STATEMENT
OF
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BEFORE THE
UNITED STATES SENATE COMMITTEE ON FINANCE
EXPIRING TAX PROVISIONS: LIVE OR LET DIE
MARCH 16, 2005

My name is Donald C. Alexander, and I am appearing today at the Committee's invitation as a former tax collector and a long-time tax practitioner with an interest in sound tax administration.

That expiring provisions are now commonly called "extenders" indicates that most of the time they don't expire on schedule; instead they are extended, usually for short periods of time. Much of this is a consequence of budgetary restraints since the adoption of the "pay-go" rules. From the standpoint of trying to keep the nation solvent, budgetary rules are a good idea. From the standpoint of producing sound, administrable, tax legislation, they are not.

As the Joint Committee on Taxation staff wrote in 2001:[1]

> The practice of extending temporary provisions for another "temporary" period creates significant uncertainty for taxpayers. It invites speculation as to whether every temporary provision will be extended. For example, the exclusion from income for employer-provided group legal assistance was enacted on a temporary basis in 1976, was extended seven times, and was allowed to expire after June 30, 1992. Similarly, the exclusion from income for employer-provided educational assistance has been extended ten times since its original enactment in the Tax Reform Act of 1978, was allowed to expire after 1994 and then retroactively was reinstated in 1996, and has at times applied to undergraduate education only, and at other times to graduate education and undergraduate education.

This practice of numerous short extenders may well be good for tax lobbyists, but I doubt that improving their livelihood is an appropriate national goal.

So long as the "pay-go" rules continue to foster short-term extenders, it is imperative that Congress somehow find the time to evaluate each candidate for extension to see how it has performed. Does the extender's benefit justify the extender's cost?

The R&D credit is the poster child extender. According to my limited research, it has been extended eleven times, and allowed to expire for a year.[2] I don't know whether research in

[1] Staff of Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986*, at 63 (Comm. Print 2001).

the United States ceased when the credit expired in 1995, to resume in mid-1996. The recently-departed Secretary of the Treasury, Paul O'Neill, would have been skeptical. According to Ron Suskind in *The Price of Loyalty,* Mr. O'Neill stated:

> "Go talk to people who make practical business decisions about how much [research and development] tax credits influence the level of R&D that they invest in. You find somebody who says, 'I do more R&D because I get a tax credit for it,' you'll find a fool."

Ron Suskind, *The Price of Loyalty* 90 (2004).

Joint Committee on Taxation's current list of twenty-one extenders (excluding those relating to tax administration) is quite instructive. Most of them confer narrow benefits to remedy a perceived social or economic problem, unrelated to what most rational people would consider to be an appropriate income tax base. They are simply tax expenditures: a substitution of an income tax benefit for an outlay. In these days where anything with a "tax increase" label attached to it is anathema to many, these tax expenditures are "two-fers": (1) a tax cut and (2) a government outlay to the lucky recipients.

Some stem from the oldest and largest of these tax expenditures, the earned income credit. Of course, this is not an extender and, of course, it has a laudable goal.[3] It is an income supplement to encourage the poor to work rather than to remain on welfare. I thought this fine idea should be administered by the then Department of Health, Education and Welfare, but Milton Friedman, who favored a negative income tax, thought otherwise, and he persuaded the then Administration to adopt the EITC in 1975. I argued that it would be very difficult to administer and that the Internal Revenue Service was not the right agency to engage in social work. Obviously, I lost, and it doesn't help to say that the predicted problems have occurred.

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[2] The R&D tax credit has been extended 11 times since it was enacted in 1981.

1981 - *Economic Recovery Tax Act* - Credit enacted from July 1981 - December 1985
1986 - *Tax Reform Act* - Credit was extended for 3 years (January 1986 - December 1988)
1988 - *Technical and Miscellaneous Revenue Act* - Extended 1 year (January 1989 - December 1989)
1989 - *Omnibus Budget Reconciliation Act* - Credit prorated to be extended for 1 year (Jan. 1990 – Dec. 1990)
1990 - *Omnibus Budget Reconciliation Act* - Extended 1 year (January 1991 - December 1991)
1991 - *Tax Extension Act* - Extended 6 months (January 1992 - June 1992)
1993 - *Omnibus Budget Reconciliation Act* - Extended for 3 years (July 1992 - June 1995)

There was no credit from July 1995 - June 1996

1996 - *Small Business Job Protection Act* - Extended for 11 months (July 1996 - May 1997)
1997 - *Taxpayer Relief Act* - Extended for 13 months (June 1997 - June 1998)
1998 - *Tax and Trade Relief Extension Act* - Extended for 1 year (July 1998 - June 1999)
1999 - *Ticket to Work Incentive Improvement Act* - Extended for 5 years (July 1999 - June 2004)
2004 - *Working Families Tax Relief Act* - Extended for 18 months (July 2004 - December 2005)

[3] "The earned income tax credit, administered through the federal income tax system, is the largest cash assistance program for low-income families. The EITC provides up to $4,200 a year for working families with two or more children—less for families with fewer children. The EITC is refundable so the credit is not limited to the amount of taxes a family owes. In 2002 the EITC lifted around 4.9 million people out of poverty (Llobrera and Zahradnik, 2004)." Elaine Maag, *Disparities in Knowledge of the EITC,* TAX NOTES 1323 (March 14, 2005) [footnote omitted].

Although the Internal Revenue Code had been used long before the 1970s to favor certain activities[4] we have now developed targeted tax expenditures into an art form. In addition to the enormous welfare program that the IRS must administer, it also administers major segments of our housing incentives, our education incentives, our health incentives, our child care needs and all sorts of narrowly-focused economic incentives. Many of these are in the extender category.

Satisfying an economic or social need through an outlay gives the Congress a chance through the exercise of its oversight responsibilities to see whether the outlay is working, to determine whether the benefit justifies the cost, and to see what corrections and changes should be made in the national interest. Extenders should get the same scrutiny. Before extension, each expiring provision should be subject to questions like the following:

1. What does it cost? (If possible, compare dollars of tax cost with dollars of benefit produced.)

2. To what extent has it met its predicted goal?

3. Are there more effective or less costly ways of accomplishing its goal?

4. Does it overlap another provision to the same or similar effect? If so, why shouldn't the two (or more) be combined?

5. Have changing conditions made it obsolete or unnecessary?

6. What administrative problems has it created for taxpayers and the Internal Revenue Service?

Unfortunately, such a review rarely happens.

Finally, Congress should not extend expiring provisions retroactively and should leave sufficient time for the Internal Revenue Service to provide forms and guidance to taxpayers.

[4] And even particular individuals.

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Commissioner, The Martin Luther King, Jr. Federal Holiday Commission, 1993-96.
Chairman, Commissioner's Exempt Organizations Advisory Group, Internal Revenue Service, 1987-89.

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B.A., with honors, Yale, 1942.
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