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# Statement of Federal Financial Accounting Standards 52: Tax Expenditures

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## Status

<b>Issued</b>	May 31, 2017
<b>Effective Date</b>	For periods beginning after September 30, 2017. Earlier implementation is encouraged.
<b>Interpretations and Technical Releases</b>	None.
<b>Affects</b>	None.
<b>Affected by</b>	None.

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## Summary

This Statement requires certain information on tax expenditures to assist users of the consolidated financial report of the U.S. Government (CFR) in understanding the existence, purpose, and impact of tax expenditures.

Specifically, this Statement requires that the CFR:

1. Include narrative disclosures and information regarding tax expenditures that inform the reader regarding the:
  - a. definition of tax expenditures,
  - b. general purpose of tax expenditures,
  - c. impact on and treatment of tax expenditures within the federal budget process, and
  - d. impact of tax expenditures on the government's financial position and condition.
2. Alert readers regarding the availability of published information on tax expenditure estimates, such as those published annually by the Department of the Treasury's Office of Tax Policy.

This Statement also encourages presentation of tax expenditure estimates as other information (OI)<sup>1</sup> in the CFR.<sup>2</sup>

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<sup>1</sup> The term *Other Information* (OI) used in this Statement and the term *Other Accompanying Information* (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

<sup>2</sup> Although the Federal Accounting Standards Advisory Board (FASAB) does not require OI to be presented, FASAB may at times encourage voluntary reporting of items to help in the development of information that may enhance overall federal financial reporting. For example, FASAB may consider an item to be relevant to entity operations but, for the moment, does not meet other criteria for required information.

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The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

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## Standards

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### Scope

1. This Statement requires narrative disclosures and information regarding tax expenditures, and it encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by the Department of the Treasury's (Treasury) Office of Tax Policy, as other information (OI) in the consolidated financial report of the U.S. Government (CFR).<sup>3</sup>
2. The reporting requirements in this Statement apply to the CFR. They do not apply to the financial statements of component reporting entities. They also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.
3. This Statement does not alter or contradict the definition of tax expenditures, as established by the Congressional Budget and Impoundment Control Act of 1974. This Statement does not affect the Treasury or the Joint Committee on Taxation's (JCT) interpretation of the statutory definition. Hence, this Statement does not affect the policies and practices of Treasury's Office of Tax Policy or the JCT with respect to the definition, identification, recognition, and measurement of tax expenditures.

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### Definitions

#### 4. Tax expenditures

The Congressional Budget and Impoundment Control Act of 1974 (Public Law 93-344) defines **tax expenditures** as "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."

While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly

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<sup>3</sup> The term other information (OI) used in this Statement and the term other accompanying information (OAI), as defined by Statement of Federal Financial Accounting Concepts (SFFAC) 6, par. 5, are synonymous.

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approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

5. Baseline provisions

**Baseline provisions** are the starting points used to measure the impact of tax expenditures on tax revenues as compared to revenues that would be collected otherwise, absent the special exclusion, exemption, deduction, credit, preferential rate, or deferral. Certain practical aspects of the tax code are incorporated into the baseline—such as progressive tax rates, personal exemptions, standard deductions, deductions of expenses incurred in order to earn income, and deferrals of unrealized income.

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## DISCLOSURE REQUIREMENTS

### FINANCIAL REPORT OF THE U.S. GOVERNMENT DISCLOSURES

6. Disclosures about tax expenditures should help provide readers with a general understanding of how tax expenditures affect the government's tax collections, financial position, and financial condition; and how budgetary objectives can be achieved through the mechanism of tax expenditures.
7. Disclosures within the notes to the financial statements should include:
  - a. a "plain language" definition of the term tax expenditures;<sup>4</sup>
  - b. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions; and
  - c. a description of how tax expenditures affect nonexchange revenue, tax collections, and refunds, as well as whether tax expenditure amounts are presented in the basic financial statements.

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## REQUIRED SUPPLEMENTARY INFORMATION

### MANAGEMENT'S DISCUSSION AND ANALYSIS

8. Management's discussion and analysis (MD&A) should include:

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<sup>4</sup>This Statement does not establish the wording of the "plain language" definition.

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- a. a "plain language" definition of the term tax expenditures;
  - b. the general purpose of tax expenditures;
  - c. examples of types of tax expenditures, such as special deductions, credits, deferrals, preferential rates, exemptions, and exclusions;
  - d. information about other factors that may affect tax collections in order to place tax expenditure information in an appropriate context;
  - e. a description of how tax expenditures are treated for budgetary and financial reporting purposes, including their impact on the surplus or deficit and their treatment within the federal budget process, and how they affect the government's financial position and condition; and
  - f. a statement regarding the availability of published information on tax expenditures, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

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## OTHER INFORMATION

9. The Federal Accounting Standards Advisory Board (FASAB or "the Board") encourages the presentation of a selection of the major tax expenditure estimates, such as those published annually by Treasury's Office of Tax Policy, as OI in the CFR.
10. The Board encourages the presentation of tax expenditure estimates in a manner that informs readers of:
  - a. the general magnitude of tax expenditures and their impact on federal revenues (revenue effect) during the fiscal year;
  - b. the source of the estimates; and
  - c. the availability of published information wherein the estimates presented in OI were originally published, such as the Treasury Office of Tax Policy's unaudited annual report on tax expenditures, and how that information can be obtained.

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## EFFECTIVE DATE

11. The requirements of this Statement are effective for reporting periods beginning after September 30, 2017. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items
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## APPENDIX A: BASIS FOR CONCLUSIONS

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement-not the material in this appendix-should govern the accounting for specific transactions, events, or conditions.

This Statement may be affected by later Statements. The FASAB Handbook is updated annually and includes a status section directing the reader to any subsequent Statements that amend this Statement. Within the text of the Statements, the authoritative sections are updated for changes. However, this appendix will not be updated to reflect future changes. The reader can review the basis for conclusions of the amending Statement for the rationale for each amendment.

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### INTRODUCTION

A1. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards. The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

a. This Statement contributes to Objectives 1, 2, and 3.

i. Objective 1, Budgetary Integrity, states that:

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

1. Sub-objective 1A states that:

Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used ...

2. Sub-objective 1C states that:



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Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

ii. Objective 2, Operating Performance, states that:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed...

iii. Objective 3, Stewardship, states that:

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

A2. Tax expenditures reduce federal revenues as a result of tax legislation. These reductions have historically been measured relative to normal baseline provisions of an individual and corporate income tax system. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds by federal agencies and programs. Accordingly, the Board sought to provide budgetary information, which contributes to Objective 1. In particular, such tax expenditure information should contribute to sub-objectives 1A and 1C by providing information to assist readers in understanding how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

A3. Tax expenditures may be used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory

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programs. The Board believes that the service efforts, costs, and accomplishments of the reporting entity—the U.S. government—include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, financial reports should provide operating performance information, which contributes to Objective 2.

- A4. Because tax expenditures may be viewed as alternatives to spending or regulatory programs, they can also be viewed as government investments of forgone budgetary resources designed to address policy objectives. Thus, individual tax expenditures may affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and/or (3) the nation's current and future well-being. Accordingly, financial reports should provide stewardship information, which contributes to Objective 3.

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## PROJECT HISTORY

- A5. In October 2014, the Board approved this project in order to determine what information regarding tax expenditures should be included in general purpose federal financial reports (GPFRRs). The decision followed an October 2013 educational briefing to the Board that resulted in identifying the topic as a high priority.
- A6. Throughout the project, the Board relied on a task force that included experts in the areas of tax expenditures, tax policy, and federal financial reporting. The task force provided critical assistance and knowledge to the Board and FASAB staff in developing (1) recommendations to the Board, (2) Appendix B: Tax Expenditures Explained, and (3) illustrations that were included in the exposure draft (ED). The task force also provided technical comments and feedback on working drafts and attended Board meetings to answer technical questions and provide insight during deliberations.
- A7. In December 2015, the task force issued its [Report to the FASAB](#), which included three recommendations to the Board and three options for the Board's consideration with respect to the presentation of tax expenditure estimates in the CFR.
- a. The first recommendation of the task force was to include an introduction section or background paper, as drafted by the task force, to educate readers of and respondents to the Board's ED and the final Statement regarding tax expenditures.
    - i. The Board approved this recommendation to be implemented in a proposed standard, but elected to include a condensed introduction section along with the full background paper developed by the task force (with minor changes) as

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an appendix section (Appendix B: Tax Expenditures Explained). This recommendation was ultimately implemented in this Statement.

- b. The second recommendation of the task force was to require certain narrative disclosures regarding tax expenditures within the notes to the financial statements and MD&A of the CFR.
  - i. Task force members decided early in the project that they did not generally support issuing proposed standards that affected component reporting entities of the federal government due to potentially significant challenges and costs associated with doing so. For example, implementing accounting standards for identifying tax expenditures that are key performance or financial indicators for a component reporting entity could be time consuming and costly to the preparer.
  - ii. The task force concluded that this recommendation would improve users' awareness and understanding of tax expenditures while avoiding extensive, voluminous, or costly disclosures.
  - iii. The Board approved the recommendation to be implemented in a proposed standard with certain minor changes to the recommendation as written in the task force report. This recommendation was ultimately implemented in this Statement.
- c. The third recommendation of the task force was to require the inclusion of hyperlinks in the CFR to inform readers regarding other online sources of information where readers of the government-wide report can obtain more detailed information regarding tax expenditures.
  - i. FASAB staff worked with members of the task force and other members of the federal financial statement auditing community to develop proposed language for implementing this recommendation.
  - ii. The Board discussed how best to implement this recommendation. Board members came to the conclusion that the language in paragraph 8.f provides discretion to the preparer to embed a hyperlink to information sources that it deems to be most appropriate, should reporting on tax expenditures evolve, expand, or improve in the future.
  - iii. The Board sought to develop a requirement that would continue to be relevant in the future and also allow the preparer to exercise discretion in selecting information sources that are referenced in the CFR.

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- iv. Board members determined that implementing the requirement in paragraph 8.f will likely necessitate the use of electronic hyperlinking in the CFR, given (1) the costs and burdens of using alternative methods for implementing the requirement, such as postage and printing costs, and (2) the availability and minimal costs associated with hyperlinking to electronic information available on the internet. The Board encourages the use of hyperlinks in implementing the requirement.
  - v. The Board concluded that the requirement in paragraph 8.f makes it sufficiently clear to the preparer and auditor that the reader should be informed that the information referenced is unaudited. Moreover, the Board concluded that MD&A was an appropriate section for directing users to unaudited reports.
- d. Options for consideration proposed by the task force regarding the presentation of tax expenditure estimates were to (1) encourage the inclusion of tax expenditure estimates as OI in the CFR, (2) require the inclusion of tax expenditure estimates within required supplementary information (RSI) of the CFR, or (3) neither encourage nor require the inclusion of tax expenditure estimates within the CFR and focus exclusively on narrative content and links to other resources for comprehensive reporting of estimates.
- i. Task force members who supported the placement of tax expenditure estimates in OI were primarily concerned about the quality, timeliness, and availability of reliable data upon which these estimates are based. These task force members were also concerned that existing differences in the list of tax expenditures identified by two credible sources of such estimates-Treasury's Office of Tax Policy and the JCT-may pose challenges, particularly if such information were audited. Additionally, estimation methodologies for certain tax expenditures can neither be tested nor improved over time by way of assessing their historical performance against tax return data or transactions; assessing historical performance for certain tax expenditures requires the use of data that are not collected on tax returns or otherwise available because these estimates are imputed rather than based on recordable transactions that actually occurred. Task force members supporting the inclusion of estimates in OI believed that these unique challenges impede the preparer's ability to (1) identify a generally accepted universe of tax expenditures; (2) develop estimates generally accepted as reliable, fair, and correctly measured; and (3) include estimates within RSI or basic information without negative or potentially unresolvable audit challenges.

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- ii. These members recommended-and the Board ultimately concluded-that encouraging the inclusion of estimates in OI avoids such costs and challenges, increases transparency and context surrounding the general magnitude and impact of tax expenditures on the government's financial position, and elevates tax expenditure estimates into an unaudited section of the CFR to create more transparency.

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## REQUIREMENT FOR INFORMATION IN MD&A AND NOTES

- A8. The Board concluded that the CFR's MD&A should include a discussion of tax expenditures, their general purpose, and how they affect the government's financial position and condition. This Statement also requires discussion of other factors that may affect tax collections in order to place tax expenditure information in an appropriate context. The specific requirements are presented in paragraph 8 and sub-paragraphs 8.a-8.f.
- A9. Requiring information on tax expenditures in the MD&A and notes to the financial statements in the CFR is important for the following reasons:
- a. Discussion regarding the topic of tax expenditures is currently absent; however, tax expenditures have had a significant impact on the federal government's financial position, tax collections, and performance outcomes each year. The significant impact of tax expenditures warrants discussion in MD&A because MD&A should "provide a clear and concise description of the reporting entity and its ... activities, program and financial performance, systems, controls, legal compliance, financial position, and financial condition."<sup>6</sup>
  - b. Tax expenditures are significant to the management, budgetary, and oversight functions of the Congress and the Administration. Tax expenditures are often used by the federal government as a mechanism to address policy objectives. Tax expenditures may also affect the judgment of citizens about the efficiency and effectiveness of the tax code in accomplishing certain financial or policy objectives. Therefore, tax expenditures are consistent with the provisions of Statement of Federal Financial Accounting Standards 15, paragraph 6, which states:

MD&A should deal with the "vital few" matters; i.e., the most important matters that will probably affect the judgments and decisions of people who rely on the GPFFR as a

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<sup>6</sup>Statement of Federal Financial Accounting Standards 15, par. 1.

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source of information. ... Matters to be discussed and analyzed are those that management of the reporting entity believes it is reasonable to assume could:

- i. lead to significant actions or proposals by top management of the reporting unit;
  - ii. be significant to the managing, budgeting, and oversight functions of the Congress and the Administration; or
  - iii. significantly affect the judgment of citizens about the efficiency and effectiveness of their federal government.
- c. In SFFAC 1, the Board established four objectives of federal financial reporting. These objectives provide a framework for assessing the existing accountability and financial reporting systems of the federal government and for considering new accounting standards.<sup>7</sup> The objectives address (1) Budgetary Integrity, (2) Operating Performance, (3) Stewardship, and (4) Systems and Controls.

- d. Objective 1, Budgetary Integrity, states that:

Federal financial reporting should assist in fulfilling the government's duty to be publicly accountable for monies raised through taxes and other means and for their expenditure in accordance with the appropriations laws that establish the government's budget for a particular fiscal year and related laws and regulations.

- i. Sub-objective 1A states that:

Federal financial reporting should provide information that helps readers to determine how budgetary resources have been obtained and used ...

- ii. Sub-objective 1C states that:

Federal financial reporting should provide information that helps readers to determine how information on the use of budgetary resources relates to information on the costs of program operations.

- e. Tax expenditures reduce federal revenues via tax legislation. Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Forgoing

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<sup>7</sup> SFFAC 1, par. 109.

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budgetary resources through the use of tax expenditures can be a method of achieving policy objectives without direct outlays of funds to federal agencies and programs. Accordingly, the MD&A and financial statement note requirements in this Statement will provide budgetary information and contribute to addressing Objective 1. In particular, the disclosure requirements will contribute to addressing sub-objectives 1A and 1C because these disclosures provide readers with an understanding of how tax expenditures affect the availability of budgetary resources and tax collections, and how certain policy objectives are addressed through the mechanism of forgoing tax revenues.

- f. Objective 2, Operating Performance, states that:

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed; and the management of the entity's assets and liabilities.

- g. Tax expenditures are used as one of many means to accomplish policy objectives of the federal government. Although tax expenditures are not direct outlays of federal funds, they are often viewed as alternatives to other policy instruments, such as spending or regulatory programs. The service efforts, costs, and accomplishments of the reporting entity—the U.S. government—include those service efforts undertaken, costs incurred through, and accomplishments resulting from the use of tax expenditures. Accordingly, this Statement will result in information that alerts readers to the efforts and costs associated with tax expenditures and, therefore, will provide operating performance information and contribute to addressing Objective 2.

- h. Objective 3, Stewardship, states that:

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial conditions have changed and may change in the future.

Federal financial reporting should provide information that helps the reader to determine whether (1) the government's financial position improved or deteriorated over the period, (2) future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and (3) government operations have contributed to the nation's current and future well-being.

- i. Because tax expenditures are often viewed as alternatives to spending or regulatory programs, they can be viewed as government investments of forgone budgetary

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resources designed to address policy objectives. Thus, tax expenditures affect (1) the government's financial position, (2) the budgetary resources available to sustain public services and to meet obligations as they come due, and (3) the nation's current and future well-being. Accordingly, the Board concluded that the requirements for MD&A and notes to the financial statements in the CFR provide stewardship information and contribute to addressing Objective 3.

A10. Requiring information on tax expenditures in the notes to the financial statements in the CFR is important for the following reasons:

- a. The requirements will help readers understand that the tax system is used to accomplish policy goals as well as collect revenue.
- b. The requirements will help readers understand that some "efforts" and related costs are not transparent in the financial statements but do affect them.
- c. The requirements provide context of other factors affecting tax collection in order to place tax expenditures in an appropriate context and help readers to have a more complete understanding of factors affecting the government's financial position and condition.

A11. The information reported in accordance with the requirements of this Statement for MD&A and the notes to the financial statements in the CFR will improve users' awareness and understanding of tax expenditures, their use, and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.

A12. The information reported in accordance with requirements of this Statement will help users to evaluate and understand (1) the impact of the tax code on budgetary resources and uses; (2) the service efforts, costs, and accomplishments of the reporting entity, and the manner in which these service efforts have been financed and/or affected by the tax system; and (3) how the tax code relates to and/or affects the government's investments and financial position, and how the government's financial condition has changed and may change in the future as a result.

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## REPORTING ESTIMATES IN OTHER INFORMATION

A13. Regarding cost-benefit considerations, SFFAC 1, paragraph 155 states that "for many purposes, other information sources and other techniques to maintain and demonstrate accountability are either essential or more cost-effective." Paragraphs 9-10 of this Statement provide readers with a means of easily accessing other relevant tax expenditure information sources.



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- A14. Regarding the inclusion of estimates in OI and informing readers of the source and availability of published information wherein the estimates were originally published; the Board concluded that suitable amounts of detail, context, and explanations can accompany estimates presented in a reasonably concise manner while also meeting the needs of users with different levels of knowledge regarding tax expenditures. Accordingly, the inclusion of statements to alert readers that the published information includes a complete population of the tax expenditure estimates identified by the reporting party and whether such information includes details of the estimating conventions and explanatory definitions of the tax expenditures presented in OI would also be helpful to users.
- A15. The Board may elect to evaluate the costs, limitations, benefits, and other implications of developing additional measurement, recognition, and disclosure guidance in the future.
- A16. Given the conceptual issues that make tax expenditures unauditable, before any future efforts are potentially undertaken, the following matters need to be considered:
- a. How best to define, identify, and measure tax provisions that are both relevant for financial reporting purposes and generally accepted by economists and other experts
  - b. Whether it is feasible to develop estimates that are considered to be representationally faithful, consistent, comparable, and auditable
  - c. If auditability can be achieved, what considerations would enable the preparer and auditor to achieve their respective responsibilities in a reasonably effective and efficient manner

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## SUMMARY OF OUTREACH EFFORTS AND RESPONSES

- A17. The ED was issued June 2, 2016, with comments requested by September 15, 2016. Upon its release, notices and press releases were sent to the following organizations:
- a. *The Federal Register*;
  - b. *FASAB News* and the related listserv subscribers, including:
    - i. *the Journal of Accountancy, AGA Today, Accounting Today, the CPA Journal, Government Executive* and the *CPA Letter*;
    - ii. the CFO Council, the Council of the Inspectors General on Integrity and Efficiency, and the Financial Statement Audit Network;

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iii committees of professional associations generally commenting on FASAB EDs in the past; and

iv other individuals and organizations in the federal accountability community.

A18. This broad announcement was followed by electronic mailings of the ED and subsequent reminder notices to:

a. Relevant congressional committees, including:

i. the House Committee on Oversight and Government Reform,

ii. the Senate Committee on Homeland Security and Governmental Affairs,

iii. the House Committee on Ways and Means,

iv. the Senate Committee on Finance,

v. the House Committee on the Budget,

vi. the Senate Committee on the Budget, and

vii. the JCT;

b. Non-profit, public policy, and accounting organizations, such as:

i. state and territorial CPA societies,

ii. accounting, tax, and public policy and research organizations,

iii. accounting and auditing firms, and

iv. taxpayer associations;

c. Individuals that have published articles, commentary, and/or research regarding tax expenditures, such as:

i. college professors,

ii. economists, and

iii. tax policy analysts.

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- A19. The Board did not rely on the number in favor of or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered each response and weighed the merits of the points raised. The respondents' comments are summarized below.
- A20. FASAB received 12 responses from federal agencies, users of federal financial information, and professional associations. The majority of respondents agreed with the proposed requirements in the ED, which are implemented in this Statement in paragraphs 6-8 and the related sub-paragraphs.
- A21. However, some respondents disagreed with Board proposals in the ED to encourage the presentation of major tax expenditure estimates in OI in a manner that informs readers of the general magnitude of tax expenditures and their impact on federal revenues. A few respondents viewed RSI as a more appropriate classification for the information. Other respondents expressed a preference to exclude estimates from the CFR altogether and refer readers to external resources wherein comprehensive reports and estimates can be obtained.
- A22. The Board carefully considered respondents' views and found them to be consistent with the considerations, costs, benefits, and views expressed by task force and Board members in earlier deliberations.
- A23. The Board concluded that it would not be appropriate to change the ED proposal from encouraging the presentation of major tax expenditure estimates from external sources in OI to requiring such information in RSI. Such a change would classify the information as required information. For reasons discussed in paragraphs A7.d.i and A16, the Board concluded that such a requirement must be preceded by the development of recognition and measurement criteria.
- A24. The Board also concluded that it would not be appropriate to remove the ED proposal to encourage the presentation of major tax expenditure estimates. For reasons discussed in paragraph A7.d.ii, the Board maintains that the implementation of paragraphs 9-10 and the related sub-paragraphs will enhance user awareness and understanding of tax expenditures and their relationship to and impact on federal revenues and the overall financial position of the U.S. government.
- A25. One respondent expressed that requirements to report on tax expenditures should also be extended to at least certain component reporting entities. The respondent noted that many component reporting entity objectives and achievements are financed as much through tax expenditures as through outlays.

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A26. The Board agrees that tax expenditures contribute to component reporting entity performance objectives and costs inherent to the achievement of those objectives. In its review of the respondent's comment letter, the Board concluded that cost-benefit considerations regarding its decision not to extend requirements to component reporting entities should be clarified in the basis for conclusions.

A27. The Board concluded early in the project that there is strong evidence of significant challenges to identifying and assigning tax provisions and aligning those provisions with agency goals. Board members considered problems identified in a Government Accountability Office (GAO) report issued in July 2016,<sup>8</sup> including the following:

- a. There is a continuing lack of clarity about the roles of different federal agencies in conducting reviews of tax expenditures. This lack of clarity can lead to inaction in identifying tax expenditures' contributions to agency goals.
- b. Whether or not agencies have a defined role in administering tax expenditures influences whether those agencies identify tax expenditure contributions to their goals.
  - i. If agencies do not have a defined role in administering a tax expenditure, they may choose not to identify the tax expenditure's contributions to their goals.
  - ii. The agencies that linked tax expenditures to performance measures typically had a defined role in administering them, and therefore collected data on those tax expenditures.

A28. Before efforts can be undertaken by FASAB to extend requirements to component reporting entities, many issues need to be considered and deliberated by the Board, such as:

- a. how best to define and identify tax provisions that are relevant for financial reporting purposes,
- b. the extent to which a component reporting entity's role in administering a tax provision should affect recognition of that tax provision for financial reporting purposes,
- c. the extent to which the alignment of a component reporting entity's missions, goals, and objectives with the accomplishments of a tax provision should affect recognition of that provision for financial reporting purposes, and

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<sup>8</sup> GAO, *Tax Expenditures: Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight*, [GAO-16-622](#) (Washington, D.C.: July 7, 2016).

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- d. the types of information most relevant to users of GPFFRs and how this information should be presented therein, if at all.

A29. A few respondents expressed concerns about or provided suggested edits to an illustration included in the ED.

A30. Instead of addressing comments on the illustration, the Board elected to remove the illustration from the ED for the following reasons:

- a. The primary purpose of the illustration was to enable ED respondents to envision how the proposed requirements might be implemented in the CFR.
- b. The illustration was in a non-authoritative appendix.
- c. There is only one CFR. Treasury and the Office of Management and Budget (OMB) officials expressed that including such an illustration in the final Statement was not essential to understanding provisions of the standard.
- d. The illustration may become outdated as the CFR preparer may develop more innovative ways to present information and/or as tax policy evolves.

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## BOARD APPROVAL

A31. This Statement was approved by the Board with a vote of seven members in favor of its issuance and two members, Ms. Ho and Mr. Reger, abstaining from the vote. Written ballots are available for public inspection at the FASAB office.

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## Appendix B: Tax Expenditures Explained

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### Purpose

In light of the Board's mission to improve federal financial reporting, it is paramount that such reporting assists report users in evaluating the service efforts, costs, accomplishments, and fiscal sustainability of the federal government and in understanding how these efforts and accomplishments have been financed. Although tax expenditures have similarities to federal spending in their impact on service efforts, costs, accomplishments, and fiscal sustainability; they have historically received little focus in general purpose federal financial reporting. Establishing reporting requirements with respect to this topic requires an understanding of tax expenditures, the methods used to estimate income tax expenditures, and considerations in using those estimates.

This section provides an overview of tax expenditures to aid preparers and users in understanding reporting in regard thereto. Specifically, this section:

1. defines tax expenditures and describes the six types of tax expenditures;
2. provides context with respect to the purpose of tax expenditures, why they are important, and their relationship to government performance, taxpayer behaviors, and the economy; and
3. summarizes how tax expenditure estimates are prepared by Treasury. This ultimately affects how tax expenditure estimates can be used and interpreted.

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### Background

The Congressional Budget and Impoundment Control Act of 1974 (the Budget Act) defines tax expenditures as

*"...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."*  
(Section 3(a)(3) of Public Law 93-344)

Generally, tax expenditures are provisions in the tax law available to certain subsets of taxpayers who engage in certain activities, face special circumstances, or otherwise meet certain criteria. The government uses tax expenditures to stimulate behavior that will accomplish public policy

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goals such as facilitating homeownership, reducing the cost of borrowing for state and local governments, encouraging higher education, or promoting domestic energy production.

Tax expenditures are “revenue losses” in that the provisions reduce income taxes owed and, therefore, revenue collected. Tax expenditures resemble federal spending in that such provisions affect the federal deficit/surplus by impacting income tax revenue; however, tax expenditures are often not treated the same as federal spending for budgetary or financial reporting purposes.<sup>9</sup> Many tax expenditures resemble mandatory spending programs for which spending is typically determined by rules for eligibility and benefit formulas. Other tax expenditures resemble discretionary spending programs for which the Congress appropriates annual funding. Many tax expenditures can only be removed or changed through tax legislation. While tax expenditures help determine the government’s net revenue, tax expenditure estimates are not explicitly displayed in the Statements of Net Cost or Changes in Net Position.

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## How Tax Expenditures Are Identified

The first step in identifying tax expenditures is defining the tax baseline so that the provisions considered “special” (per the Budget Act definition above) can be distinguished from those provisions consistent with a baseline tax system. Traditionally, for the federal income tax, the baseline tax system is a comprehensive income tax with certain practical provisions that are generally accepted as being part of a baseline tax system. Accordingly, provisions such as the personal exemption, standard deductions, deductions of expenses incurred in earning income, and a progressive rate structure are considered to be part of the baseline tax system for measurement purposes.

Judgments about such provisions are based on a general consensus view of analysts regarding practical provisions of a baseline tax system versus “special” provisions that constitute a tax expenditure. For example, the personal exemption and standard deduction are viewed as defining a zero-rate bracket that is part of baseline tax law as are the other graduated rate brackets in the individual income tax. In contrast, the child tax credit is considered a tax expenditure because it provides a “special” benefit that would not exist under baseline tax law.

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<sup>9</sup> In certain cases a tax preference may provide cash in the form of a refundable tax credit even if the taxpayer owes no tax. The budget records payments to taxpayers for refundable tax credits (such as earned income tax credits) that exceed the taxpayer’s tax liability as outlays. As such, a portion of this type of tax preference is reported as outlays in the budget to the extent payments exceed the taxpayer’s liability, whereas the portion offsetting the taxpayer’s liability reduces budget revenues but is not explicitly reported in the budget.

After determining the baseline tax system, the credits, deductions, special exceptions and allowances that reduce tax liability below the level implied by the baseline tax system are then considered to be tax expenditures.

## Types of Tax Expenditures

There are six types of tax expenditures—exclusions, exemptions, deductions, credits, preferential rates, and deferrals. below describes each and provides an example.

**Table 1: Examples of Provisions That Are Tax Expenditures When They Are Exceptions to the Normal [Baseline] Tax Structure**

<b>Tax expenditure</b>	<b>Description</b>	<b>Examples</b>
Exclusion	Excludes income that would otherwise constitute part of a taxpayer's gross income.	Employees generally pay no income taxes on contributions their employers make on their behalf for medical insurance premiums.
Exemption	Reduces gross income for taxpayers because of their status or circumstances.	Taxpayers may be able to reduce their tax liability if they have a dependent who is a child aged 19 through 23 and is a full-time student.
Deduction	Reduces gross income due to expenses taxpayers incur.	Taxpayers may be able to deduct state and local income taxes and property taxes.
Credit	Reduces tax liability dollar-for-dollar. Additionally, some credits are refundable meaning that a credit in excess of tax liability results in a cash refund.	Taxpayers with children under age 17 potentially can qualify for up to a \$1,000 partially refundable, per child credit, provided their income does not exceed a certain level.
Preferential tax rate	Reduces tax rates on some forms of income.	Capital gains on certain income are subject to lower tax rates under the individual income tax.
Deferral	Delays recognition of income or accelerates some deductions otherwise attributable to future years.	Taxpayers may defer paying tax on interest earned on certain U.S. savings bonds until the bonds are redeemed.

Source: [GAO-13-167SP](#): Guide for Evaluating Tax Expenditures.

In considering these six types of tax expenditures, it may be possible to achieve certain public policy outcomes in a variety of ways. For example, some public policy outcomes may be achieved through a preferential rate, a deduction, or a credit. Because a variety of approaches can produce the same cash effect, the types are different in form rather than substance.

Most reports do not categorize tax expenditures by type. The types are presented to aid in understanding the mechanisms used to establish preferences.



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## Budget Act Requirements and History

The term “tax expenditures” was introduced in 1967 by Assistant Secretary for Tax Policy, Stanley Surrey, in a speech calling for a “full accounting” of them. Following his speech, estimates were prepared by Treasury and later by the JCT of the Congress.

In 1974, the Budget Act charged the House and Senate Budget Committees with the duty “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 on a recurring basis.” The Budget Act further required that the annual President’s Budget include tax expenditure estimates.<sup>10</sup>

Estimates are now available annually from both the JCT<sup>11</sup> and the President’s Budget.<sup>12</sup> Each JCT report contains a discussion of the concept of tax expenditures, identification of new tax expenditures enacted into law, a general explanation on how the committee staff measures tax expenditures, estimates of tax expenditures, and distributions of selected individual tax expenditures by income class.

Treasury prepares estimates provided in the President’s Budget. These estimates are for the current fiscal year and the ten years thereafter. The estimates are intended to support budget analysis and are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in assessing the efficiency and effectiveness of achieving specific public goals through the use of tax expenditures. Treasury provides the tax expenditure estimates before the end of each fiscal year and makes them available on the Treasury website before the President’s Budget is issued.<sup>13</sup>

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<sup>10</sup> Kleinbard, Edward. Tax Expenditure Framework Legislation, *Research Paper Series and Legal Studies Research Paper Series, Paper No. C10-1*. USC Center in Law, Economics and Organization. 2010.

<sup>11</sup> See <https://www.jct.gov/publications.html?func=select&id=5> for JCT Publications on Tax Expenditures. As of January 6, 2017, estimates for fiscal years 2015-2019 were available in report number JCX-141R-15.

<sup>12</sup> See [https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap\\_14\\_expenditures.pdf](https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/ap_14_expenditures.pdf) for the Fiscal Year 2017 President’s Budget. The Analytical Perspectives, Chapter 14 provides estimates for fiscal years 2015 through 2025. (Last accessed January 6, 2017.)

<sup>13</sup> See <http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx> for the latest estimates of tax expenditures. (Last accessed January 6, 2017.)

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## Government Performance Reporting for Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) originally put in place a framework for performance planning and reporting, and the GPRA Modernization Act of 2010 (GPRAMA) has significantly enhanced the statutory framework.<sup>14</sup> The GPRAMA framework aims at taking a more crosscutting and integrated approach to focusing on results and improving government performance. OMB is required to coordinate with agencies to establish federal government priority goals—otherwise referred to as cross-agency priority (CAP) goals.<sup>15</sup> GPRAMA requires certain agencies to identify a subset of agency goals as agency priority goals (APG), which reflect the highest priorities of each agency. Fully implementing GPRAMA requirements could provide the foundation for reviewing tax expenditure performance and assessing their contributions toward federal goals. GPRAMA requires OMB to identify tax expenditures that contribute to the CAP goals. In addition, OMB guidance has directed agencies to identify tax expenditures that contribute to their APGs since 2012 and to their strategic objectives since 2013.<sup>16</sup>

While OMB has determined that there are no tax expenditures that are critical to achievement of the current CAP goals, agencies have not yet completed actions necessary to identify tax expenditures that contribute to their APGs.<sup>17</sup>

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## How Treasury Prepares the Administration's Estimates

As noted in the definition above, tax expenditures arise from special provisions allowing an exclusion, exemption, or deduction from gross income, a credit, a preferential rate of tax, or a deferral of liability. Deciding whether a provision of tax law is a special exception to the baseline income tax system is a matter of judgment. The baseline used by Treasury to identify these special exceptions is adapted from a comprehensive income tax approach in which income is the sum of consumption and the change in net wealth in a given period of time with certain

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<sup>14</sup> Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993) and Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

<sup>15</sup> OMB set the first interim CAP goals in 2012 and identified the next set of CAP goals in March 2014, which is to be updated every four years.

<sup>16</sup> OMB, Circular A-11 (2015).

<sup>17</sup> GAO, *Managing for Results: Implementation of GPRA Modernization Act Has Yielded Mixed Progress in Addressing Pressing Governance Challenges*, [GAO-15-819](#) (Washington, D.C.: Sept. 28, 2015) and GAO, *OMB Improved Implementation of Cross-Agency Priority Goals, But Could Be More Transparent About Measuring Progress*, [GAO-16-509](#) (Washington, D.C.: May 20, 2016).

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departures.<sup>18</sup> This baseline assumes an individual income tax and a separate corporate income tax.<sup>19</sup>

Preparing tax expenditure estimates requires consideration of certain information about the economy, presently and in the future. Treasury estimates for economic activity are consistent with the economic assumptions in the President's Mid-Session Review of the prior year's budget and reflect current law as of July 1.<sup>20</sup>

Each tax expenditure is measured by the difference between tax liability under current law and the tax liability that would result if the tax expenditure provision were repealed and had never existed. It is assumed that there is no behavioral response to the elimination of the provision and taxpayers simply recalculate their tax in the absence of the provision in question. Thus, tax expenditures calculate revenues forgone by the existence of the rule but not necessarily the amount of revenue that would be raised if it were repealed. For example, the ability to deduct mortgage interest expense on owner-occupied housing is considered to be a tax expenditure. The tax expenditure estimate reports the revenue change that would occur if this deduction were repealed, but does not take into account any revenue effect that might occur as a result of most changes in taxpayer behavior, such as taxpayer decisions to own homes. However, in recalculating the tax due in the absence of this deduction, the tax expenditure estimate assumes taxpayers would switch from itemizing deductions to claiming the standard deduction if that were tax minimizing in the absence of the ability to deduct mortgage interest on an itemized return.

When possible, Treasury uses samples of tax returns provided by the Internal Revenue Service as the basis for tax expenditure estimates. For provisions benefiting individual tax filers the Individual Tax Model (ITM) Tax Calculator is often used. The ITM is based upon a stratified sample of individual tax returns that represent the entire tax filing population. This sample is augmented by additional data to represent the U.S. population. The ITM projects these individual records forward consistent with the Administration's economic forecast. The ITM Tax Calculator allows the computation of tax for each record under differing tax laws.

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<sup>18</sup> For example, one major departure is that income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as a tax expenditure. Another example is that values of assets and debt are not generally adjusted for inflation.

<sup>19</sup> Treasury and the JCT differ in their assumed baselines from which tax expenditures are measured. For a summary of the differences see Altshuler, Rosanne and Robert Dietz. "Reconsidering Tax Expenditure Estimation." *The National Tax Journal*, June 2011, 64 (2, Part 2), 459-490.

<sup>20</sup> "Current law baseline" refers to the budget estimates prepared by the Administration based on laws enacted at the time they are prepared. If a provision will expire or change under currently enacted law then the baseline projections reflects the effects of that expiration or change.

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For example, the Lifetime Learning tax credit is considered a tax expenditure because the baseline tax system would not allow credits targeted at particular activities, investments, or industries. Treasury uses the ITM Tax Calculator to compute tax liability for each filing unit under current law and current law with the Lifetime Learning tax credit removed.

As another example, the exclusion of public assistance benefits is considered a tax expenditure because transfers from the government would be considered income to the taxpayer under the baseline tax system. Since tax records do not record the receipt of these types of benefits, Treasury estimates the value of this tax expenditure by supplementing historical Bureau of Economic Analysis National Income and Product Accounts data with U.S. Department of Health and Human Services and state expenditure data to determine the total forecasted value of public assistance transfers to taxpayers under current law over the budget window. The tax expenditure is calculated by multiplying the aggregate public transfers by an estimate of the average effective tax rate for tax filers receiving public assistance benefits.

Treasury estimates the cash effect of each tax expenditure. Some tax expenditures represent deferrals of taxation (a tax not paid in the current tax year will be paid in a future tax year when the deferral reverses). Estimates for such deferrals are based on the net tax effect of current year deductions or exclusions and reversals of prior year deferrals included in current year taxable income.<sup>21</sup> For example, defined contribution employer plans are estimated as the net tax effect of current year contributions excluded from income and income reported upon withdrawals from plans.

Year-to-year differences in the calculations for each tax expenditure reflect changes in tax law, including phase outs of tax expenditure provisions and changes that alter the baseline income tax structure, such as the tax rate schedule, the personal exemption amount, the standard deduction, and other factors. For example, the dollar value of tax expenditures tends to increase and decrease as tax rates increase and decrease, respectively, without any other changes in law.

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## Understanding Estimates

Tax expenditure estimates are developed to aid policymakers. It is important to understand that they are not transaction-based amounts. The estimates are updated annually using the best available data and models. However, data limitations and resource constraints are inherent in the process. For example, some data collected on tax returns are not available in time for the annual estimates; other data are not collected on tax returns at all and must always be estimated.

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<sup>21</sup> To complement these estimates, Treasury also reports a discounted present-value estimate of the future net revenue effects for the tax expenditure activity in the most recently concluded calendar year.

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The major considerations regarding the estimates are identified below.

**Not Necessarily Equivalent to Forgone Revenue.** Estimates should be regarded as approximations. As with expenses incurred with spending programs, tax expenditure estimates do not necessarily equal the change in the deficit<sup>22</sup> that would result from repealing these special provisions because:

- a. eliminating a tax expenditure may have incentive effects that alter economic behavior and
- b. tax expenditures are interdependent even without incentive effects.

**Difficulty in Calculating Totals.** A total for the estimated tax expenditures is not provided in the President's Budget because each tax expenditure is estimated independently assuming other parts of the tax code remain unchanged. The estimates might be different if two or more tax expenditures were changed simultaneously because of potential interactions among provisions. Nonetheless, other experts do present a total summing the separate estimates. The Congressional Budget Office (CBO) has modeled the interaction of the ten largest tax expenditures in the individual income tax law and found that interactions that overstate the effect are similar in size to interactions that understate the effect.<sup>23</sup> As a result, CBO concluded that the total is a meaningful estimate for the general magnitude of tax expenditures under current tax law. If the law changes in significant ways the interactions may not result in offsetting over- and understatements of the effect to the same extent.

**Completeness.** As noted earlier, significant judgments are required to identify special provisions of the income tax code. Given the complexity of the tax code, differences in judgments lead some to include provisions in tax expenditure lists that others would exclude and vice versa. In addition, special provisions can be included in taxes other than income taxes (for example, excise taxes), but these generally are not included in reports on tax expenditures.

**Expiring Provisions.** Estimates are based on tax law enacted as of July 1 of the reporting year and assume that any provisions scheduled to expire will expire. As noted above, provisions likely to be extended are ignored for estimation purposes until

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<sup>22</sup> Note that repealing certain spending programs would also not reduce the deficit by the amount of spending because of interaction with other programs and the tax system. For example, Social Security benefits may be taxed so that eliminating the benefits would also reduce tax revenue and possibly increase spending in other benefit programs. Thus, the change in the deficit would be smaller than the direct spending eliminated through the adjustment to the Social Security program.

<sup>23</sup> Congressional Budget Office. *The Distribution of Major Tax Expenditures in the Individual Tax System*. May 2013.

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such legislation is actually enacted. In other words, estimates are based on current law rather than analyzing policy outcomes likely to occur. As a result, an extensive knowledge of tax policy may be required in order to understand multi-year tax expenditure projections when provisions are scheduled to expire or when provisions of previous legislation are phased in.

**Alternatives.** Estimates involve significant judgments and, as a result, there are alternative approaches to estimation. For example, alternatives regarding the application of marginal tax rates, treatment of related tax provisions, or selection of a different baseline (such as a consumption tax rather than an income tax) would affect tax expenditure estimates. In addition, while estimates are provided for the cash (current revenue) effect for each of the ten fiscal years covered by the projections, a present value alternative that considers the full life cycle of the taxable activity may be more useful for tax expenditures involving deferrals or other long-term revenue effects. For such tax expenditures, the present value effects are important because deferrals will reverse in later years, and a present-value estimate for the activity in the current calendar year would include this activity.

See <http://www.treasury.gov/resource-center/tax-policy/Pages/Tax-Expenditures.aspx> for a complete listing of tax expenditures reported and estimated by Treasury.

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## Appendix C: Task Force Members

R. Scott Bell	Department of the Treasury, Senior Accountant
Robert Bixby	The Concord Coalition, Executive Director
Robert Dietz	NAHB, Tax and Market Analysis, Senior Vice President
Bert Edwards	GWSCPA Federal Issues and Standards Committee (FISC) Member
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John McClelland	Department of the Treasury, Office of Tax Analysis, Economist
James McTigue, Jr.	Government Accountability Office, Strategic Issues, Director
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## Appendix D: Abbreviations

APG	Agency Priority Goals
CAP	Cross-Agency Priority
CBO	Congressional Budget Office
CFR	Consolidated Financial Report of the U.S. Government
ED	Exposure Draft
FASAB	Federal Accounting Standards Advisory Board
GAO	Government Accountability Office
GPFRR	General Purpose Federal Financial Report
GPRA	Government Performance and Results Act of 1993
GPRAMA	GPRA Modernization Act of 2010
ITM	Individual Tax Model
JCT	Joint Committee on Taxation
MD&A	Management's Discussion and Analysis
OAI	Other Accompanying Information
OI	Other Information
OMB	Office of Management and Budget
RSI	Required Supplementary Information
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards