September 15, 2016

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6H19
Washington, DC 20548

Via fasab@fasab.gov

Dear Ms. Payne:

We are pleased to submit these comments on the Exposure Draft of the proposed Statement of Federal Financial Accounting Standards entitled Tax Expenditures: Management's Discussion and Analysis and Disclosure Requirements.[1]

It would be constructive for FASAB to set a standard which would result in tax expenditures being included in the consolidated financial report of the U.S. Government (CFR). It is important for the public to understand how tax revenue is reduced by tax preferences that Congress enacts which reduce tax revenues below where they would be under an ideal tax system.

However, it is vital that the CFR use a proper definition of tax expenditures, otherwise it will mislead the public. It appears as though FASAB proposes to use the tax expenditures list used by the Treasury Department, the White House Office of Management and Budget, and the Joint Committee on taxation. In the proposal, FASAB indicates that the list used by these agencies is widely-accepted and neutral. That is far from true.

The standard tax expenditures list is idiosyncratic. It closely adheres to the definition of a "normal tax system" by one individual – Stanley Surrey.[2] That definition has subsequently been adopted by Treasury and the Joint Committee on Taxation. Because of political inertia, it has remained largely unchanged.[3] That does not make it correct. In fact, because the list is inconsistent with either accepted definition of economic income, it is objectively wrong. If the CFR uses that list it will bias the figures it includes.

[1] Exposure Draft , Statement of Federal Financial Accounting Standards entitled Tax Expenditures: Management's Discussion and Analysis and Disclosure Requirements June 2, 2016 http://files.fasab.gov/pdffiles/taxexpenditures_ed_2016.pdf.

[2] Surrey was a Harvard law professor and Assistant Secretary of the Treasury for Tax Policy during the Kennedy and Johnson administrations.

[3] "Rethinking Tax Expenditures," Edward D. Kleinbard, Chief of Staff, Joint Committee on Taxation to the Chicago-Kent College of Law Federal Tax Institute May 1, 2008 http://www.jct.gov/Rethinking_Tax_Expenditures.pdf ("Our 2007 pamphlet, by contrast, *while employing essentially the same methodology as that of our first description 35 years earlier*, listed 170 tax expenditures." (emphasis added))

The accepted definitions of economic income are the Haig-Simons definition and the Fisher-Ture definition. The Haig-Simons definition of income is consumption plus changes in net worth.[4] The Fisher-Ture definition of income is gross income minus all outlays or expenditures made to earn current or future income. [5] The definition of tax expenditure varies depending on which definition of income is employed. Since the existing U.S. tax system has provisions based on both definitions, a nuanced and carefully thought out definition of tax expenditure is necessary. [6] The current list does not meet that criterion.

The FASAB proposal defines a tax expenditure as a "special exclusion, exemption, deduction, credit, preferential rate, or deferral" from the baseline system. The baseline system employed by the current tax expenditure list is neither Haig-Simons nor Fisher-Ture. Instead, it implicitly accepts as its baseline a definition of income – the Surrey definition – that is inconsistent with the two definitions accepted by economists.

Even if the Haig-Simons comprehensive income definition were accepted as the baseline, the tax expenditures list would still be deficient. For instance, a comprehensive income tax does not countenance the double taxation of income. In fact, Henry Simons explicitly rejected the double taxation of corporate income in his influential book Personal Income Taxation.[7]

The standard tax expenditures list assumes double taxation is proper in a "normal" tax system. It also assumes that personal and dependent exemptions and standard deductions (or zero bracket amounts) are not tax expenditures. Such a position is political decision, not one rooted in economics. In fact, it is inconsistent with either economic definition of income. If the CFR does not include them it will report strongly biased figures because these tax preferences greatly reduce tax revenue.

The current methodology treats graduated corporate rates as tax expenditures (i.e. the reduction in tax due to lower tax rates on lower incomes) but fails to treat graduated individual rates as a

[4] Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (The University of Chicago Press, 1938), p. 50; Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects," in *The Federal Income Tax*, Robert Murray Haig, Ed., (New York: 1921) reprinted in American Economic Association Readings in the Economics of Taxation, Vol. IX, Richard A. Musgrave and Carl S. Shoup, Eds., (Homewood, IL: Richard D. Irwin, 1959).

[5] Irving Fisher, "Income in Theory and Income Taxation in Practice," Econometrica (January, 1937); Irving Fisher, "The Double Taxation of Savings," 29 American Economic Review 1 (March, 1939); Irving Fisher, "The Unperceived Double Taxation of Income, Answers to Those That Deny Its Existence," 1946, previously unpublished manuscript published in The Works of Irving Fisher, Volume 12, Contributions to the Theory and Practice of Public Finance, William J. Barber, Ed., (London: Pickering and Chatto, 1997); Irving Fisher, "Paradoxes in Taxing Savings," Econometrica (April, 1942); Irving Fisher and Herbert Fisher, Constructive Income Taxation (New York: Harper and Brothers, 1942); Norman B. Ture, "Supply Side Analysis and Public Policy," in David G. Raboy, Essays in Supply Side Economics, Heritage Foundation and Institute for Research on the Economics of Taxation (1982) http://iret.org/pub/SupplySideBook.pdf; Norman B. Ture, "The Inflow Outflow Tax — A Saving-Deferred Neutral Tax System," (1997) http://iret.org/pub/inflow_outflow.pdf.

[6] For a more detailed explanation of the distinction between the two systems and how they affect the definition of tax expenditures, see Office of Management and Budget, *Budget of the U.S. Government, FY 2007, Analytical Perspectives*, pp. 285-328, https://www.gpo.gov/fdsys/pkg/BUDGET-2007-PER/pdf/BUDGET-2007-PER.pdf .

[7] Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (The University of Chicago Press, 1938).

tax expenditure. There is no acceptable intellectual argument for such a treatment. Their exclusion from the tax expenditures list is a personal preference of those creating the list. In short, current methodology ignores some of the largest tax expenditures altogether.

Absent from the FASAB proposal is an acknowledgment of *negative* tax expenditures. These are instances where those revenue increases attributable to provisions of the federal tax laws which overstate income by denying a deduction, impose a special higher rate of tax, accelerate tax liability or impose multiple taxes on the same income.

FASAB should recommend the CFR include tax expenditures, but only after a thorough review of what should actually be counted as a tax expenditure. If it uses the current list it will create a biased number that will hinder instead of assist the public debate on tax policy.

Signed,

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