as a "tax" paid, thereby producing a higher tax than the actual tax payment and hence a higher effective tax rate than would be produced if this loss of gross income were not taken into account?

Suppose that individuals *A* and *B* each have the same income and have the opportunity to invest either in tax-exempt bonds yielding \$100,000 of income or in taxable bonds yielding \$130,000. *A* decides to invest in the tax-exempt bonds and *B* in the taxable bonds. *A* pays no tax on the income; *B* pays \$65,000. Ordinarily, *A* would be considered as having an effective rate of tax of zero and *B* an effective tax rate of 50 percent. However, if *A* had invested in taxable bonds his gross income would have been \$130,000. Is it proper, therefore, to conclude that in fact *A* has paid an imputed "effective tax rate" of 23.1 percent and that *this* figure—not zero—is the one to utilize when comparing the effective tax rates paid by *A* and *B* on their respective incomes?

The approach of imputing a "tax" because of income foregone is not a useful analytic technique for the policy-maker as part of the determination of effective tax rates. The above example holds true only in a closed investment world where *A*'s only alternative investment choice is the taxable investment yielding \$130,000. In reality, however, we do not know the amount of gross income that *A* has foregone, since we do not know what *A* would have done with his capital had the option of investing in tax-exempt bonds not been presented. Indeed we cannot know just how well *A* has done by utilizing the tax-exempt benefit. All we can say is that *A* in this example decided to forego 23.1 percent of the gross income he would have received had he invested in the particular taxable bonds yielding that much more than his tax-exempt bonds. This "loss" of 23.1 percent is not comparable to *B*'s effective tax rate of 50 percent—it merely reflects the yield of particular tax-exempt bonds as compared with that of particular taxable bonds.

The diminution in *A*'s gross income is thus not the same as a tax provision stating that if *A* receives \$1.3 million of taxable income, his tax rate will be 23.1 percent instead of the regular rate schedule. Rather, *A* is being given a zero tax rate on his investment in tax-exempt bonds. How well he does with that investment is up to *A*. He may, if he is willing to take some risk, do very well indeed since some tax-exempt bonds have a yield that is much higher than the 23.1 percent below taxable bond yield used in the above example.

To put the matter another way, suppose that in looking at the entire range of available investments, *A* could have invested in a high-risk oil venture that would have yielded \$2.6 million in gross in-

come. Should we now say that *A*'s "effective rate" is 61.5 percent (a tax of \$1.6 million on the hypothetical \$2.6 million)? Indeed this would suggest that *B* did not pay a 50 percent effective rate either since he too opted for a lower yield investment.

A similar situation exists with other tax expenditures. The tax system grants generous tax benefits to tax shelters. What an investor in a real estate tax shelter does with his tax shelter investment—how little he must pay the developer for buying the tax benefits and hence how large an overall return he obtains—depends on his investment policies and acumen.

It is therefore neither appropriate nor helpful, as an aspect of effective tax rate analysis, to attempt to state these varying results to the different direct beneficiaries of tax expenditures as imputed effective tax rates. Effective tax rate analysis involves actual incomes and actual taxes. The construction of a "tax rate" through the imputation of a hypothetical income that an individual might have received by following a different investment path and then comparing the hypothetical income with the individual's actual income is a different task that should not be associated with effective tax rate analysis. Indeed in a world of widely varying investment opportunities, each with its own risks and yields, the task seems generally unproductive.⁷⁷ As far as the Treasury is concerned, *A*'s effective tax rate is zero. Looking at actual dollar flows and actual taxes paid, this is the most useful way to describe the direct federal income tax consequences for *A* and *B*, and the impact of tax expenditures on horizontal tax equity.

We may of course keep in mind that *A* is "giving up" some gross income in using the tax expenditure, which leads us to the discussion of "efficiency" in the use of tax expenditures and the varying "com-

⁷⁷ In comparing the effective tax rates of commercial banks and savings and loan associations, a research study for the National Savings and Loan League does discuss the imputation of a gross income loss for commercial banks investing in tax exempt bonds, and introduces the result into the effective tax rate comparison. The description of the analysis used illustrates the problems discussed in the text of this article. The data also indicate that an adjustment taking account of the "lost income" would produce only a minor upward adjustment in the effective tax rate obtained in the customary fashion. BIEDERMAN AND TUCCIO, *supra* note 75, at 23-30. This study also analyzes the "gains" and "losses" resulting from regulatory restrictions placed on financial institutions and seeks to work these effects into an overall effective tax rate, *id.* at 11-18. This combination of varying federal measures does seem confusing. If this method of analysis is pursued it would seem more appropriate to: (1) compute the conventional effective tax rate comparison and give the result this descriptive term; (2) describe the consequences of the lower gross income resulting from utilizing tax expenditures and if possible quantify the "loss" by a comparison with some alternative standard or customary income producing activity, and give this figure some descriptive term, such as "cost of utilizing tax expenditure;" and (3) describe, and if possible quantify, the economic consequences of regulatory measures and give this figure some descriptive term, such as "regulatory cost" or "regulatory benefit." If possible, the three figures could then be combined into an overall quantitative measure, given a descriptive term such as "overall government subsidy." See also POSNER, *TAXATION BY REGULATION*, BROOKINGS REPRINT 218 (1971), which analyzes the effects of regulation in tax terms.

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missions" involved in the different tax expenditures.⁷⁸ In our example, *A* could be regarded as having been paid \$35,000 (his net benefit compared with *B*) by the Government to deliver a \$30,000 check to a state or local government (the benefit in interest saving to that government). *A* thus received a "commission" of \$35,000 for delivering that check. This "commission" results when a tax expenditure is granted to one person, the "first order beneficiary" (*A* in the above example), but the real object of the tax expenditure is another party—the intended beneficiary (the state or local government issuing the bond). The intended beneficiary can derive a benefit only if there is some flow-through of the economic value of the tax expenditure to the intended beneficiary. The flow-through is usually, however, less than complete for a variety of reasons depending on the particular tax expenditure. As a consequence, the first-order beneficiary (the direct taxpayer recipient) receives in effect a "commission" for acting as the intermediary or "messenger" who delivers the tax subsidy benefits to the second-order or intended beneficiary (and to others as the subsidy moves through the economy).

This "commission" may be substantial. Its amount is, in effect, a measure of the inefficiency or lack of effectiveness of the tax expenditure in achieving its intended tax subsidy purpose. A high commission indicates a wastage of government funds in using the tax expenditure route compared with a direct subsidy to the intended beneficiary. Thus, the tax-exempt bond commission is overall about one-third of the total revenue loss involved—with some individual commissions running much higher—indicating a highly inefficient tax expenditure.⁷⁹ Tax shelter commissions vary with the particular tax shelter.⁸⁰

Even if no monetary commission results, as may be the situation with the charitable deduction (though the final evidence here is yet to be obtained),⁸¹ this does not mean that the "messenger" receives no value or benefit for his service. Thus, though the direct taxpayer beneficiary of the charitable deduction may convey in full the tax benefit of that deduction (the tax expenditure subsidy) to charitable beneficiaries through an increase in his charitable giving, it is conveyed to the charitable beneficiaries *selected by the taxpayer*, so that *he* is given the "power" to spend the government funds allocated overall to charities.⁸² Obviously, that "power" has its values to those performing

⁷⁸ See note 52 *supra*.

⁷⁹ See, e.g., H.R. REP. NO. 413, 91st Cong., 1st Sess. 172-73 (1969); SURREY, *supra* note 7, at 360.

⁸⁰ See McDaniel, *supra* note 52.

⁸¹ For a study showing no direct monetary commission, see Feldstein, *The Income Tax and Charitable Contributions: Part I—Aggregate and Distributional Effects*, 28 NAT'L TAX J. 81 (1975).

⁸² See MCDANIEL, STUDY OF FEDERAL MATCHING GRANTS FOR CHARITABLE CONTRIBUTIONS, pt. 3 (1975) (prepared for the Commission on Private Philanthropy and Public Needs) (study available from the Commission, Wash., D.C.).

the selection. As another example, a lessor bank that may derive a relatively small direct commission in arranging a tax shelter lease will undoubtedly receive business benefits from the activity.

Thus, while the "giving up of income"—performing as a messenger or the deliverer of the tax subsidy check—very often involves an exercise of real power over government assistance (as in the charitable deduction situation or in the decision of what housing will be built in the real estate tax shelter), the value of this power is difficult to determine. This seems another reason to remain with conventional effective tax rate analysis rather than to impute the gross income that might have been received on an alternative investment and express the difference between the two incomes as a "tax."

3. Tax Reform, Spending Reform and Simplicity in the Tax System

To return to the main theme of tax reform, it is clear that the causes of individual tax escape in the United States and the causes of the aforementioned wide variations in the corporate effective tax rates lie in the tax expenditure list.⁸³ As a consequence, and as the mirror image of this situation, the issues of tax reform in the United States revolve essentially around proposed and present tax expenditures. To be sure, the matter of overall rate schedules and exemptions is a constant tax and political issue. But the intense struggles of tax reform are over tax expenditures.⁸⁴ Those groups or activities that are benefiting from tax expenditure assistance—government funds—desire to keep those funds. Those interested in tax reform—tax fairness, horizontal equity, elimination of tax escape—and also those interested in budget reform—less spending and more efficient use of government money—seek to reduce those funds and hence to eliminate or cut back the tax expenditures.⁸⁵ Since

⁸³ See text at notes 59-76 *supra*.

⁸⁴ Thus, while tax reductions through increases in the low income allowance (minimum standard deduction) and the percentage standard deduction were effected with relative ease in the Tax Reduction Act of 1975 and the Revenue Adjustment Act of 1975, Congress became stymied in its efforts at more substantive tax reform. The tax reform bill, on which the House Ways and Means Committee had worked off and on for three years, finally emerged from the Committee in a less-than-strong form, passed the House (which actually strengthened the bill)—H.R. 10612, 94th Cong., 1st Sess. (1975)—but was split off from the tax reduction measures by the Senate Finance Committee to be acted upon in 1976. Virtually all of the tax reform provisions contained in the House-passed bill involved tax expenditure items.

⁸⁵ Senator Kennedy in 1975 illustrated the connection between tax and budget reform in an amendment he proposed to Senate Concurrent Resolution 76 (the Second Concurrent budget resolution required by the Budget Reform Act) which provided for a \$300 million increase in government revenues from tax reform. The amendment, which was at variance with the strategies necessary to achieve prompt passage of the budget resolution, was defeated 76-21, with the vote recognizing those strategies. See 121 CONG. REC. S. 20653 (daily ed. Nov. 20, 1975). Senator Kennedy urged that the Budget Resolution for fiscal 1977 contain a specific figure by which overall tax expenditures would have to be reduced. See 122 CONG. REC. S. 3899 (daily ed. March 22, 1976).

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tax expenditure assistance covers so many fields, these tax reform struggles spread over a wide range of business and social activity. The issues, of course, are not tax issues but basic matters of governmental expenditure policy. Yet they are concentrated in the tax committees, and hence much of the expertise and insight that would otherwise be brought to bear on the resolution of the issues is never utilized. Similarly, tax technicians in government and tax practitioners in private practice are required to spend an inordinate amount of time on areas in which they have little expertise—pollution control, housing, solar energy, and the like.

It should also be noted that a study of the causes of complexity in the tax system would also lead to the tax expenditure list. A normative income tax is bound to be complex in itself. But a tax system that encompasses both a normative income tax and a very wide and expansive set of spending programs will obviously take on a large degree of additional complexity. However, those who criticize modern tax systems for their complexity fail to see that much of the troublesome complexity lies in the tax expenditure process.

C. Constitutional Law Aspect

An aspect of the tax expenditure concept that is beginning to surface is the *constitutional law aspect*. Under United States constitutional doctrines, the government may in general not engage in discriminatory activities, as regards race or sex for example, or act without due regard for fair procedures and process. Hence, direct government spending programs that may involve such practices can be challenged in the courts.⁸⁶ Similarly, private entities significantly supported by government funds and engaging in such practices are also

1977 assumed a \$2.0 billion revenue increase for "changes in existing tax expenditures and related provisions." S. REP. NO. 731, 94th Cong., 2d Sess. 8 (1976). The House Budget Resolution revenue projections similarly assumed "that the Congress will modify existing tax expenditures to realize a net increase of \$2.0 billion in revenues during fiscal year 1977." REPORT OF THE HOUSE BUDGET COMM. ON H. CON. RES. 611, FIRST CONCURRENT RESOLUTION ON THE BUDGET—FISCAL YEAR 1977, H. REP. NO. 1030, 94th Cong., 2d Sess. 23 (1976). The Conference Committee Report stated: "The conference substitute assumes, as did both houses, realization of a net \$2 billion increase in revenues through tax reform." H. REP. NO. 1008, 94th Cong., 2d Sess. (1976). Reportedly, the change in wording from "tax expenditures" in both the House and Senate Budget Committee Reports to "Tax reform" in the Conference Committee Report was inadvertent and did not reflect any substantive change. The term "tax expenditure" is the more precise and should be adhered to in Budget resolution actions. See text at notes 133-34, *infra*. The First Concurrent Resolution was approved by both Houses. See 122 CONG. REC. S. 7076 (daily ed. May 12, 1976); 122 CONG. REC. H. 4381-82 (daily ed. May 13, 1976).

The increasing congressional awareness of the identity of tax reform tax expenditure issues was reflected in a recent colloquy on tax reform in the Senate. See 122 CONG. REC. S. 5556-86 (daily ed. April 13, 1976).

⁸⁶ See, e.g., *Flast v. Cohen*, 392 U.S. 83 (1968).

subject to challenge.⁸⁷ The question now being raised is whether these constitutional doctrines apply to tax benefits and to private entities receiving those benefits.⁸⁸ Thus, the grant of direct government aid to a private school or other entity that practices race discrimination would be unconstitutional.⁸⁹ This being so, is the income tax exemption granted to that school or entity as a charitable organization, or the grant of a charitable deduction to individuals contributing to the school or entity, similarly subject to challenge?⁹⁰ A grant of funds to parents who send their children to parochial schools is unconstitutional as state aid to religion.⁹¹ Does the granting of an income tax credit to those parents also violate the Constitution?⁹² As another example, it is arguable that an owner of an apartment building constructed in part with federal funds cannot evict tenants without allowing them a fair hearing.⁹³ Is the owner of an apartment building who utilizes an investment tax credit, accelerated depreciation, and the expensing of certain construction costs also subject to the same constraints?

The underlying issue in the above queries is that of whether such tax assistance is equivalent to direct assistance. It would seem that the tax expenditure list is a useful index to those provisions in the tax system that should be subject to the same constitutional restrictions as parallel programs financed by direct government spending. The lawyers involved in litigating in this area, however, have not yet fully perceived the significance of the tax expenditure concept, and hence the courts have yet to effectively utilize it. The courts have, however, in several instances acted to subject tax assistance to the re-

⁸⁷ See, e.g., *Evans v. Newton*, 382 U.S. 296 (1966); *Burton v. Wilmington Parking Authority*, 365 U.S. 715 (1961).

⁸⁸ For a discussion of the doctrine of "state action" in relation to governmental assistance through both direct and tax expenditures, see Brown, *State Action Analysis of Tax Expenditures*, 11 HARV. CIV. RIGHTS—CIV. LIB. L. REV. 97 (1976).

⁸⁹ *Poindexter v. Louisiana Fin. Assistance Comm.*, 275 F. Supp. 833 (E.D. La. 1967), *aff'd*, 389 U.S. 571 (1968).

⁹⁰ See *McGlotten v. Connally*, 338 F. Supp. 448 (D.D.C. 1972) (indicating the tax benefits are unconstitutional); *Green v. Connally*, 330 F. Supp. 1150 (D.D.C. 1971), *aff'd without opinion, sub nom. Coit v. Green*, 404 U.S. 997 (1971).

⁹¹ See, e.g., *Lemon v. Kurtzman*, 403 U.S. 602 (1971).

⁹² See *Committee for Pub. Educ. & Religious Liberty v. Nyquist*, 413 U.S. 756 (1973), holding both direct grant and tax credit unconstitutional. In addition to the cases cited in note 90 *supra*, and *Nyquist*, see the following cases where, although the grant of tax assistance was upheld, the courts appeared to apply rules applicable to direct government expenditure programs: *Walz v. Tax Comm.*, 397 U.S. 664 (1970); *Marker v. Shultz*, 485 F.2d 1003 (D.C. Cir. 1973); *McCoy v. Shultz*, 73-1 U.S.T.C. ¶9233 (D.D.C. 1973). See also Comment, *Tax Incentives as State Action*, 122 U. PA. L. REV. 414 (1973); Note, *The Internal Revenue Code and Racial Discrimination*, 72 COLUM. L. REV. 1215 (1972); Bittker & Kaufman, *Taxes and Civil Rights: "Constitutionalizing" the Internal Revenue Code*, 82 YALE L.J. 51 (1972); Comment, *Religion in Politics and the Income Tax Exemption*, 42 FORDHAM L. REV. 397 (1973).

⁹³ See Note, *Procedural Due Process in Government-Subsidized Housing*, 86 HARV. L. REV. 880, 904 n.115 (1973).

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strictions that would apply to direct programs.⁹⁴ This entire field is still in a formative state and presents extremely interesting and important questions for both tax systems and constitutional law.

VII. GOVERNMENTAL PROCESS ASPECTS

A. Legislative Process

1. The Budget Act Framework

The Budget Reform Act and the congressional structure and process it created for consideration of budgetary matters will, in all likelihood, cause increased attention to be given to the tax expenditure concept in the years ahead. Thus, that Act established a Senate Budget Committee and a House Budget Committee whose essential functions are to develop an overall congressional approach to the annual budget process.⁹⁵ One duty specifically assigned to these Committees is

to request and evaluate continuing studies of tax expenditures, to devise methods of coordinating tax expenditures, policies and programs with direct budget outlays, and to report the results of such studies to the Senate (House) on a recurring basis⁹⁶

The Act also created the Congressional Budget Office, with a Director and a large staff.⁹⁷ One of the duties assigned to that Office is that of providing information to congressional committees with respect to bills providing tax expenditures and related general information on tax expenditures.⁹⁸ Further, as earlier described,⁹⁹ the Act requires the President to include a list of tax expenditures in his annual Budget¹⁰⁰ (Special Analysis F in the 1976 and 1977 Budgets). It also requires each Budget Committee, in reports accompanying its First Concurrent Resolution fixing the initial overall budget amount, to state the projected levels of tax expenditures.¹⁰¹ In preparation for such Budget Committee reports, the tax committees, just as other standing committees are required to report their programs as to di-

⁹⁴ See material cited in notes 90 and 92 *supra*. In some cases, *e.g.*, *Marker v. Shultz*, 485 F.2d 1003 (D.C. Cir. 1973), *McCoy v. Shultz*, 73-1 U.S.T.C., ¶9233 (D.D.C. 1973) and *Junior Chamber of Comm. v. The United States Jaycees*, 495 F.2d 883 (10th Cir. 1974), the courts seem also to be assuming that tax exemption given to an organization is not per se sufficient assistance to invoke constitutional sanctions, usually referring to *Walz v. Tax Comm.*, 397 U.S. 664 (1970). This indicates the need for further analysis of such tax exemption provisions, see note 35 *supra*.

⁹⁵ Budget Act, *supra* note 2, §§ 101, 102.

⁹⁶ *Id.* §§ 101(c), 102(a).

⁹⁷ *Id.* § 201.

⁹⁸ *Id.* §§ 202, 308(b), (c).

⁹⁹ See text at notes 1, 2 *supra*.

¹⁰⁰ Budget Act, *supra* note 2, § 601.

¹⁰¹ *Id.* § 301(a), (d).

rect expenditures, must, by March 15, submit to the Budget Committees information concerning their programs that can effect increases or decreases in the appropriate level of federal revenues.¹⁰² Presumably such reports should include proposed changes in tax expenditures. Also, the tax committees are required in the reports accompanying any bills involving tax expenditures to state how the bills affect the existing tax expenditure levels.¹⁰³ There can be no bill considered decreasing revenues (and hence presumably increasing tax expenditures) until the initial budget resolution is adopted, and, after the resolution fixing the final budget limit there can be no tax expenditure legislation that would reduce the total revenues below the figure in the latter resolution.¹⁰⁴

Under this framework, the Senate and House Budget Committees have each established a Task Force relating to tax expenditures.¹⁰⁵ Also the Congressional Budget Office has a unit, headed by an Assistant Director for Tax Policy, charged among other duties with analyzing tax expenditures. The members and staffs involved are now beginning to chart their future steps. It is likely they will begin by analyzing, on an ad hoc basis, some of the new tax expenditures involved in current proposals as well as some significant existing tax expenditures.¹⁰⁶ In certain areas, they may also engage in cooperative studies of the interrelationships of tax expenditures and direct programs, with the legislative committees having jurisdiction over the direct programs and the staffs of the tax committees.¹⁰⁷ Such cooperative studies in the various fields covered by tax expenditures are an obvious necessity, since as indicated above,¹⁰⁸ the basic questions for tax expenditures are whether the particular monetary assistance involved is a national goal, and if so, whether that assistance should be handled via the direct budget or channelled through the tax system. If the answer for a specific item turns out to be that

¹⁰² *Id.* § 301(c). For an example of the considerations affecting the report of the tax committees to the Budget Committees, see SENATE FIN. COMM., DATA AND MATERIALS FOR THE FISCAL YEAR 1977 FIN. COMM. REPORT UNDER THE CONGRESSIONAL BUDGET ACT, 94th Cong., 2d Sess. (Comm. Print, Feb. 23, 1976).

¹⁰³ Budget Act, *supra* note 2, § 308(a). For an example of such a report provision, see H.R. REP. NO. 19, 94th Cong., 1st Sess. 81 (1975).

¹⁰⁴ Budget Act, *supra* note 2, §§ 303(a), 311(a) and Conference Report thereon.

¹⁰⁵ 3 TAX NOTES No. 30 at 10 (July 28, 1975).

¹⁰⁶ For example, Senator Kennedy proposed that the Congressional Budget Office institute a study on methods of providing federal assistance for construction and rehabilitation of low income housing. 122 CONG. REC. S. 3755, 3761 (daily ed. March 22, 1976).

¹⁰⁷ For a proposal to institute such a study in the agricultural area, see *Hearings on Tax Reform Before the House Ways and Means Comm.*, 94th Cong., 1st Sess. 1362 (1975) (statement of Paul R. McDaniel).

The Congressional Budget Office is undertaking a study of tax expenditures and direct programs in the area of housing, which involves the staff of the CBO, and the staffs of the Congressional tax and housing committees. See also 122 CONG. REC. S. 3761 (daily ed. March 18, 1976) (statement of Senator Kennedy).

¹⁰⁸ See text at notes 39-40 *supra*.

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monetary assistance is desirable but that it should be handled as a direct program, then obviously coordinated legislative action is needed to drop the tax expenditure and adopt the direct program, and to insure the proper transitional steps. In recognition of this need for coordination, the so-called Hansen resolution of 1974¹⁰⁹ regarding the House Committee structure provides that each legislative committee must review and study on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction.

2. Impact of Committee Jurisdictions

The legislative aspects of enacting and revising tax expenditures have a special focus in the United States because of the committee system operating within Congress, including the large professional staffs employed by the Congress. In the United States, committee jurisdiction in Congress is of critical importance. With respect to tax expenditures and related aspects, what is beginning to emerge as a crucial matter is the ease with which many legislative issues can become "tax matters" through a simple restructuring of the suggested solution, and hence fall within the jurisdiction of the tax committees rather than within that of the legislative committees otherwise having jurisdiction over the area. While the House and Senate must of course ultimately pass on any bill reported by a committee, it is of great importance which committee, which committee chairman, which committee staff—and often as a concomitant—which executive agency, develop the bill. Put another way, the tax committees have the jurisdictional ability to take over much of the legislative field by providing a "tax answer" to the issue.

Thus, if it is a question of increasing the conservation of energy by encouraging home owners to insulate their homes or by encouraging business firms to utilize solar energy, the legislative committees with jurisdiction in the energy area can produce a program of direct assistance for these activities. But the tax committees can obtain jurisdiction—and the Treasury can enter the act—by providing a tax incentive for these activities, such as a special tax deduction or credit for money spent on home insulation or solar energy equipment.¹¹⁰ If it is a matter of encouraging the purchase of new homes, while the banking committees could offer direct assistance, the tax committees can obtain jurisdiction by providing a tax credit for such purchases.¹¹¹ These simple examples may be applied to almost any issue involving

¹⁰⁹ H.R. RES. 988, 93d Cong., 2d Sess. 23-24 (1974); H.R. REP. NO. 916 (Part II), 93d Cong., 2d Sess. 65-69, 119 (1974).

¹¹⁰ See, e.g., the House-passed version of the Energy Conservation and Conversion Act of 1975, H.R. 6860, H.R. REP. NO. 221, 94th Cong., 1st Sess. 48, 51 (1975). For a topical discussion of the energy bill, see Drew, *The Energy Bazaar*, THE NEW YORKER at 35 (July 21, 1971).

¹¹¹ See INT. REV. CODE OF 1954, § 44, enacted in 1975 but not extended in the Revenue Adjustment Act of 1975.

government assistance. The approach can also apply to issues involving government control. Thus if it is thought desirable to discourage energy waste by restricting the use of automobiles consuming excess amounts of gasoline, the legislative committees could produce a program of direct regulation and controls utilizing certain standards and direct sanctions. But the tax committees can obtain jurisdiction by providing an excise tax on the sale of such automobiles, thereby utilizing the same standards though applying a tax instead of a regulatory sanction.¹¹² The same approach can extend to pollution control or any field in which an excise tax or other tax sanction can be devised. It may be seen that the use of tax sanctions to control conduct is akin to the use of expenditures to encourage conduct. Both control and encouragement are essentially governmental non-tax policies engrafted onto a normative tax system and channelled through it instead of being pursued through the use of direct non-tax programs.

All this being so, the need for further thinking about these problems is clear. The jurisdictional situation among congressional committees is but a surface indication of deeper problems centering on the appropriate uses of the tax system. Tax expenditure analysis is teaching us that important issues lie within the questions of when desired government assistance should be provided through direct programs and when through the tax system, and what are the criteria applicable to and the consequences of that choice. An extension of that analysis is beginning to teach us that similar issues lie within the questions using the same standards.¹¹³ The appropriate forums for the resolution of these questions should, for the Congress, primarily be the new Budget Committees and the new Congressional Budget Office. In the Executive Branch the forums should be the Office of Budget and Management in the President's Executive Office and the Treasury Department.

There are indications that the congressional forums are beginning to see their responsibilities. Certainly the structure now exists in the Congress to consider these basic questions as well as their surface manifestations in committee jurisdictional disputes. (There are many possible solutions to such disputes, such as joint action by a tax committee and a legislative committee, divided but coordinated action by the two, and so on. The basic questions earlier mentioned¹¹⁴ that underlie the jurisdictional aspects are more difficult to answer.) The structure is new, however, and much will depend upon the degree to which those who operate it demonstrate perception, skill and diplomacy in determining the guidance needed for committee and congressional conduct. Unfortunately, however, parallel understanding of

¹¹² See H.R. REP. NO. 221, 94th Cong., 1st Sess. 38 (1975).

¹¹³ For preliminary discussion, see SURREY, *supra* note 7, at 155 *et seq.* See also A. KNEESE & C. SCHULTZE, POLLUTION, PRICES, AND PUBLIC POLICY (1975) [hereinafter cited as KNEESE & SCHULTZE].

¹¹⁴ See text at notes 110-14 *supra*.

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the problems and the need for guidance in the solutions does not appear to exist currently within the Executive Branch. The Treasury Department is clearly situated at the center of these issues and a responsible Treasury would be working forcefully to seek their resolution. At the moment, this is not the case in the United States. But academic tax professionals do recognize the issues and are devoting attention to them.¹¹⁵

3. Some Aspects of the 1975 Experience

The attention being given to tax expenditure analysis in the United States is beginning to have its effect on legislative debate and decision. The 1975 energy legislation illustrated the situation. The House tax committee, the Ways and Means Committee, took jurisdiction over that legislation and, as required by jurisdictional rules, proceeded to consider tax-oriented solutions. Examples were an increase in the tax on gasoline, an excise tax on automobiles consuming large quantities of gasoline, and tax incentives to encourage energy conservation such as incentives for the installation of solar energy equipment and home insulation.¹¹⁶ The resolution of the particular issues need not concern us. The House did debate the matter of regulatory sanctions versus tax sanctions for automobiles and for various ad hoc reasons favored the former.¹¹⁷ The treatment of tax incentives in this area is instructive. The Ways and Means Committee adopted several tax incentives but the House, in large part using tax expenditure talk, debated these and ended up approving some and defeating others.¹¹⁸

One significant aspect of the legislative familiarity with tax expenditure analysis is that the individual tax incentives, such as those for home insulation or solar energy equipment, were structured as *credits against tax* instead of *deductions* so as to limit their "upside-down" effect.¹¹⁹ A few years ago these incentives in all probability would have been structured as deductions with decided "upside-down" effect. Moreover, in the Senate Finance Committee, tentative consideration was given to making these incentives refundable where an individual's tax is insufficient to absorb the credit.¹²⁰ A refundable tax credit is in effect a direct spending program going to taxpayers and non-taxpayers in equal amounts and is not as tainted by either the "upside-down" aspect or the restriction to taxpayers that charac-

¹¹⁵ See, e.g., SURREY, *supra* note 7, KNEESE & SCHULTZE, *supra* note 113; Statement of Paul R. McDaniel, *supra* note 40.

¹¹⁶ See notes 111 and 113 *supra*.

¹¹⁷ See House Floor Debate on the Energy Conservation and Conversion Act, 121 CONG. REC. H. 5350-5400 (daily ed., June 12, 1975).

¹¹⁸ For examples, see 121 CONG. REC. H. 5426-60 (daily ed. June 13, 1975); *id.* at H. 5659-76 (daily ed. June 18, 1975); *id.* at H. 5727-51 (daily ed. June 19, 1975).

¹¹⁹ H.R. REP. NO. 221, 94th Cong., 1st Sess. 51 (1975).

¹²⁰ Goodnough, *Senate Finance Reports Out Windfall Tax Measure*, 3 TAX NOTES No. 31 at 23-26 (Aug. 4, 1975).

terize the usual tax incentives.¹²¹ Moreover, in the Tax Reduction Act of 1975,¹²² the new 10% earned income tax credit (applicable to families with children with up to \$4,000 of earnings, and then tapering off) was made refundable.¹²³ Also, President Ford in 1974 had recommended that the investment tax credit essentially be made refundable.¹²⁴ In 1976, the Senate-passed tax credit for wages paid to welfare recipients employed by child care centers was made refundable, so as to benefit public and non-profit centers as well as the for-profit centers.¹²⁵

All this indicates that tax expenditure analysis and the guidance it suggests regarding the choice between tax assistance and direct assistance, with the consequent effects on budget efficiency and tax reform, are beginning to be understood by legislators.¹²⁶ The pattern of

¹²¹ *But see* note 43 *supra*.

¹²² Act of March 29, 1975, Pub. L. No. 94-12, 89 Stat. 27.

¹²³ *Id.* § 204 (codified at INT. REV. CODE OF 1954, § 43). The credit applied to 1975 and was extended for the first 6 months of 1976 by the Revenue Adjustment Act of 1975, Act of Dec. 23, 1975, Pub. L. No. 94-164, § 2, 88 Stat. 970.

¹²⁴ See U.S. TREAS. DEPT. FACT SHEET, A PROGRAM TO CONTROL INFLATION IN A HEALTHY AND GROWING ECONOMY, TREAS. DOC. NO. WS-122 at 38 (Oct. 8, 1974), issued in conjunction with the PRESIDENT'S ADDRESS TO CONGRESS, H. DOC. NO. 93-366 (Oct. 8, 1974). See also Sunley, *Towards a More Neutral Investment Tax Credit*, 26 NATL. TAX J. 209 (1973). A proposal to make the credit taxable and refundable was set forth in McDaniel, *Tax Reform and the Revenue Act of 1971: Lesions, Lagniappes and Lessons*, 14 B.C. IND. & COM. L. REV. 813, 838-39 (1973).

¹²⁵ See note 43 *supra*.

¹²⁶ For example, as to budget efficiency, see the following from the REPORT OF THE SENATE BUDGET COMM. ON THE FIRST CONCURRENT RESOLUTION ON THE BUDGET—FISCAL YEAR 1977 AND THE BUDGET FOR THE TRANSITION QUARTER, S. REP. NO. 731, 94th Cong., 2d Sess. 8 (1976):

Tax expenditures are revenue losses that occur as a result of Federal tax provisions that grant special tax relief to encourage certain kinds of activities by taxpayers or to aid taxpayers in special circumstances. The net result of these provisions is equivalent to a simultaneous collection of revenue and a direct budget outlay of an equal amount. . . .

The Committee believes it is as important to control the growth of tax expenditures as it is to control the growth of direct spending programs. Tax expenditures must be subject to the same standards of review as are spending programs if the new congressional budget process is to have a positive effect over the complete spectrum of Federal budget management.

As one step toward establishing revenue review, the Budget Committee recommends, as a target, the enactment of legislation which would result in a net increase of \$2.0 billion in fiscal 1977 revenue collections by changes in existing tax expenditure and related provisions.

Tax expenditures often are enacted with phased-in or deferred effective dates. As with some spending programs, such new tax expenditure provisions may have a relatively small influence on revenues in the year in which they are enacted. Their budgetary impact is similar to that of a direct outlay "wedge" which is a small slice of a spending program that is approved with a limited initial outlay that will increase in subsequent years. For this reason, it is particularly important that the long-term budgetary effects of new tax expenditures be carefully considered at the time of

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new tax assistance is commencing to change. Moreover, such new tax assistance is beginning to be directly challenged by those who prefer the direct assistance route, or at least see the need to consider the non-tax alternative.¹²⁷ The debates over the issues are becoming better informed and more relevant. There are the beginnings in some areas of efforts to shift from existing tax expenditures to direct assistance.¹²⁸ Hopefully, this trend will continue as the new congressional units—the Budget Committees and the Congressional Budget Office—and their staffs become more familiar with the field and commence to exert leadership.

This is not to say that the changes will be rapid. The tax committees still desire to expand their activities and they can only do so

enactment. The "wedge" effect also is important in the context of reducing tax expenditures. Because the termination of a tax expenditure provision may involve the choice of an effective date at some time in the future or may be phased over a number of years, revenue gains from a termination of or reduction in tax expenditures may be much smaller in the year of enactment than they will be when they become fully effective. The impact of reducing tax expenditures should not be minimized because the revenue gain may be small in the year of enactment.

As to tax reform, see the study of the staff of the HOUSE BUDGET COMM. ON DISC, AN ANALYSIS OF DOMESTIC INTERNATIONAL SALES CORPORATIONS, 94th Cong., 1st Sess. (1975).

¹²⁷ Senator Muskie in the Senate floor debate on the Financial Institutions Act of 1975, S. 1267, 94th Cong., 1st Sess. (1975), which involved a new tax expenditure recommended by the Treasury in the form of a tax credit for a percentage of mortgage interest on residential mortgages—the issue being put in abeyance through the unique device of the Senate's passing the legislation, which contains new regulations regarding financial institutions, but making it effective only if the credit is voted—stated that as Chairman of the Budget Committee, he was serving notice that the Committee would have to consider the matter:

These are extremely substantial sums of money the Federal Government will be foregoing indefinitely if the combined new regulatory rules and tax credit are ultimately enacted. These sums are justified by proponents of the legislation as necessary to insure that adequate funds flow into residential mortgage lending activities.

The Budget Committee will be striving hard to reduce future budget deficits to a minimum. Therefore, the case for enactment of this new credit must be compelling since its adoption will make it that much more difficult to balance the budget or to permit general tax cuts in the future.

Careful consideration must be given to whether the proposed mortgage interest credit is necessary as well as whether it is the most efficient means of assuring adequate home mortgage funds compared with other possible nontax forms of governmental assistance.

121 CONG. REC. S. 21835 (daily ed. Dec. 11, 1975). See also Hearings held by the House Budget Committee Tax Expenditures Task Force on the President's recommendations for tax benefits for electric utilities and a mortgage interest tax credit, *supra* note 107.

The House Budget Committee Report on the First Concurrent Resolution on the Budget—Fiscal Year 1977 especially rejected the President's recommendation for new tax expenditures for public utilities and the mortgage interest tax credit. See HOUSE BUDGET COMM. REP. *supra* note 85, at 39, 46.

¹²⁸ See, e.g., Reuss-Kennedy Bill, H.R. 11214 and S. 2800, 94th Cong., 1st Sess. (1975), providing for optional taxable municipal bonds; *Hearings on Optional Taxable Bonds*, *supra* note 52.

through resort to tax expenditures and tax sanctions.¹²⁹ The congressional staffs for the tax committees, though presumably perceiving the issues, are restricted by their masters and either do not appear to be offering guidance on the basic question of the choice between tax and direct routes or appear to be lending support to the tax route. The other legislative committees are slow to perceive the appropriateness—"need" is a better term—of asserting their jurisdiction to provide the assistance rather than yielding the programs to the tax committees.¹³⁰ The present Treasury Department and Executive Office have a warm fondness for using tax incentives for the programs they prefer and are otherwise either generally irresolute about, or uninterested in, the basic issues involved in spending through the tax system. In the present setting, if guidance and change do come, it will be through the new congressional units, public interest groups, and the academic persons interested in tax expenditure analysis and the related field of tax sanctions versus direct sanctions.

¹²⁹ Note the following report of observations of Senate Fin. Comm. Chairman Long during Committee discussions of a proposal for a tax credit to homeowners who replace inefficient furnaces:

Mr. Dole: What if someone is too poor to pay taxes? Mr. Long: Let's make this a refundable tax credit. . . . Refundability makes it clear this is a tax expenditure. Fritz Mondale put in the Congressional Record the other day how much tax expenditures cost. But so what? Let's call it what it is as I said the other day. (On a previous day Sen. Long had noted, "Professor Surrey and, I suppose, Ralph Nader have said these tax breaks are really tax expenditures, but that label doesn't bother me. I've never been confused about it. I've always known that what we were doing was giving government money away.") I'd like to have at least one tax expenditure in there I can brag about and say here's one I like

Of course when it comes to helping homeowners, if I were on the Banking Committee, I'd favor a loan guarantee for them because that would be in my jurisdiction, but since I'm on the Finance Committee I favor the use of tax credits.

PEOPLE AND TAXES 2, 5 (Aug. 1975).

¹³⁰ An obvious area in which coordination is needed between the congressional tax committees and the appropriate legislative committees—Banking, Housing and Urban Affairs in the Senate, and Banking, Currency and Housing in the House—is that of rental housing, and yet the latter Committees have been slow in seeking ways to achieve the needed coordination. As a consequence, meaningful tax reform in the real estate tax shelter area has been blocked, in considerable part because of the previous reluctance of the Housing Committees to consider whether there is a need for direct assistance to replace the inefficient and inequitable tax assistance involved in such tax shelters. See Kurtz, *Tax Incentives for Real Estate Have Failed*, 3 REAL ESTATE REV. No. 2 at 66 (Summer 1973). A good deal of the blame lies also with HUD, and also with the housing lobbyists. These lobbyists assert that their objection to tax reform is that it would remove needed monetary assistance and that the two sets of committees will not coordinate in substituting the needed direct assistance. However, the lobbyists apparently have made no effort to use their considerable lobbying muscle to achieve that coordination. This lack of coordination appears to be changing, however, and the Congressional Budget Office is now conducting a study in the housing area that involves the staffs of the CBO, the tax committees and the housing committees.

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4. Development of Effective Mechanisms for Coordinating Tax Expenditures and Direct Expenditures

The essential and necessary connection between tax expenditures and direct expenditures is clearly recognized in the Budget Reform Act. The task is therefore to develop the mechanisms that will make the connection an operationally effective part of the overall congressional process under that Act of relating expenditures to revenues and thereby establishing a congressional fiscal policy. There are, as previously described, sufficient building blocks in the Budget Reform Act to achieve those mechanisms. A rational use of those building blocks would envisage the following procedure. The tax expenditures would be classified according to the functional categories used by the Budget Committees for direct expenditures. A bill increasing the tax expenditures in any category could not be considered in the House or Senate prior to the first Budget resolution, just as a bill providing for new budget authority cannot be considered—this seems to be a rational reading of section 303 prohibiting the consideration of bills decreasing revenues. The tax committees should by March 15 inform the Budget Committees of proposals to increase or decrease tax expenditures by functional categories, just as the other committees must inform the Budget Committees of programs affecting budget outlays and new budget authority—this seems to be a rational reading of the obligation imposed on the tax committees under section 301(c) in view of the obligation in turn placed on the Budget Committees under section 301(d)(6) to accompany the first resolution with a report stating the estimated level of tax expenditures by major functional categories. This reading also dovetails with the duty of the Congressional Budget Office under section 202(f)(1) to report to the Budget Committees by April 1 on changes in the levels of tax expenditures. The Budget Committees would then be in a position, when they reported in their first resolution the appropriate level of total budget outlays and the recommended level of federal revenues (section 301(a)(1) and (4)), to state the assumptions regarding both direct expenditures and tax expenditures in each functional category that underlay their recommendations on outlays and revenues.

The Budget Committees, in their resolutions in 1975, adopted the procedure of explicitly stating their assumptions as to the amounts to be allocated to specific programs within functional categories.¹³¹ They also directed that there be an overall reduction in revenues.¹³² Further, in the first resolution in 1975, they assumed that \$1 billion in revenue would be achieved through "tax reform legislation."¹³³ Experience has indicated that "tax reform" is too vague a term to be

¹³¹ See First and Second Concurrent Resolutions on the Budget and Conference Reports, H.R. REP. NO. 198, 94th Cong., 1st Sess. (1975).

¹³² *Id.*

¹³³ See H.R. REP. NO. 698, 94th Cong., 1st Sess. (1975).

used for such an assumption in a budget resolution—as Chairman Long stated in floor debate: “[Tax reform] means anything that can muster 51 votes in the Senate.”¹³⁴ But a budget resolution could meaningfully assume that \$X billion in revenue be raised through reducing “net tax expenditures,” and thus avoid the vagueness of an assumption using the term “tax reform.”

The structure and intention of the Budget Reform Act permit going even further than this overall action regarding tax expenditures. Thus, as to some tax expenditures, it is clear that if they are reduced, additional sums could and should be made available through direct programs. One ready example is that of legislation providing for optional taxable bonds to be issued by state and local governments with an interest subsidy paid by the federal government. This would reduce tax expenditures in the functional category of “Revenue Sharing and general purpose fiscal assistance”¹³⁵ but would increase direct outlays in that category. Another example is that of proposals to restrict or eliminate real estate tax shelters, which, while reducing tax expenditures, would presumably require an increase in direct outlays for low and perhaps middle income housing.¹³⁶ The Budget Committees are obligated to achieve that coordination, and indeed may provide the only effective congressional mechanism for such needed coordination.

The many provisions of the Budget Reform Act requiring details and procedures regarding tax expenditures clearly point to the conclusion that those expenditures should ultimately be directly coordinated with budget outlays in each functional category. Thus, it would be appropriate for the Budget Committees, in the reports and explanatory statements on their budget resolutions describing their assumptions and objectives, to state that, in a particular functional category, they are assuming that tax expenditures will be reduced (or increased) by \$X and direct outlays increased (or reduced) by \$X or \$Y. Indeed, a particular tax expenditure and a particular direct program could be specified. This specificity as to direct programs is already being utilized in the statements accompanying the budget resolutions and, as stated above, the Budget Reform Act clearly points to the utilization of a similar specificity as to tax expenditures. Indeed, as to new tax expenditure programs recommended by the President, it is necessary for the Budget Committees to state their assumptions as to such programs and, if they consider it desirable to use government funds for those programs, to determine whether the funds should be spent through a tax expenditure or a direct expenditure. Glowing statements on holding budget expenses down are without meaning if

¹³⁴ 121 CONG. REC. S. 20655 (daily ed. Nov. 20, 1975). See also *id.* at S. 20653-62. As indicated *supra* note 85, the first Resolution in 1976 closely paralleled the language suggested in the text.

¹³⁵ See Appendix A.

¹³⁶ See 122 CONG. REC. S. 2522-25 (daily ed. March 1, 1976) (statement of Senator Kennedy).

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at the same time new programs are phrased as tax expenditures and total real expenditures thus increased.

It must be recognized, in thinking about these mechanisms for coordination, that the tax committees—because of their jurisdiction over tax expenditures—are exercising jurisdiction over all functional categories in which tax expenditures exist. Hence, since the Budget Committees must present assumptions and objectives as to these functional categories and thus must pass directly on the programs of legislative committees and the appropriations of appropriation committees, the Budget Committees must equally consider the programs of the tax committees that relate through tax expenditures to the same functional categories. Coordination as to tax expenditures, by functional categories¹³⁷ or particular tax expenditures within a category, thus presents a different situation from the mechanisms relating to general revenue raising or reduction. Thus, the Budget Committees, if they feel revenues in the fiscal sense should be increased or decreased, can well leave the contours of the change to the tax committees. As to tax expenditures, however, since the tax committees act both as legislative and appropriations committees, and do so over the entire range of functional categories, the relationship of the Budget Committees to that phase of the work of the tax committees should necessarily be the same as it is to other committees.

The nature of tax legislation regarding tax expenditures does present an aspect that must be kept in mind in developing these mechanisms. Many changes regarding tax expenditures involve effective dates and transitional arrangements that make the fiscal impact of a change quite different in the initial years following the change from that in later years. Thus, the elimination of a tax expenditure phased in over five years can show a small revenue gain in the first year and increasing amounts of revenue gain over the next four years. In the fifth year, when the transition is ended, the revenue gain will then approximate the amount presently listed for the tax expenditure, under the procedure used for estimating tax expenditures. Moreover, as to the first year, the revenue gain will depend upon the effective date of the change, which could be late in the budgetary fiscal year involved and hence the revenue gain involved in the tax expenditure change may be quite small for that fiscal year. Of course, the adoption of a new tax expenditure can follow the same course, but here with gradual increases in the revenue lost through the new tax expenditure. New tax expenditures that appear to have little effect on the revenue can soon grow into major and costly programs. Direct expenditure changes can also show these characteristics, but the effective date and transitional aspects are likely to be more significant

¹³⁷ THE CONGRESSIONAL BUDGET OFFICE FIVE YEAR BUDGET PROJECTIONS, FISCAL YEARS 1977-81, 15-40 (Jan. 26, 1976), does include a discussion of tax expenditures in its analysis of various Program Issues. The House Budget Comm. Rep. on the first resolution in 1976, *supra* note 85, did list the tax expenditures that related to each budget function.

and more prevalent for tax expenditures. These effects must be taken into account in deriving the assumptions and objectives of the Budget Committees when tax expenditures are involved, and for any direct expenditure change similarly structured. However, these considerations should not present any problems. Rather, they underscore the wisdom of requiring the Budget Committees, in the reports on their resolutions, to include five year projections of outlays and tax expenditures.¹³⁸

The Budget Committees thus have the authority under the Budget Reform Act to develop efficient mechanisms to coordinate tax expenditures and direct expenditures. An appropriate exercise of that authority, together with a comparable approach in the Executive branch, would achieve a rational and effective control over both types of expenditures and thereby improve both budget policy and tax policy.

B. Executive Departments

While the Treasury Department and Office of Management and Budget have for some time been active in developing the tax expenditure budget,¹³⁹ the use of the concept by other executive departments has been slow to materialize. What has been stated above indicates that the various departments and agencies responsible for administration of federal programs should have a lively interest in tax expenditure programs. Yet there is only a smattering of evidence that this is so.

The need for coordination of tax expenditure and direct expenditure policies in Congress applies equally to the Executive branch. It is incongruous, for example, that the largest single agricultural aid program in the United States is run, not by the Department of Agriculture, but by the Internal Revenue Service.¹⁴⁰ It seems self-evident that the Department charged with developing and executing farm policy should assure itself that the tax expenditure programs for agriculture are at least consistent with overall agriculture policy—existing and proposed. Fortunately, some economists within the Department of Agriculture recognize this fact and have instituted studies to analyze the tax provisions as federal subsidies for farm operations.¹⁴¹ Significantly, in each case, the tax programs have been

¹³⁸ Budget Act, *supra* note 2, § 301(d)(6).

¹³⁹ The various Budget Special Analyses in the areas of Health, Education, Training, Income Security, State and Local Assistance, and Research now recognize that tax expenditures do provide significant assistance in these areas, though they have yet to integrate the tax data with the direct outlay data and to analyze the differing distributional effects of the two types of assistance. Those who worked on the Environmental analysis apparently did not get the word and did not mention the tax expenditures in this field.

¹⁴⁰ See Statement of Paul R. McDaniel, *supra* note 40.

¹⁴¹ HARRISON AND WOODS, FARM AND NONFARM INVESTMENTS IN COMMERCIAL

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found wanting when examined under principles employed to evaluate direct farm programs. But the findings of these researchers do not yet appear to have influenced Department policy with respect to farm tax expenditures, or to have been noticed by the Treasury Department.

Some groups within the Department of Housing and Urban Development have also shown an increasing awareness of the need for study and analysis of tax expenditure programs for housing.¹⁴² And it is encouraging that when the Senate was considering extension of the tax credit for new home purchases,¹⁴³ Senator Brooke requested an evaluation of the effectiveness of the credit, not from the Treasury, but from Secretary Hills of HUD.¹⁴⁴ HUD, not the Treasury, is the agency that should be the repository of housing expertise. The fact that HUD already had underway a study of the housing tax credit at the time of Senator Brooke's inquiry reflects an increasing awareness on the part of this Department of its responsibilities to properly analyze and evaluate tax expenditures that are within its programmatic scope.

As another example, it would seem appropriate that the various special provisions in the Internal Revenue Code affecting health care¹⁴⁵ should be examined as part of the study of national health insurance. However, one can review nine volumes of testimony before the Ways and Means Committee in 1974 on national health insurance without finding a single reference to the existing tax expenditure health programs.¹⁴⁶ Fortunately, other agencies of government¹⁴⁷ and various academics¹⁴⁸ have recognized the need for critical analysis,

BREEDING HERDS: INCENTIVES AND CONSEQUENCES OF THE TAX LAW, ERS—497, U.S. DEPT. OF AGR. (1972); WOODS AND CARLIN, UTILIZATION OF SPECIAL FARM TAX RULES AND AGRICULTURE, SPECIAL REPORT 172 (Agricultural Experiment Station, Univ. of Mo.—Columbia, 1975); CARLIN & WOODS, TAX LOSS FARMING, ERS—546, U.S. DEPT. OF AGR. (1974).

¹⁴² See U.S. DEPT. OF HOUSING AND URBAN DEVELOPMENT, STUDY ON TAX CONSIDERATIONS IN MULTI-FAMILY HOUSING INVESTMENTS (Touche Ross & Co. report under HUD contract H-1227).

¹⁴³ See INT. REV. CODE OF 1954, § 44.

¹⁴⁴ 121 CONG. REC. S. 22174-75 (daily ed. Dec. 15, 1975). Despite HUD's extremely lukewarm response to the efficacy of the credit in achieving its avowed objective—removing the inventory overhang from the housing market—the Senate by a vote of 48-44 approved a six-month extension of the tax credit. 121 CONG. REC. S. 22178 (daily ed. Dec. 15, 1975). The conference committee, however, deleted the provision. H.R. REP. NO. 739, 94th Cong., 1st Sess. 10 (1975).

¹⁴⁵ INT. REV. CODE OF 1954, §§ 104-06, 213.

¹⁴⁶ *Hearings on National Health Insurance Before the House Ways & Means Comm.*, 93d Cong., 2d Sess. (1974).

¹⁴⁷ See MITCHELL AND VOGEL, HEALTH AND TAXES: AN ASSESSMENT OF THE MEDICAL DEDUCTION, PREPARED FOR THE OFFICE OF ECONOMIC OPPORTUNITY, R-1222—OEO (Rand Corp., 1973).

¹⁴⁸ See, e.g., K. DAVIS, NATIONAL HEALTH INSURANCE 85 (Brookings Institution, 1975); FELDMAN AND ALLISON, TAX SUBSIDIES OF PRIVATE HEALTH INSURANCE: DISTRIBUTION, REVENUE LOSS AND EFFECTS, DISCUSSION PAPER 237 (Harv. Univ., Harv. Inst. of Econ. Research, 1972).

and have commenced the requisite studies. But the Department of Health, Education and Welfare would have better fulfilled its responsibilities if it had presented to Congress an analysis and evaluation of the existing tax expenditure programs for health care at the same time it was urging changes in the direct expenditure programs.

While there are thus some examples here and there of involvement in tax expenditures analysis by non-tax executive agencies of the Government, it unfortunately remains true that such analysis has not become an accepted part of the responsibilities of executive departments other than the Treasury and the Office of Management and Budget. The Treasury cannot and should not employ staffs of lawyers and economists who are experts on non-tax measures ranging from welfare to housing to pollution control to health care and so on through the entire list of areas of government responsibility to which tax expenditures are now addressed. The various non-tax Executive Departments must undertake systematic analyses of the tax expenditure provisions that affect their respective areas of responsibility if they and Congress are to understand the full impact of total government financial effort in a given sector of our economic or social life. Moreover, the Treasury and especially the Office of Management and Budget should be more active in prodding those Departments in that direction.

C. *Public Interest Groups*

After the passage of the Tax Reform Act of 1969, a new phenomenon arose that has increasingly influenced the tax legislative process—the public interest tax groups. Until 1970, those who did not have vested interests in the various tax expenditure provisions simply were not represented in the tax legislative process except to the extent the Treasury undertook to fulfill this function. For example, during the three weeks in 1969 in which the Senate Finance Committee was in executive session on the Tax Reform Bill, the hall outside the Committee Room was virtually impassable as lobbyists for the various tax expenditure provisions followed and attempted to influence the Committee deliberations. In this throng there were no representatives of those who would benefit from repeal or restriction of the tax expenditures. Indeed, the only day the Senate Committee corridor was empty was that on which the Committee took up non-tax expenditure provisions—the personal exemption, the minimum standard deduction and rate changes for low income taxpayers.¹⁴⁹

This situation has changed, however, with the advent of a few public interest groups, notably the Tax Research Reform

¹⁴⁹ Professor McDaniel was, at the time of the events described, a legislative aide to Senator Albert Gore, then a member of the Senate Finance Committee.

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Group¹⁵⁰—whose primary concern is the federal tax system—and with increasing activity by the AFL-CIO. As these groups have developed in strength and expertise, their attention has focused to a significant degree on tax expenditures.¹⁵¹

While the use by public interest tax groups of the tax expenditure concept is encouraging, it is clear that other public interest groups have not yet realized the significance of tax expenditure programs in their areas of concern. For example, consumer groups in various states have in recent years become increasingly involved in rate-making proceedings by public utilities. In a number of instances these groups have effectively represented consumer interests to prevent or moderate proposed rate increases. But these consumer groups appear to be unaware that their efforts have been somewhat undercut by the public utilities in the United States Congress. In 1969 and again in 1975, Congress considered accelerated depreciation and the investment credit for public utilities. In each case, when these tax expenditures were made available to the utilities, a provision was added that prevented rate-making bodies from permitting or requiring that the benefits of the tax expenditures be passed on to consumers in the form of lower gas, electric, or telephone rates.¹⁵² In effect, the utilities obtained from taxpayers, generally through tax expenditures, what they could not get from consumers through higher rates. Yet consumer groups were never involved in the congressional deliberations on these matters which would appear to have a direct impact on their work.

There are other examples of the concern that non-tax public interest groups should have with respect to tax expenditure provisions. Those groups interested in control of local property tax rates ought to take a considerable interest in the exemption provided by section 103(c) of the Internal Revenue Code for interest paid on industrial development bonds, especially pollution control bonds, as there is considerable evidence that this federal tax expenditure actually helps

¹⁵⁰ The Tax Research Reform Group is a part of Ralph Nader's operations and is headed by Robert Brandon. It also publishes *PEOPLE AND TAXES*. Another group which supplies useful information in this area is Tax Advocates and Analysts, which publishes *TAX NOTES*.

¹⁵¹ See also the Tax Justice Act of 1975, H.R. 10086, 94th Cong., 1st Sess. (1975), developed by the National Committee for Tax Justice, an umbrella organization for a dozen local citizens' tax reform groups around the country. This measure deals almost entirely with the elimination or modification of tax expenditures. A colloquy on the Act appears at 121 CONG. REC. H. 10223-36 (daily ed. Oct. 22, 1975).

¹⁵² The result was achieved by the "normalization" requirement in INT. REV. CODE OF 1954, § 167(l) as to accelerated depreciation, and in § 46(e) as to the investment credit. The benefits of the investment credit may be "flowed-through" to consumers by a utility if it accounts for the credit in this fashion both for book accounting and tax accounting purposes. Section 101(c) of the Revenue Act of 1971 insures, however, that "flow-through" is purely at the option of the utility—it cannot be required to adopt this method.

drive up local property taxes.¹⁵³ Groups interested in local rent control should be knowledgeable about the extent to which landlords receive federal financial aid through the investment credit, accelerated depreciation, and expensing of construction interest and taxes, so that tenants could be in a position to bargain for lower rents as the results of these federal subsidies. Environmental groups should certainly understand the scope and effects of tax subsidies, some of which are designed to encourage pollution control and others of which may have the effect of inducing wastage of our natural resources.¹⁵⁴

The point to be made is that public interest groups have a vital stake in tax expenditures even if their concern is not with federal income taxation as such. These groups need to understand that they must monitor the work of the House Ways and Means Committee and the Senate Finance Committee as closely as they do federal and state legislative and administrative bodies that are directly responsible for their particular areas of interest. Development of tax expenditure expertise by these non-tax public interest groups will surely aid in the understanding of the proper scope for the use of tax expenditure programs.

VIII. TAX EXPENDITURE CONCEPT—OTHER TAXES

The above discussion has been in terms of an income tax. This is because the tax expenditure concept in the United States was developed in relation to that tax. This was natural, given the continuing discussion relating to income tax incentives and their widespread use. But it would seem that the tax expenditure concept is equally applicable to any tax that has a "global" or overall reach similar to that of the income tax. The normative income tax is designed to encompass all items of "income." It is this global reach that characterizes the tax and provides its essential fairness and hence, utility. A normative estate or transfer tax would also appear to have such a global content, since it should be designed to cover all wealth transferred by the decedent or donor. Likewise, a normative annual wealth tax would also appear to involve a global reach. This being so, we should be able to construct tax expenditure lists for such taxes.¹⁵⁵ In the excise field, a normative

¹⁵³ See, e.g., Peterson & Galper, *Tax-Exempt Financing of Private Industry's Pollution Control Investment*, 23 PUBLIC POLICY No. 1, at 81 (Winter, 1975); Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352, 371-80 (1970).

¹⁵⁴ See KNEESE & SCHULTZE, *supra* note 113; McDaniel & Kaplinsky, *The Use of the Federal Income Tax System to Combat Air and Water Pollution: A Case Study in Tax Expenditures*, 12 B.C. IND. & COM. L. REV. 351 (1971).

¹⁵⁵ A preliminary tax expenditure list for the estate and gift taxes prepared by the authors was set forth in the testimony of Senator Kennedy before the Senate Finance Committee in its hearings on estate and gift tax revision on May 17, 1976. A more refined list will be presented in W. WARREN, S. SURREY, P. MCDANIEL & H. GUTMAN, *FEDERAL ESTATE AND GIFT TAXATION* (late 1976).

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value-added tax or other general sales tax (such as a retail sales tax or manufacturer's sales tax) would seem to have a sufficient global reach or universality so that it would also be susceptible to tax expenditure analysis. Other excise taxes, being inherently limited in scope ab initio, are presumably not ready candidates for such analysis. A real property tax, if intended to be comprehensive, would be a candidate.¹⁵⁶ On the whole, it is evident that tax expenditure analysis may be extended to a number of taxes beyond the income tax, so that this matter merits consideration and research.

CONCLUSION

Treatment of tax expenditures as the functional equivalent of direct expenditures in the Budget Reform Act of 1974 marks a major advance both for those concerned with budget efficiency and for those concerned with tax equity. Movement of the tax expenditure concept from a definitional to an operational stage should serve as a stimulus for increased study of existing and proposed tax expenditures by Congress, the Executive Branch, public interest groups and academics. The result of these efforts can be a fairer and more rational allocation of public resources.

¹⁵⁶ For a description of a tax expenditure budget for the City of New York derived from property tax exemptions it affords for regional special purposes, see Benjamin, *New York City's Costly Tax Exemptions*, N.Y. Times, March 28, 1976, § F, at 16, col. 2.

APPENDIX A*

TAX EXPENDITURE ESTIMATES, BY FUNCTION²

[Millions of dollars, fiscal years]

Function	Corporations					Individuals				
	1977	1978	1979	1980	1981	1977	1978	1979	1980	1981
National defense (050):										
Exclusion of benefits and allowances to armed forces personnel						650	650	650	650	650
Exclusion of military disability pensions						90	100	110	120	130
International affairs (150):										
Exclusion of income earned abroad by U.S. citizens	55	55	55	55	55	160	175	195	205	220
Exclusion of gross-up on dividends of LDC corporations	1,420	1,460	1,495	1,580	1,735					
Deferral of income of domestic international sales corporations (DISC)	365	365	365	365	365					
Deferral of income of controlled foreign corporations	50	50	50	50	50					
Special rate for Western Hemisphere trade corporations										
Natural resources, environment and energy (300):										
Exclusion of interest on state and local government pollution control bonds	170	220	265	300	330	75	100	125	145	160
Expensing of exploration and development costs	840	1,045	1,285	1,540	1,850	195	245	305	365	435
Excess of percentage over cost depletion	1,020	1,015	1,110	1,215	1,325	575	625	640	670	695
Pollution control: 5-year amortization	15	5								
Capital gains treatment of royalties on coal and iron ore	20	20	25	25	30	50	60	65	75	85
Capital gains treatment of certain timber income	165	175	190	200	215	65	70	75	80	85
Agriculture (350):										
Expensing of certain capital outlays	115	120	130	135	150	360	370	380	390	400
Capital gains treatment of certain income	40	40	45	50	50	565	655	705	760	820
Cooperatives: deductibility of noncash patronage dividends and certain other items	455	485	520	555	595					
Commerce and transportation (400):										
Exemption of credit unions	135	145	155	165	175					
Corporate surtax exemption	6,185	6,745	7,300	7,865	8,455					
Deferral of tax on shipping companies	130	155	180	205	230					
Railroad rolling stock: 5-year amortization	10	5								
Financial institutions: excess bad debt reserves	570	635	730	900	1,060					
Deductibility of nonbusiness state gasoline taxes						600	665	735	815	910
Depreciation on rental housing in excess of straight line	125	135	145	155	170	455	480	510	545	580
Depreciation on buildings (other than rental housing) in excess of straight line	280	300	325	350	375	215	235	250	275	300

TAX EXPENDITURE ESTIMATES, BY FUNCTION^a—continued

[Millions of dollars, fiscal years]

Function	Corporations					Individuals				
	1977	1978	1979	1980	1981	1977	1978	1979	1980	1981
Expensing of research and development expenditures	695	725	755	785	815	.....	.....	.....	.....	.....
Capital gains: Corporate (other than farming and timber)	900	1,015	1,090	1,170	1,260	.....	.....	.....	.....	.....
Investment credit	7,585	8,045	8,480	8,890	9,310	1,530	1,635	1,750	1,870	1,995
Asset depreciation range	1,630	1,825	2,000	2,095	2,135	175	195	220	290	295
Dividend exclusion	.....	.....	.....	.....	.....	350	370	385	405	425
Capital gains: Individual (other than farming or timber)	.....	.....	.....	.....	.....	6,225	7,360	7,905	8,490	9,145
Capital gains at death	.....	.....	.....	.....	.....	7,280	8,120	9,015	10,005	11,105
Deferral of capital gains on home sales	.....	.....	.....	.....	.....	890	935	980	1,030	1,080
Deductibility of mortgage interest on owner-occupied homes	.....	.....	.....	.....	.....	4,710	5,225	5,800	6,440	7,150
Deductibility of property tax on owner-occupied homes	.....	.....	.....	.....	.....	3,825	4,245	4,710	5,230	5,805
Deductibility of interest on consumer credit	.....	.....	.....	.....	.....	1,075	1,195	1,325	1,475	1,635
Exclusion of interest on state and local industrial development bonds	195	235	270	315	355	90	110	130	150	170
Excess 1st year depreciation	165	180	200	220	240	85	95	105	115	130
Expensing of construction period interest and taxes	1,065	1,110	1,150	1,190	1,230	570	595	620	645	670
Credit for purchase of new home	.....	.....	.....	.....	.....	100	.....	.....	.....	.....
Community and regional development (450):	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Housing rehabilitation: 5-year amortization	25	20	15	10	10	40	25	15	15	15
Education, training, employment, and social services (500):	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Exclusion of scholarships and fellowships	.....	.....	.....	.....	.....	220	235	245	255	270
Parental personal exemption for student age 19 and over	.....	.....	.....	.....	.....	715	735	760	780	805
Deductibility of charitable contributions (education)	280	325	355	390	430	500	555	610	670	735
Deductibility of child and dependent care expenses	.....	.....	.....	.....	.....	420	460	510	560	615
Child care facilities: 5-year amortization	5	5	.....	.....	.....	.....	.....	.....	.....	.....
Credit for employing AFDC recipients and public assistance recipients under work incentive program	10	10	10	10	10	.....	.....	.....	.....	.....
Deductibility of charitable contributions (social services)	352	402	446	489	536	3,124	3,468	3,847	4,274	4,740
Health (550):	.....	.....	.....	.....	.....	.....	.....	.....	.....	.....
Exclusion of employer contributions to medical insurance premiums and medical care	.....	.....	.....	.....	.....	4,225	4,730	5,300	5,935	6,650
Deductibility of medical expenses	.....	.....	.....	.....	.....	2,095	2,325	2,580	2,865	3,175
Deductibility of charitable contributions (health)	173	198	219	241	264	831	922	1,023	1,136	1,260

See footnote at end of table.

TAX EXPENDITURE ESTIMATES, BY FUNCTION^a—continued

[Millions of dollars, fiscal years]

Function	Corporations					Individuals				
	1977	1978	1979	1980	1981	1977	1978	1979	1980	1981
Income security (600):										
Exclusion of social security benefits:										
Disability insurance benefits						370	415	470	525	595
OASI benefits for aged						3,525	3,965	4,460	5,020	5,645
Benefits for dependents and survivors						565	635	715	805	905
Exclusion of railroad retirement system benefits						200	215	230	245	260
Exclusion of unemployment insurance benefits						2,855	2,655	2,470	2,295	2,135
Exclusion of workmen's compensation benefits						640	705	775	855	940
Exclusion of public assistance benefits						130	145	165	185	210
Exclusion of special benefits for disabled coal miners						50	50	50	50	50
Exclusion of sick pay						350	370	385	405	425
Net exclusion of pension contributions and earnings:										
Employer plans						6,475	7,120	7,835	8,620	9,480
Plans for self-employed and others						965	1,065	1,180	1,300	1,440
Exclusion of other employee benefits:										
Premiums on group term life insurance						895	965	1,050	1,135	1,230
Premiums on accident and accidental death insurance						60	65	70	80	85
Income of trusts to finance supplementary unemployment benefits						5	5	5	5	5
Meals and lodging						305	320	335	350	365
Exclusion of capital gains on home sales if over 65						50	55	60	65	70
Excess of percentage standard deduction over minimum standard deduction						1,560	1,635	1,720	1,805	1,895
Additional exemption for the blind						25	25	25	25	25
Additional exemption for over 65						1,220	1,280	1,340	1,410	1,480
Retirement income credit						110	100	90	80	70
Earned income credit: nonrefundable portion						280	270	255	245	235
Earned income credit: refundable portion						1,110	1,065	1,025	985	945
Exclusion of interest on life insurance savings						1,855	2,025	2,210	2,410	2,625
Deductibility of casualty losses						330	355	380	405	430
Maximum tax on earned income						505	580	670	770	885
Veterans' benefits and services (700):										
Exclusion of veterans' disability compensation						595	595	595	595	595
Exclusion of veterans' pensions						30	30	30	30	30
Exclusion of GI bill benefits						280	265	255	240	230

See footnote at end of table.

TAX EXPENDITURE ESTIMATES, BY FUNCTION^a—continued

[Millions of dollars, fiscal years]

Function	Corporations						Individuals					
	1977	1978	1979	1980	1981	1981	1977	1978	1979	1980	1981	
General government (800):												
Credits and deductions for political contributions							65	40	50	50	85	
Revenue sharing and general purpose fiscal assistance (850):												
Exclusion of interest on general purpose state and local debt	3,150	3,375	3,630	3,925	4,300		1,390	1,490	1,605	1,735	1,880	
Exclusion of income earned in U.S. possessions	285	305	325	350	375							
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)							6,680	7,415	8,230	9,140	10,140	
Interest (900):												
Deferral of interest on savings bonds							685	765	845	925	1,005	

^aSum of the Tax Expenditure Items by Type of Taxpayer and Fiscal Year¹

(Millions of dollars)

Fiscal year	Corporations and individuals		Individuals	
	Corporations	Individuals	Corporations	Individuals
1977	105,970	77,290	28,680	84,650
1978	115,600	84,650	30,950	92,160
1979	125,475	92,160	33,315	100,460
1980	136,250	100,460	35,790	109,675
1981	148,160	109,675	38,485	110,140

¹ These totals represent the mathematical sum of the estimated fiscal year effect of each of the 82 tax expenditure items included in this table.

APPENDIX B*
ESTIMATED DISTRIBUTION OF TAX EXPENDITURES OF INDIVIDUALS
BY ADJUSTED GROSS INCOME CLASS
FISCAL YEAR 1974

(Dollars in millions)

Adjusted Gross Income Class	Number of Taxable Returns ¹ (Thousands)	Percent of Taxable Returns		Total Tax Expenditures by Income Class	Percentage Distribution	
		By Income Class	By Segment		By Income Class	By Segment
(\$000)						
0-3	4,057	6.1		1,085	1.9	
3-5	7,579	11.3		1,738	3.0	
5-7	8,273	12.4	46.9	2,357	4.1	16.6
7-10	11,428	17.1		4,403	7.6	
10-15	15,952	23.8		8,875	15.3	
15-20	9,856	14.7	38.5	8,881	15.3	30.6
20-50	9,006	13.4	13.4	17,414	29.9	29.9
50-100	655	1.0		6,116	10.5	
100 and over	160	0.2	1.2	7,906	12.6	23.1
Total	66,966	100.0	100.0	58,175	100.0	100.0

*Source: U.S. Treasury Department.

¹ Calendar 1974.

Exclusion of benefits and allowances to Armed Forces personnel	Exclusion of military disability pensions		of certain income earned by U.S. citizens		Expensing of certain agriculture capital outlays		Capital gains treatment of certain agriculture income		Expensing of exploration and development costs	
	Percentage distribution by segment	Exclusion	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
10	1	15	10	10	10	10	10	*		
135	13	13	35	35	35	30	30	1		
160	16	7	60	60	60	80	80	1		
125	13	9	90	90	90			2	5.0	
110	11	7	115	115	115	105	105	10		
55	6	7	70	70	70	60	60	8		22.5
50	5	24	125	125	125	115	115	19		23.8
4	*	6	40	40	40	35	35	13		48.8
1	*	2	35	35	35	30	30	26		
650	65	90	580	580	580	520	520	80	100.0	100.0
(7)	(8)	(9)	(10)	(11)	(12)					
Excess of percentage over cost depletion	Capital gains treatment of certain timber income		Deduction of non-business state gasoline taxes		Housing rehabilitation 5-year amortization		Exclusion of scholarships and fellowships		Parental personal exemptions for student age 19 and over	
	Percentage distribution by segment	Capital gains treatment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
1	*	1	2	2	2	6	6	*		
5	2	5	*	*	*	39	39	8		
4	2	22	*	*	*	48	48	38		
11	3	81	*	*	*	41	41	100		22.3
19	4	198	2	2	2	31	31	212		52.1
21	3	215	2	2	2	19	19	129		
76	10	307	6	6	6	11	11	74		11.3
62	9	28	14	14	14	*	*	73		14.4
106	22	8	24	24	24	*	*	21		
305	55	865	50	50	50	195	195	655	100.0	100.0

(13)	(14)	(15)	(16)	(17)	(18)
Deduction of contributions to educational institutions	Deduction of child and dependent care expenses	Exclusion of employer contributions to medical insurance and premiums for medical care	Deduction of medical expenses	Exclusion of social security disability insurance benefits	Exclusion of social security OASI benefits for aged
Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
* } * } 1 } 2 }	* } 1 } 7 } 31 }	26 } 73 } 131 } 285 }	4 } 38 } 112 } 264 }	44 } 43 } 35 } 44 }	470 } 460 } 380 } 470 }
0.8	17.0	17.5	19.7	70.6	70.4
3 } 20 }	85 } 92 }	662 } 655 }	481 } 376 }	31 } 13 }	330 } 140 }
6.5	77.0	44.8	40.3	18.7	18.6
64 } 65 } 200 }	14 } 0 } 0 }	827 } 193 } 88 }	634 } 145 } 71 }	20 } 4 } 1 }	215 } 45 } 20 }
18.0	6.1	28.1	29.8	8.5	8.5
74.6	74.6	9.6	10.2	2.1	2.6
100.0	100.0	100.0	100.0	100.0	100.0
355	230	2,940	2,125	235	2,530

(19)	(20)	(21)	(22)	(23)
Exclusion of social security benefits for dependents and survivors	Exclusion of railroad retirement system benefits	Exclusion of sick pay	Exclusion of unemployment insurance benefits	Exclusion of workmen's compensation benefits
Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
80 } 75 } 60 } 75 }	30 } 29 } 24 } 30 }	10 } 16 } 17 } 24 }	50 } 80 } 100 } 160 }	25 } 40 } 50 } 60 }
70.7	70.6	26.3	37.1	37.5
55 } 20 }	21 } 9 }	66 } 60 }	250 } 150 }	120 } 75 }
18.3	18.8	49.4	38.1	37.5
35 } 5 } E }	13 } 3 } 1 }	57 } 4 } 1 }	200 } 50 }	100 } 25 }
8.5	8.1	22.4	19.0	19.2
0.4	0.4	0.4	0.4	5.8

(24)	(25)	(26)	(27)	(28)
Exclusion of public assistance benefits	Net exclusion of pension contributions and earnings		Exclusion of premiums on group term life insurance	Exclusion of premiums on accident and death insurance
Percentage distribution by segment	Employer plans	Plans for self-employed and others	Percentage distribution by segment	Percentage distribution by segment
30 } 25 } 15 } 5 }	15 } 50 } 110 } 290 }	* } * } 1 } 2 }	5 } 15 } 30 } 65 }	* } 1 } 2 } 4 }
100.0	9.7		1.3	16.9
	790 } 990 }	6 } 11 }	155 } 155 }	9 } 9 }
	1,740 }	107 }	190 }	11 }
	545 } 260 }	87 } 16 }	45 } 20 }	3 } 1 }
75	4,790	230	680	40
100.0	100.0	100.0	100.0	100.0
			44.8	9.6
			46.5	27.9
			7.4	45.6
			1.3	17.5
				45.0
				27.5
				10.0
				100.0

(29)	(30)	(31)	(32)	(33)
Exclusion of privately financed supplementary unemployment benefits	Exclusion of employer furnished meals and lodging	Exclusion of capital gain on house sales if age 65 or over	Excess of percentage standard deduction over minimum standard deduction	Additional exemption for the blind
Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
* } * } 1 } 1 }	1 } 4 } 8 } 17 }	1 } * } * } 1 }	1 } 13 } 64 }	* } 1 } 3 } 3 }
40.0	17.1	20.0	6.2	46.7
2 } 1 }	39 } 39 }	1 } 1 }	645 } 352 }	3 } 2 }
60.0	44.6	20.0	79.1	33.3
*	50 }	2 }	178 }	2 }
*	12 }	2 }	6 }	1 }
* } 5 }	5 }	2 }	1 }	* }
100.0	9.7	40.0	.55	6.7
	100.0	100.0	100.0	100.0
	175	10	1,260	15

Additional exemption for age 65 or over	Percentage distribution by segment	Retirement income credit	Percentage distribution by segment	Exclusion of veterans disability compensation	Percentage distribution by segment	Exclusion of veterans pensions	Percentage distribution by segment	Exclusion of GI Bill benefits	Percentage distribution by segment
7		1		61		17		34	
95		18		39		8		124	
185	48.3	22	61.0	44	43.5	*	100.0	60	87.2
268		20		67		*		35	
196		19		102				16	
106	26.3	9	28.0	72	35.9			10	9.0
211	18.3	10	10.0	87	17.9			9	3.1
56		1		10				2	
26	7.1	*	1.0	3	2.7			*	.69
1,150	100.0	100	100.0	485	100.0	25	100.0	290	100.0
(39)		(40)		(41)		(42)		(43)	

Credits and deduction for political contributions	Percentage distribution by segment	Exclusion of interest on state and local debt	Percentage distribution by segment	Exclusion of income earned in U.S. possessions	Percentage distribution by segment	Deduction of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)	Percentage distribution by segment	Depreciation on rental housing in excess of straight line	Percentage distribution by segment
*		*		*		1		2	
*		*		*		13		6	
1	20.0	*	.09	*		55	4.4	10	10.4
1		1		*		239		21	
2		4		1		661		42	
2	40.0	22	2.5	2	60.0	1,016	24.1	38	21.3
3	30.0	98	9.3	2	40.0	2,968	42.7	128	34.1
1		389		*		1,063		80	
*	10.0	546	88.2	*		939	28.8	48	34.1
10	100.0	1,060	100.0	5	100.0	6,955	100.0	375	100.0

(44)	(45)	(46)	(47)	(48)
Depreciation on buildings (other than rental housing) in excess of straight line . . .	Investment credit	Dividend exclusion	Capital gain (other than farming and timber)	Exclusion of interest on life insurance savings by segment
Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
2 } 3 } 6 } 13 }	1 } 12 } 32 } 71 }	3 } 8 } 11 } 26 }	76 } 34 } 81 } 158 }	10 } 60 } 90 } 120 }
	10.9	13.2	15.0	5.7
25 } 22 } 75 }	149 } 135 } 300 }	42 } 46 } 134 }	304 } 282 } 1,137 }	200 } 170 } 420 }
	21.4	32.3	27.5	9.5
47 } 27 }	108 } 72 }	37 } 13 }	969 } 3,109 }	195 } 155 }
	33.6	20.5	15.6	66.3
220	880	320	6,150	1,420
	100.0	100.0	100.0	100.0

(49)	(50)	(51)	(52)	(53)
Deferral of capital gain on home sales	Deduction of mortgage interest on owner-occupied homes	Deduction of property taxes on owner-occupied homes	Deduction of casualty losses	Deduction of charitable contributions (other than for distribution by segment)
Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment	Percentage distribution by segment
1 } 7 } 9 } 19 }	* } 13 } 52 } 265 }	1 } 24 } 66 } 221 }	* } 3 } 4 } 18 }	3 } 18 } 67 } 190 }
	14.1	6.8	7.7	9.8
42 } 47 }	886 } 1,133 }	583 } 771 }	54 } 42 }	445 } 548 }
	34.9	41.5	33.3	37.6
98 } 21 } 11 }	2,078 } 348 } 95 }	1,774 } 407 } 213 }	74 } 34 } 26 }	1,251 } 506 } 792 }
	38.4	42.7	43.7	29.0
	12.5	9.1	15.3	23.5
				7.3
				26.0
				32.7
				34.0

(54)

Deduction of interest on consumer credit	Percentage distribution by segment
* 7	
26	6.8
133	
443	41.5
567	
1,039	42.7
174	
46	9.0
2,435	100.0