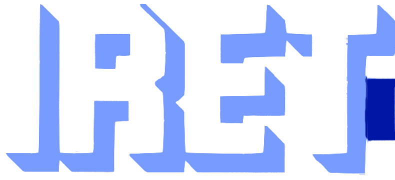

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THE END OF TAX EXPENDITURES AS WE KNOW THEM?

Introduction

In its 2002 budget, the Bush Administration launched a stealth attack on the concept of "tax expenditures." The Reagan Administration made a similar effort in 1982, only to backtrack in the face of criticism and continue with the status quo henceforth. Although the Bush effort has come in for criticism as well, observers believe that it is much more likely to stick to its guns. A key reason is that in the years since the Reagan initiative, various aspects of tax expenditures have been heavily critiqued by tax theorists, both economists and legal scholars. If the Bush Administration stands up to the critics and presses forward with its attack on the way tax expenditures have been calculated and used, it could have a very profound, long-term effect on future tax policy in the United States.

Origin of Tax Expenditures

Ever since the beginning of the federal income tax in 1913, there have been deductions and exclusions that caused taxable income to be less than gross income. For example, the very first income tax return allowed deductions for all interest paid, state and local taxes paid, and depreciation.

Economists have always been interested in these deductions and exclusions because of their impact on the distribution of the tax burden, their incentive effects and their impact on overall revenue.[1] However, until the 1960s there was no comprehensive catalogue of tax preferences, nor a standard method for analyzing them.

This situation began to change when Stanley Surrey, a professor of law at Harvard University, became assistant secretary of the Treasury for tax policy during the Kennedy Administration. Surrey believed strongly that many provisions of the Tax Code had economic effects identical to government spending. However, as part of the Tax Code, they came under much less scrutiny than did spending programs. Surrey sought to create a method whereby tax provisions and spending programs could be reviewed simultaneously by Congress in order to improve the policymaking process.[2]

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Under Surrey's leadership, the Treasury Department began to catalogue tax preferences and develop a methodology for measuring them. By the closing days of the Johnson Administration the Treasury had completed its preliminary work on the subject of what Surrey now called tax expenditures.[3] Surrey clearly intended the term "tax expenditure" to be pejorative, undermining political support for tax preferences. Treasury Secretary Joseph Barr presented the results at a hearing of the Joint Economic Committee a few days before President Nixon's inauguration. The hearing is best remembered for Barr's disclosure that 21 people earned more than $1 million in 1967 without paying any federal income tax, due to their utilization of tax preferences.[4]

Almost immediately, there were efforts in Congress to require the Treasury Department to publish a tax expenditure budget annually. These efforts were resisted by the Nixon Administration. However, the Congressional Budget and Impoundment Control Act of 1974 forced the President to report annually on tax expenditures in his budget. It also required a tax expenditure estimate to be made for all bills reported by congressional committees.[5]

Conceptual, Accounting, and Measurement Problems

Because tax expenditures went from being a concept to becoming part of the law so quickly, basic conceptual problems of selection and measurement were glossed over. In the Budget Act, tax expenditures were defined as follows:

> The term "tax expenditure" means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability; and the term "tax expenditures budget" means an enumeration of such tax expenditures.[6]

Professor Boris Bittker of Yale University was one of the first to call attention to the problems inherent in identifying and measuring tax expenditures. First, he said, there is no general agreement on what constitutes an ideal or correct tax structure to begin with, against which to determine deviations that can be considered tax expenditures. Second, there are problems in defining the taxpaying entity, the appropriate taxable period, and a set of accounting principles. And third, there is a problem of measurement.[7] The first problem is most important. As Bittker put it:

> A systematic compilation of revenue losses requires an agreed starting point, departures from which can be identified. What is needed is not an ad hoc list of tax provisions, but a generally acceptable model, or set of principles, enabling us to decide with reasonable assurance which income tax provisions are departures from the model, whose costs are to be reported as "tax expenditures"....The lack of an agreed conceptual model makes it impossible to say whether a large number of structural features of the existing federal income tax laws are, or are not, "tax expenditures"....The proposal is feasible

> only to the extent that we can agree on a conceptual model, for a "tax expenditure" is nothing more than an estimate of the amount of revenue that would be raised if the law conformed to such an agreed model.

As to the second point, there are important conceptual and measurement problems related to whether the taxpaying entity is the individual or the family and how corporations should be treated, among other things. There is also a question of the appropriate accounting period. A year, after all, is somewhat arbitrary, and one could argue that tax burdens ought to be calculated over a lifetime.[8] However, choosing between the two makes a great deal of difference in calculating tax expenditures.

Lastly, the issue of measuring tax expenditures is complicated by their effects on behavior. One cannot simply recompute an individual's tax liability with and without the tax expenditure, Bittker argued, because we cannot know what the taxpayer would have done in its absence. If a tax provision caused a taxpayer's behavior to change, then eliminating the provision may only cause him to change back again. This makes any measurement of how much revenue the government would gain from repealing a tax provision almost impossible to calculate accurately. It also means that we cannot know the distributional consequences of many tax provisions, even though distributional considerations now dominate the tax policymaking process.[9]

Haig-Simons

As Bittker noted, it is essential to have some point of reference or baseline against which to determine what is and what is not a tax expenditure. Since World War II, economists and lawyers have tended to rely upon the definition of income developed by Professors Robert M. Haig and Henry C. Simons in the 1920s and 1930s to determine what does and what does not belong in the tax base.[10] Simons' definition is the one most widely quoted:

> Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.[11]

Thus for tax purposes, income consists of consumption plus the change in the value of one's net wealth between December 31 of one year and December 31 of the next. While this may appear to be straightforward, there are innumerable problems in applying such a definition to specific tax situations As Bittker put it:

> The trouble is that, aside from the many ambiguities that become apparent as soon as one attempts to apply the Haig-Simons definition to the protean stream of economic life, any system of income taxation is an aggregation of decisions about a host of structural issues that the Haig-Simons definition does not even purport to settle.[12]

Surrey implicitly admitted that a pure Haig-Simons definition of income could not serve as the ideal.[13] While acknowledging that the tax expenditure concept was based on Haig-Simons, Surrey amended it to exclude the imputed income on owner-occupied housing, the personal exemption, differential tax rate schedules and income-splitting for married couples—all deviations from a pure Haig-Simons tax base. He argued that what tax expenditures were really designed to show is deviation from some generally accepted normal tax base, not the variations from a theoretically unattainable ideal.[14]

Bittker replied that no consensus existed as to what a normal tax base should be. Therefore, having abandoned the purity of Haig-Simons, Surrey is adrift in a sea of value judgements and his is no better than any other expert's. Thus it is presumptuous for him to label his definition (i.e., the Treasury's) as the one correct definition, any deviations from which will be labeled tax expenditures.[15] A more recent critique makes the same point as follows:

> While the several existing tax expenditure budgets give an appearance of being the products of a highly sophisticated, expert, neutral examination of the tax system, they could just as accurately be characterized as exercises in mystification. They create an illusion of value-free scientific precision in a heavily politicized domain.[16]

As Surrey himself noted, a strict application of the Haig-Simons definition would require that individuals be taxed on the imputed income they derive from living in their own homes.[17] For instance, if two people each lived in the identical house and each owned the other's home, they would pay rent to each other, which would be taxable. But if they simply lived in their own home they would not pay rent to themselves and thus no taxable income would arise. Yet, in principle, the income is still there even though it is untaxed. Consequently, the Department of Commerce includes such income in its calculation of gross domestic product. In 1999, it amounted to $576.4 billion.[18] However, the nontaxation of imputed rent on owner-occupied homes does not appear on the list of tax expenditures.[19]

It has also been suggested that a pure Haig-Simons definition of income would require people to be taxed on the imputed income they derive from public capital, such as roads.[20] It has been argued that married couples, where only one spouse works outside the home, be taxed on the household production of the nonworking spouse.[21] Similarly, since leisure has economic value, it too should be taxed.[22] And it has been suggested that Haig-Simons requires the taxation of human capital, such as education, since human capital is as much a form of wealth as anything else.[23]

Furthermore, experts have questioned the exclusion of marginal tax rates below the top rate from the tax expenditure list. After all, the lower rates for corporations are treated as tax expenditures currently.[24] They have also questioned the exclusion of the personal exemption and standard deduction as well.[25]

On the other hand, experts have argued that such things as the deductions for charitable contributions,[26] medical expenses,[27] qualified pension plans,[28] casualty and theft losses,[29] state and local taxes,[30] mortgage interest,[31] and accelerated depreciation,[32] as well as the exclusions for scholarships,[33] foreign earned income,[34] and inside buildup on life insurance policies,[35] the deferral of taxes on foreign-source income,[36] and other items currently listed as tax expenditures are in fact part of the normal tax structure and ought not to be considered as tax expenditures.[37]

Similarly, it has been argued that such things as personal interest expenses, which are not now deductible, ought to be deductible under an appropriate definition of income.[38] It has been argued that there should be a full offset for net operating losses by businesses.[39] And a number of supporters of the Haig-Simons concept, including Simons himself, have argued that there should be no corporate income tax under Haig-Simons.[40] This obviously raises an important question as to whether there can be any such thing as a corporate tax expenditure.

A strong case can even be made that lower rates on capital gains are not a tax expenditure because there should be no taxation of capital gains.[41] In fact, it has been argued that if one defines income in present-value terms, there would be no taxation of capital at all even under a Haig-Simons definition of income.[42] At a minimum, capital gains should be fully adjusted for inflation, a position endorsed by Haig, Simons and virtually all tax experts.[43]

Indeed, so great is the confusion over what is and is not a tax expenditure that the Treasury Department and the Joint Committee on Taxation do not even agree on the issue. The appendix lists those items considered to be tax expenditures by the JCT but not by the Treasury and vice versa. It is also worth noting that different countries place different items on their tax expenditure lists, even when they generally agree on the same basic principles for analysis.[44]

In addition, compilers of tax expenditures sometimes change their minds. For example, in the fiscal year 1983 budget, Treasury dropped a number of items from its previously published list of tax expenditures, on the grounds that they were really part of the basic tax structure rather than deviations from it.[45]

This is not to say that each of these often contradictory positions is necessarily correct. The point simply is to demonstrate that there is no consensus and many sharp disagreements about fundamental issues on the question of what is and is not a tax expenditure.

Measurement of Tax Expenditures

This discussion of saving also highlights another important problem with the tax expenditures concept, which is how they should be measured. Historically, tax expenditures have been measured on a static revenue-loss basis. That is, taxpayers' liabilities are calculated with

and without the tax expenditure and no change in behavior is assumed. Also, each tax expenditure is calculated separately.

Critics of this methodology have raised a number of important problems with it. Perhaps the most important is that calculating tax expenditures in this way does not make them comparable to budget outlays, which was the whole purpose of creating the tax expenditure budget in the first place. As former Treasury Department economist Seymour Fiekowsky explains:

> First, tax expenditure budgets have not been constructed with consistent reference to a budgetary format that distinguishes tax provisions that function to execute an expenditure program objective from those provisions that bear on questions about the efficiency and equity of the basic tax structure. Second, the estimated magnitudes of tax expenditures are generally neither dimensionally comparable to amounts conventionally entered on the uses side of the budget, nor are they computed in a manner which makes them additive with each other.[46]

In other words, tax expenditures do not measure how much money the government would have to spend to induce the same behavior or put taxpayers in the same position they would be in without the tax expenditure. And because each tax expenditure is calculated without reference to the rest of the tax expenditure budget, they cannot be added together to give a meaningful budgetary presentation. Moreover, many tax expenditures are fungible. For example, a taxpayer denied the use of a 401(k) pension plan might be able to take advantage of a Keogh plan, an Individual Retirement Account, or an annuity to achieve the same tax saving.

The additive problem is also complicated by the fact that revenue losses are calculated against a given statutory rate structure. This means that the higher marginal tax rates are, the greater the revenue loss attributed to a tax expenditure. This is because a $1 deduction or exclusion is worth 40 cents to someone in the top tax bracket, but only 15 cents to someone in the lowest bracket. If the average marginal tax rate rises, then the dollar value of the entire tax expenditure budget will rise even if there is no change in tax expenditures per se. Conversely, of course, reductions in marginal tax rates will shrink the size of the tax expenditure budget. Thus the rate reductions in the Tax Reform Act of 1986 reduced the aggregate size of the tax expenditure budget by an estimated $115 billion.[47]

Beginning in 1982 the Treasury improved its presentation of tax expenditures by calculating them on both a revenue-loss and outlay-equivalent method. This gives policymakers a clearer picture of what the government would have to spend in order to accomplish the same purpose for which the tax expenditure was created. Thus they are more equivalent to the other numbers in the budget. In general, the outlay-equivalent numbers are higher than the revenue-loss figures, because outlays would be taxable, thereby requiring higher spending to achieve the same goal.

Another measurement problem is related to the way specific tax expenditures are calculated. For example, in the case of tax-exempt interest on municipal bonds, the tax expenditure is simply calculated as if the interest were taxable. However, this ignores the fact that interest rates on municipal bonds are lower than those on equivalent taxable securities precisely because they are tax-free. In 2000, the average interest rates on high-grade corporate and municipal bonds were 7.62% and 5.77%, respectively. Thus buyers of municipal bonds are paying an implicit tax rate of about 24%, in the form of a lower return, that is not measured in the tax expenditure budget. Obviously, if municipal bonds were made taxable their yields would rise by this amount. If one made this assumption, the revenue lost due to municipal bonds would shrink dramatically.[48]

Lastly, there is the question of the appropriate accounting period in calculating tax expenditures and whether they should be calculated on a cash or an accrual basis. For example, according to Haig-Simons, capital gains should be taxed as accrued, rather than when realized. However, neither the Treasury nor the Joint Committee on Taxation lists the deferral of taxation on accrued gains as a tax expenditure. Only the revenue loss attributable to lower rates on realized capital gains is calculated.

In other cases, however, the deferral of taxation is treated as a tax expenditure. Moreover, the methodology used makes the items appear far larger than they really are. This is because not only will the government eventually receive a tax payment, but in many cases the payment will be larger than would be the case without deferral. Looking at the revenue loss over a longer time period, therefore, would greatly reduce and perhaps even eliminate any revenue loss.[49]

Recently, the Treasury began calculating some tax expenditures in present value terms in order to eliminate the distortion caused by treating deferrals as if they were permanent tax exemptions. The impact is dramatic. In the case of IRAs, for example, the Treasury calculates a 2000 revenue loss of $15.2 billion. However, because taxes will eventually be paid on IRA withdrawals and earnings, the revenue loss in present value terms is just $5.9 billion.[50]

Assessment

The tax expenditures concept is deeply flawed. The most fundamental problem is the implicit assumption that there is some ideal tax system against which to judge tax preferences. The result is that the decision to include or not include a particular item is totally arbitrary. As a recent OECD report put it, "the concept of tax expenditures is subjective and ambiguous in principle as well as in practice."[51]

Although it is often implied that everyone would be better off under a comprehensive income tax that excluded all tax expenditures, it is seldom stated explicitly how this would be the case. And estimates of the economic cost of tax preferences tend to be low.[52] Rather, advocates of the tax expenditure concept prefer to argue their case as a matter of principle. Yet a closer examination of their arguments suggests that egalitarianism, rather than good tax policy,

is the true motive. As Henry Simons admitted, "The tax system should be used systematically to correct excessive economic inequality and to preclude inordinate, enduring differences among families or economic strata in wealth, power, and opportunities."[53] His definition of income was clearly devised to further this goal.

Although it is often assumed that tax expenditures primarily benefit the wealthy, this is not true. The largest tax expenditures, such as for mortgage interest, primarily benefit the middle class. On balance, tax expenditures are proportional to income and tax liability.[54]

It has often been argued that the very concept of tax expenditures implies that any income that is not taxed due to a tax preference belongs to the government. As the late Aaron Wildavsky put it, "In the mythology of tax expenditures, only politicians prevent experts from taxing everything."[55] For example, in the opinion of some of the tax specialists cited earlier, a case can be made for taxing, among other things, the imputed value of owner-occupied housing, the imputed income people derive from roads and other public capital, the imputed income from the household production of nonworking spouses, the value of education and other human capital, unrealized paper gains on stock and other property, and the value of leisure. In an unusual case of candor, one tax expenditure budget even admitted this fact:

> The term "tax expenditures" is...unfortunate in that it seems to imply that Government has control over all resources. If revenues which are not collected due to "special" tax provisions represent Government "expenditures," why not consider all tax rates below 100% "special," in which case all resources are effectively Government-controlled?[56]

More recently, Charles Fried, a prominent Harvard Law School professor, restated the point. "Lurking behind the concept of tax expenditures is a more sinister premise," he said. "It is the subtle disposition to think of all income as virtual state property, and forbearance to tax away every last penny of it as itself a tax expenditure."[57]

Although the supporters of tax expenditures like to say that the concept is value-free, it is significant that tax expenditures are only calculated for tax provisions that lose revenue. A consistent application of the concept would also list tax provisions that raise government revenue above what would be the case under the reference case. As noted earlier, Henry Simons believed that the entire corporate income tax is a deviation from his definition of income. A consistent application of the Haig-Simons concept, therefore, would list the corporate income tax as a negative tax expenditure or tax surcharge. A recent survey of tax practitioners found support for including many other tax provisions this way as well. Among those mentioned are the alternative minimum tax, marginal tax rates above the average rate, the phase-out of personal exemptions and the standard deduction for high income taxpayers, and limitations on capital losses.[58]

One must also ask, What is wrong with tax expenditures anyway? If they accomplish some useful purpose, why shouldn't policymakers make use of them? It may well be that using the

Tax Code, rather than the government's spending or regulatory power, is a better way to achieve some legitimate government purpose.[59] In Sweden, for example, it has been argued that tax expenditures have been very successful in promoting economic growth.[60]

Whether tax expenditures are ultimately worthy of repeal depends on one's perspective. There is certainly no general case to be made for wiping the slate clean.

The Future

Were the tax expenditures budget nothing but an analytical tool, it might be unobjectionable, despite its shortcomings. But it is far more than that. It institutionalizes, in a very powerful way, a particular view of tax policy that makes it exceedingly difficult to make positive reforms.

The late Norman B. Ture once told me that almost everything bad in the Tax Code is there because of Haig-Simons. It took me a while to realize that he was right. In particular, Haig-Simons sanctions the excessively heavy taxation of capital in the United States that is both unfair and a severe constraint on economic growth. Although, to be fair, adoption of a pure Haig-Simons definition of income would improve the Tax Code in some ways. For example, the corporate income tax would disappear. But the advocates of Haig-Simons seldom advocate abolition of the corporate income tax. They are far more likely to complain about the failure to fully tax capital gains, accelerated depreciation and other tax provisions that benefit capital.[61]

Over the last 25 years, however, a different view has emerged among many, if not most, tax theorists that a consumption base makes a lot more sense.[62] As the late Joseph A. Pechman noted, in his presidential address to the American Economic Association in 1989: "Today, it is fair to say that many, if not most, economists favor the expenditure tax or a flat rate income tax."[63] Of course, most versions of the flat tax are pure consumption-based taxes, because all saving and investment are tax deferred (i.e., expensed) or, equivalently, their returns are nontaxable.[64]

When Ture became Under Secretary of the Treasury for Tax and Economic Affairs in 1981, he made an effort to change the Reagan Administration's treatment of tax expenditures. Ture believed strongly that Haig-Simons was the wrong implicit base against which to determine what is and isn't a tax expenditure. He believed that tax neutrality was the appropriate guideline, and that such a criteria essentially led to a consumption base.

In November, 1981, Mr. Ture was asked to explain his views at a hearing of the Senate Budget Committee. As was customary, the testimony was reviewed by the Office of Management and Budget, which determines whether all testimony by administration officials is in conformity with administration policy. OMB refused to clear the testimony and the hearing was canceled. Subsequently, however, the undelivered testimony was published in *Tax Notes*.[65]

First, Ture said, "the concept of tax expenditures is too vague to permit a precise definition." Second, "in contrast to outlays estimates, formidable problems are encountered in attempts to measure tax expenditures." If the attempt is nevertheless made to estimate tax expenditures, Ture argued that the benchmark against which deviations are measured should at least be coherent and principled. He recommended using a tax neutrality criterion. The items on the tax expenditure list would then show positive and negative tax subsidies relative to a neutral tax. Several years after leaving Treasury, Ture explained his alternative formulation this way:

> A neutral tax system is one that would not alter the relative prices and costs of goods, services, and activities that would prevail in an efficiently functioning private market, i.e., a market the results of which are not influenced by government actions or policies. The neutrality criterion calls for a tax that changes in the same proportion the costs and prices of all alternatives confronting taxpayers... A neutral tax system would include no provisions that provide subsidies nor would it contain any provisions that differentially raise the price or cost of any product, service, or activity....
>
> It should raise the cost of saving in the same proportion as it raises the cost of consuming, and it should raise the cost of each form of saving and of each type of consumption in the same proportion. It should raise the cost of any particular kind of job to the same degree that it raises the cost of doing any other kind of work. It should raise the cost of using capital inputs in the same proportion as it increases the cost of using labor services in production processes, and it should increase the cost of any kind of capital use to the same degree as that of any other capital use.[66]

In his suppressed testimony, Ture pointed out that his alternative formulation of a neutral tax base against which to measure tax expenditures would produce important changes in the tax expenditures listing. Notably, many tax provisions that are biased against saving would appear as negative tax subsidies, that is, as special tax penalties:

> Application of the neutrality criterion dictates that the entire corporation income tax should be seen as a *negative* tax expenditure—as an *incremental* levy on the net returns to capital used by corporations compared with a tax on the net returns on capital used by businesses organized in some other form. More fundamentally, we must perceive the fact that the personal income tax levied on the amount of current income which is saved and also on the returns realized on saving... [is] a *negative* tax expenditure, and any tax provision which abates the tax on current saving should be seen as a reduction in a *negative* subsidy. In the same context, the neutrality criterion dictates that *any* tax on capital gains is a *negative* tax expenditure, and any reduction in that tax is to be seen as a reduction in an extraordinary tax penalty on saving.[67]

Some of Ture's ideas made it into the text of the tax expenditures presentation for the Reagan Administration's fiscal 1983 budget.[68] This presentation came under heavy attack from supporters of the traditional approach to tax expenditures, Stanley Surrey in particular.[69] Afterwards, the budget reverted to the earlier presentation and all official criticism of tax expenditures disappeared from it.

Now the Bush Administration returns to the fray. In its 2002 budget, it reiterates much of the criticism of tax expenditures from the 1983 budget. It refers to them as "so-called tax expenditures," makes reference to the concept of "negative tax expenditures (i.e., a tax penalty)," and says "the Administration intends to reconsider this presentation in the future."

The 2002 budget goes on to say that the traditional method of calculating tax expenditures "assumes an arbitrary tax base is available to the Government in its entirety as a resource to be spent." For this reason, "the Administration believes that the concept of 'tax expenditure' is of questionable analytic value."

Recognizing this threat to liberal dominance of the tax reform debate, the Bush Administration tax expenditures presentation has been attacked, just as the earlier Reagan effort was. Joel Friedman of the liberal Center on Budget and Policy Priorities said, "They're extremely off the mark." The tax expenditures list is "extremely useful and highly analytical," he added.[70]

Economist Martin Sullivan suggested that the Bush Administration may be building a foundation for using consumption, rather than Haig-Simons, as the reference tax base for calculating tax expenditures in the future. This would have vast implications for what is and is not a tax expenditure. As he writes:

> If the tax expenditures budget used consumption taxation instead of income taxation as its norm, all incentives for capital formation—from accelerated depreciation to capital gains relief to IRAs—would not be scored as tax expenditures....If taxes on capital, on estates, and on foreign income were removed from the normal tax system used as a baseline for scoring tax expenditures, the tax expenditures budget would be transformed from a political liability to a positive force for the types of change Republicans seek. Not only would relief from taxes on capital, on estates, and on foreign income no longer be brandished as tax expenditures, but any remaining taxes on capital, estates, or foreign income could be deemed tax penalties or negative tax expenditures.[71]

In conclusion, the Bush Administration's move to downgrade and revise the tax expenditures budget will help to lay the groundwork for fundamental tax reform. This is widely viewed as the administration's next major tax initiative.[72]

It is too soon to say if the Bush Administration will move in the direction of a consumption-based tax system. But it is clear that if it did want to move in such a direction, then it would be very helpful to establish that a Haig-Simons income base is not the only "ideal" one that can be justified. Since Haig-Simons underpins tax expenditures analysis, it reinforces the supposed superiority of an income base and is a barrier to adoption of a consumption-based system. Therefore, showing the flawed intellectual underpinning of tax expenditures is desirable to overthrowing income as the basis of taxation and establishing consumption in its place.

So far, the administration is not backing down from its criticism of tax expenditures. If it stands firm, it will greatly improve the odds that it will in fact push for a major tax reform in the near future that will shift taxation away from saving and investment. Establishing that reduced taxes on capital is not a tax expenditure is the first step.

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Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.

APPENDIX

JCT Tax Expenditures Not on the Treasury List

Natural resources and environment
- Exclusion of contributions in aid of construction for water and sewer utilities
- Special rules for mining reclamation reserves
- Special tax rate for nuclear decommissioning reserve funds

Agriculture
- Exclusion of cost-sharing payments
- Cash accounting for agriculture
- Five-year carryback period for net operating losses attributable to farming

Insurance companies
- Special treatment of life insurance company reserves
- Deduction of unpaid property loss reserves of property and casualty companies

Business and commerce
- Expensing of magazine circulation expenditures
- Special rules for magazine, paperback book, and record returns
- Completed contract rules
- Cash accounting, other than agriculture
- Deferral of gain on in-kind exchanges
- Exception from net operating loss limitations for corporations in bankruptcy
- Tax credit for employer-paid FICA taxes on tips
- Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters

Employment
- Exclusion of miscellaneous fringe benefits
- Exclusion of employee awards
- Exclusion of income earned by voluntary employee beneficiary associations

Medicare
- Exclusion of untaxed Medicare benefits for Hospital Insurance
- Exclusion of untaxed Medicare benefits for Supplementary Medical Insurance

Treasury Tax Expenditures Not on the JCT List

Energy
- Tax credit for electric vehicles
- Deductions for clean-fuel vehicles and refueling property
- Natural resources and environment
- Tax credit and seven-year amortization for reforestation expenditures

Agriculture
- Deferral of tax on gains from sale of stock in a qualified refiner or processor to an eligible farmer's cooperative

Financial Institutions
- Bad debt reserves of financial institutions

Insurance companies
- Special alternative tax on small property and casualty insurance companies
- Tax exemption for insurance companies owned by tax-exempt organizations

Business and commerce
- Ordinary income treatment of losses from sales of small business corporation stock
- Exclusion of income from discharge of indebtedness incurred in connection with qualified real property

Social Services
- Expensing of costs for removing architectural barriers

Source: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2001-2005* (Washington: U.S. Government Printing Office, 2001), pp. 10-12.

Endnotes

1. See, for example, the papers by Walter J. Blum, Harold Groves, Randolph Paul and others in U.S. Congress, Joint Committee on the Economic Report, *Federal Tax Policy for Economic Growth and Stability: Papers Submitted by Panelists Appearing before the Subcommittee on Tax Policy*, Joint Committee Print, 84th Congress, 1st session (Washington: U.S. Government Printing Office, 1955). See also Joseph A. Pechman, "Erosion of the Individual Income Tax," *National Tax Journal*, vol. 10, no. 1 (March 1957), pp. 1-25.

2. Jonathan Barry Forman, "Origins of the Tax Expenditure Budget," *Tax Notes*, vol. 30, no. 6 (February 10, 1986), pp. 537-545.

3. Forman, "Origins of the Tax Expenditure Budget," p. 538; Aaron Wildavsky, "Keeping Kosher: The Epistemology of Tax Expenditures," *Journal of Public Policy*, vol. 5, no. 3 (August 1985), pp. 417, 425.

4. U.S. Congress, Joint Economic Committee, *The 1969 Economic Report of the President*, 91st Congress, 1st session (Washington: U.S. Government Printing Office, 1969), pt. 1, pp. 4-94.

5. Public Law 93-344.

6. Sec. 3(3).

7. Boris I. Bittker, "Accounting for Federal 'Tax Subsidies' in the National Budget," *National Tax Journal*, vol. 22, no. 2 (June 1969), pp. 244-261.

8. On rejection of the lifetime approach to measuring tax burdens, see Thomas Barthold, "How Should We Measure Distribution?" *National Tax Journal*, vol. 46, no. 3 (September 1993), pp. 291-299. One proposal that would, in effect, equalize lifetime tax burdens between those with the same lifetime incomes involves unlimited lifetime averaging. See William Vickrey, "Averaging of Income for Income-Tax Purposes," *Journal of Political Economy*, vol. 47, no. 3 (June 1939), pp. 379-397.

9. Boris Bittker, "Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities? *San Diego Law Review*, vol. 16, no. 4 (July 1979), pp. 735-748; Michael Graetz, "Paint-by-Numbers Tax Lawmaking," *Columbia Law Review*, vol. 95, no. 3 (April 1995), pp. 609-682.

10. Robert M. Haig, "The Concept of Income — Economic and Legal Aspects," in Robert M. Haig, ed., *The Federal Income Tax* (New York: Columbia University Press, 1921), reprinted in Richard A. Musgrave and Carl Shoup, eds., *Readings in the Economics of Taxation* (Homewood, Illinois: Richard D. Irwin, 1959), pp. 54-76; Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938).

11. Simons, *Personal Income Taxation*, p. 50.

12. Bittker, "Accounting for Federal 'Tax Subsidies,'" p. 260.

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14. Stanley S. Surrey, *Pathways to Tax Reform* (Cambridge: Harvard University Press, 1973): 12-13; Stanley S. Surrey and William F. Hellmuth, "The Tax Expenditure Budget — Response to Professor Bittker," *National Tax Journal*, vol. 22, no. 4 (December 1969), pp. 528-537.

15. Boris Bittker, "The Tax Expenditure Budget — A Reply to Professors Surrey & Hellmuth," *National Tax Journal*, vol. 22, no. 4 (December 1969), pp. 538-542.

16. Douglas A. Kahn and Jeffrey S. Lehman, "Tax Expenditures: A Critical View," *Tax Notes*, vol. 54, no. 13 (March 30, 1992), p. 1663.

17. Donald B. Marsh, "The Taxation of Imputed Income," *Political Science Quarterly*, vol. 58, no. 4 (December 1943), pp. 514-536; Richard Goode, "Imputed Rent of Owner-Occupied Dwellings Under the Income Tax," *Journal of Finance*, vol. 15, no. 4 (December 1960), pp. 504-530.

18. *Survey of Current Business*, vol. 80, no. 8 (August 2000), p. 117.

19. The Joint Committee on Taxation justifies the exclusion on the grounds that including imputed income would require treating the deductions for mortgage interest and local property taxes as ordinary business expenses, and thus part of the normal tax structure that would not be considered tax expenditures. It would also have to allow a deduction for maintenance and depreciation. No explanation is given for why it does not simply do so. Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2001-2005* (Washington: U.S. Government Printing Office, 2001), p. 5. A number of foreign countries do include imputed rent in their list of tax expenditures. See *Taxation and Household Saving* (Paris: Organization for Economic Cooperation and Development, 1994), p. 165; Paul Merz, "Foreign Income Tax Treatment of the Imputed Rental Value of Owner-Occupied Housing: Synopsis and Commentary," *National Tax Journal*, vol. 30, no. 4 (December 1977), pp. 435-439.

20. Charles Hulten and Robert M. Schwab, "A Haig-Simons-Tiebout Comprehensive Income Tax," *National Tax Journal*, vol. 44, no. 1 (March 1991), pp. 67-78.

21. Glenn E. Coven, "The Decline and Fall of Taxable Income," *Michigan Law Review*, vol. 79, no. 8 (August 1981), p. 1541.

22. Edward A. Zelinsky, "Qualified Plans and Identifying Tax Expenditures: A Rejoinder to Professor Stein," *American Journal of Tax Policy*, vol. 9, no. 2 (Fall 1991), pp. 257-282.

23. William A. Klein, "Timing in Personal Taxation," *Journal of Legal Studies*, vol. 6 , no. 2 (June 1977), pp. 461-481; Louis Kaplow, "Human Capital Under an Ideal Income Tax," *Virginia Law Review*, vol. 80, no. 7 (October 1994), pp. 1477-1514; Louis Kaplow, "On the Divergence Between 'Ideal' and Conventional Income-Tax Treatment of Human Capital," *American Economic Review*, vol. 86, no. 2 (May 1996), pp. 347-352. For criticism, see Lawrence Zelenak, "The Reification of Metaphor: Income Taxes, Consumption Taxes and Human Capital," *Tax Law Review*, vol. 51, no. 1 (Fall 1995), pp. 1-34; Jennifer J.S. Brooks, "Taxation and Human Capital," *American Journal of Tax Policy*, vol. 13, no. 2 (Fall 1996), pp. 189-213.

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29. Walter J. Blum, "Book Review: Pathways to Tax Reform," *Journal of Corporate Taxation* vol. 1, no. 4 (Winter 1975), pp. 489-90. For criticism, see William Vickrey, "Insurance Under the Federal Income Tax," *Yale Law Journal*, vol. 52, no. 3 (June 1943), pp. 554-585; Kaplow, Income Tax as Insurance."

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