



UNITED STATES

Internal
Revenue
Service
Building

Government Spending Undercover

Spending Programs Administered by the IRS

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Introduction and summary

When policymakers look to trim fat from the federal government they too often ignore half the problem: the vast and complicated set of spending programs administered by the Internal Revenue Service. These programs are often referred to as tax expenditures, but this report will make the case that they should be viewed just like any other type of government spending.

As Figure 1 shows, in fiscal year 2011 we will spend over \$1 trillion on tax expenditures. That's more than three-fourths of all corporate and individual income tax revenues and more than one-and-a-half times the cost of all federal domestic discretionary spending. If all these programs were repealed we could cut corporate and individual income tax rates by over 40 percent and still collect the same amount of revenue.

Despite their big price tag, however, these programs fly under the radar of media and popular opinion for two reasons. First, almost all IRS-administered spending programs are not subject to the same annual appropriations process as discretionary spending. Just as with big entitlement programs like Social Security, Medicare, and farm subsidies, their costs depend on formulas created by Congress that once set are rarely changed. Spending on them rises automatically with increases in eligible beneficiaries and changes in economic conditions, such as health care costs or interest rates.

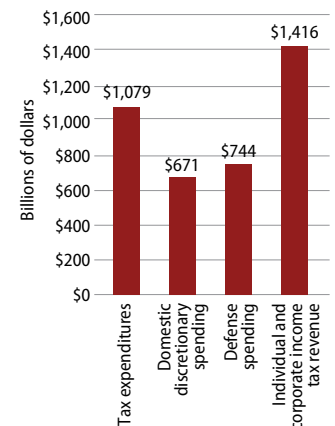
Second, IRS-administered spending programs appear to be tax cuts instead of spending because they transfer funds to businesses and individuals through rebates that reduce tax liability. But make no mistake: These programs are the same as spending by other agencies.

Both IRS-administered spending programs and other spending programs may promote socially desirable behavior, signal social approval of certain private activities, or help those in need. Both may also fail to achieve their objectives or outlive their usefulness, serving no clear goal other than satisfying constituencies accustomed to government aid. And both may simply respond to the concerns of hired lobbyists, representing narrow interest groups rather than the broader taxpaying public.

On one dimension, however, they do differ: IRS-administered spending programs are more likely to be ineffective initiatives or giveaways to the politically powerful than direct outlays. Advocates of IRS-administered spending programs are able to portray the pro-

FIGURE 1
Tax expenditures add up to more than three-fourths of all individual and corporate tax revenue

Estimated spending and revenue raised in different budget categories, fiscal year 2011



Source: Budget of the United States Government, FY 2011.

Notes: We discuss our views on the differences between tax expenditures and IRS-administered spending programs below. Estimates of tax expenditures do not take into account interaction effects, but Burman, Geissler, and Toder (2008) find that, for a large subset of individual income tax expenditures, ignoring interactions understates the total cost by 5 to 8 percent.

grams as tax cuts instead of spending, which makes them easier to enact and more difficult to reduce or eliminate than spending administered by other agencies. For this reason, the bar is simply lower for them. No one asks what goal a spending program dressed up as “a middle-class tax cut” serves because it seems self-evidently good to give people tax cuts. Never mind that IRS-administered spending programs do not simply cut taxes—they place innumerable conditions on what taxpayers must do to receive benefits and which taxpayers are eligible.

The last time Congress systematically reviewed and cut back these programs was 1986—almost a quarter century ago.¹ Given the mounting fiscal pressures facing the United States it is time to take a hard look at IRS-administered spending once again.

This paper explains what IRS-administered spending programs are and why they’re viewed differently than spending by other agencies. It also outlines the obstacles to treating IRS spending programs the same as other government spending, which include definitional issues and measuring their cost. It then offers suggestions for beginning to work IRS spending programs into the budget process including:

- Requiring Congress, a bipartisan commission, or a designated agency to create a list of tax provisions that should be defined as “IRS-administered spending programs”
- Directing CBO to display alternative projections of federal revenue and spending that count all IRS-administered spending programs as revenue raised and then spent
- Requiring the IRS to inform taxpayers of the benefits they receive from IRS-administered spending programs
- Allowing taxpayers to claim these benefits separately from remitting tax due

Finally, the paper raises four questions that policymakers should consider in deciding which IRS-administered spending programs to keep and which ones to cut:

- What goals does the program potentially seek to achieve, if any?
- Do these goals remain worthy of taxpayer support and, if so, how much?
- Within this budget constraint is the program structured as effectively as it could be in order to achieve its objectives? Is it well targeted? And is the IRS the best agency to administer it?
- If not, how could it be restructured to maximize its effectiveness?

The answers to these questions will create an agenda for reform.

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