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Highlights

Highlights of GAO-12-760T, a testimony before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, House of Representatives

June 8, 2012

TAX POLICY

Factors for Evaluating Expiring Tax Provisions

Why GAO Did This Study

GAO was asked to discuss the extension of tax provisions, sometimes called tax extenders, that either expired in 2011 or are scheduled to expire at the end of 2012. For a prior hearing of this subcommittee, the Joint Committee on Taxation (JCT) prepared a document detailing 64 expiring tax provisions. Most of these provisions are tax expenditures—reductions in a federal taxpayer's tax liability that result from special credits, deductions, exemptions and exclusions from taxation, deferral of tax liability, and preferential tax rates. Tax expenditures are often aimed at policy goals similar to those of spending programs, such as encouraging economic development in disadvantaged areas and stimulating research and development. Because revenue is foregone, these provisions may, in effect, be viewed as spending programs channeled through the tax system. For those provisions the President proposed extending through 2013, JCT estimated the budgetary effect would be at least $40 billion in foregone revenue over its 10-year budget window.

This testimony outlines factors useful for considering trade-offs when deciding whether and how to extend provisions and illustrates their application to some of the expiring provisions. GAO's testimony is based on previous work on tax reform and tax expenditures.

What GAO Recommends

GAO has made many recommendations in its previous reports on tax expenditures that reflect the factors described in this testimony. Some have been acted on, while others have not.

View GAO-12-760T. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

Factors commonly used to evaluate tax policy, as well as other policy tools such as spending programs or regulations, can be applied to decisions about whether and how to extend expiring tax expenditures, as discussed below.

Revenue Effects. Revenues foregone through tax expenditures either reduce resources available to fund other federal activities or require higher tax rates to raise a given amount of revenue. Like decisions about spending, deciding whether to extend an expiring tax expenditure involves considering whether the benefit of the intended outcome is worth the effect on other programs or tax rates. The nation's long-term fiscal challenge makes it all the more important to ensure tax expenditures are efficient and relevant.

Criteria for Good Tax Policy. Three long-standing criteria typically used to evaluate tax policy—equity; economic efficiency; and a combination of simplicity, transparency, and administrability—can be applied to the expiring tax expenditures. Because the criteria may sometimes conflict with one another, there are usually trade-offs to consider when evaluating particular tax expenditures.

Relationship to Other Policy Tools. Tax expenditures represent just one policy tool of several—including spending, grants, loans, and regulations—that policymakers can use to achieve policy goals. If not well designed, tax expenditures can create the potential for duplication with other policy tools.

Measurement Challenges. Unavailable or insufficient data can hinder policymakers' ability to consider how the factors described above relate to particular tax expenditures. A key challenge is that data necessary to assess how a tax expenditure is used and by whom generally are not collected on tax returns unless the Internal Revenue Service needs the information to ensure tax compliance or is legislatively mandated to collect or report the information.

GAO's prior reports on tax expenditures illustrate how these factors can be used to evaluate whether and how to extend expiring tax provisions. For example, GAO found that the research tax credit, as currently designed, provides many recipients with windfall benefits earned for spending they would have done anyway. A report on domestic ethanol production—in which GAO suggested modifying or phasing out a tax credit that was duplicative of the renewable-fuel standard—highlights the importance of considering how tax expenditures relate to other policy tools. GAO's work on higher-education tax expenditures illustrates how tax expenditures that are not transparent (i.e., cannot be easily understood by taxpayers) can result in taxpayers making decisions that do not maximize their tax benefits. This work also concluded that little is known about the effectiveness of education-related federal grants, loans, and tax expenditures in promoting certain student outcomes, such as college attendance. Research gaps may be due, in part, to data and methodological challenges—such as difficulty isolating the behavioral effects of the tax expenditure under study from other changes—that have proven difficult to overcome.