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The Tax Expenditure Budget Is a Zombie Accountant

Steven A. Dean*

Like a student blocking his access to the internet to help him study, governments across the globe rely on commitment devices to generate fiscal discipline. From the collapse of the Congressional Supercommittee in the United States to the near-cataclysmic failure of a mechanism designed to prevent the European Union debt crisis, the evidence suggests that faith in such commitment devices is misplaced. This Article focuses on one such device that stubbornly refuses to stay dead: the tax expenditure budget. Created to guard against abuse by publicizing the costs of tax subsidies then resurrected as a bean counter, the tax expenditure budget is a zombie accountant. Dreadfully unsuited to its new life, the tax expenditure budget produces information that is both flawed and limited.

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INTRODUCTION

Long dead as a constraint on policymaker behavior,¹ a guardian known as the tax expenditure budget has been reanimated to serve a different role: accountant.² Unfortunately, as poor a goad as the tax expenditure budget proved, it makes an even worse guide. Now a zombie accountant shambling through the corridors of power, the tax expenditure budget has become an object of derision where it was once hailed as a champion.³

Enacted into law decades ago, the tax expenditure budget computes the dollar cost of a wide range of tax breaks. It serves as a shadow budget for tax benefits that would otherwise fall through cracks in the budget process.⁴ Unfortunately, treating tax expenditures as mere accounting glitches — rather than a complex political phenomenon capitalizing on psychological failures and legislative asymmetries — ensures that the tax expenditure budget can neither contain nor describe tax expenditure abuse.

The tax expenditure budget — like the Congressional Supercommittee and the E.U. Stability and Growth Pact — is a commitment device.⁵ Although he did not use these labels, Stanley

¹ See Daniel N. Shaviro, *Rethinking Tax Expenditures and Fiscal Language*, 57 TAX. L. REV. 187, 187 (2004) [hereinafter Shaviro, *Rethinking Tax Expenditures*] (concluding that after several decades the tax expenditure budget had “made little if any headway” towards the goal of preventing policymakers from using tax expenditures).

² The tax expenditure budget is increasingly viewed as a critical source of fiscal policy insight. See Edward D. Kleinbard, *The Congress Within the Congress: How Tax Expenditures Distort Our Budget and Our Political Processes*, 36 OHIO N.U. L. REV. 1, 3 (2010) [hereinafter Kleinbard, *The Congress Within the Congress*] (“Tax expenditure analysis should serve as an important pragmatic tool for policymakers to use in sorting out their priorities, and in understanding in a straightforward way both the economic consequences of their decisions and the policy alternatives that might be relevant to the implementation of their ideas.”) (emphasis added).

³ Zombies come in many forms. See Adam Chodorow, *Death and Taxes and Zombies*, 98 IOWA L. REV. (forthcoming 2012), available at <http://ssrn.com/abstract=2045255> (describing wide variety of zombie types). The tax expenditure budget might best be described as one that “slowly stumble[s] along” but “retain[s] some of the memories or personalities of the original person.” *Id.*

⁴ It guides by serving as an “informational aid.” Julie Roin, *Truth in Government: Beyond the Tax Expenditure Budget*, 54 HASTINGS L. J. 603, 608 (2003). The notion is that since tax expenditures have many of the “same economic and social effects as direct government expenditures,” it is useful for them to “be analyzed accordingly for economic and political purposes.” *Id.*

⁵ See J. Clifton Fleming, Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and its International Dimension*, 27 VA. TAX REV. 437, 561 (2008) [hereinafter Fleming & Peroni, *Reinvigorating*] (“[T]he principal purpose and justification of TEA

Surrey persuaded Congress to codify the tax expenditure budget as a “disabling rule” intended to “preclude[] the possibility of” tax expenditure abuse.⁶ Like a student installing software on his laptop to “disable” his internet access to help him study,⁷ Surrey gambled that ending the privileged “off-budget” status of tax expenditures would allow policymakers to cure themselves of their collective weakness for abusing tax expenditures.⁸ Unfortunately, just as our student might easily defeat the most cleverly designed software by accessing the internet on his phone, time has revealed the tax expenditure budget to be a poor source of “discipline, enforcement, [and] resistance to temptation.”⁹

is to serve as a triggering mechanism for mandatory recasting and cost/benefit analysis of governmental programs accomplished through the federal income tax system.”); Edward D. Kleinbard, *Tax Expenditure Framework Legislation*, 63 NAT'L TAX J. 353, 356-57 (2010) [hereinafter Kleinbard, *Framework*]. Surrey's goal — the purpose of the commitment device — was to force legislators to “convert[]” tax expenditures “into direct expenditures or repeal [them] altogether.” Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 187.

⁶ See Thomas C. Schelling, *Enforcing Rules on Oneself*, 1 J. L. ECON. & ORG. 357, 370 (1985) [hereinafter Schelling, *Enforcing Rules*] (defining disabling rules). For much of its existence, the tax expenditure budget has been characterized as a “strictly informational” exercise intended to “give Congress reliable estimates of the costs in foregone revenue of tax provisions that are functionally equivalent to spending programs.” Michael J. McIntyre, *A Solution to the Problem of Defining a Tax Expenditure*, 14 UC DAVIS L. REV. 79, 88 (1980). That may be the role it has come to play, but was not what Surrey intended. See Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 187 (explaining that Surrey's “aim” was to do away with tax expenditures). Looking for meaning in the tax expenditure budget makes as little sense as seeking meaning in any other commitment device.

⁷ Freedom is a popular program that blocks internet use for a specified amount of time. Once turned on, users must restart their computer to turn it off. See FREEDOM, <http://macfreedom.com/> (last visited Aug. 12, 2012).

⁸ Surrey argued that “less critical analysis is paid to these tax expenditures than to almost any direct expenditure program one can mention.” STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* 6 (1973) [hereinafter SURREY, *PATHWAYS*]. Because tax expenditures allowed policymakers to provide benefits without scrutiny, they became addicted to tax expenditures. For Surrey, creating a tax expenditure budget served the same role as modifying a drug addict's physiology to prevent him from metabolizing his drug of choice. Case, a hacker in William Gibson's influential cyberpunk novel, finds himself unwillingly cured of an addiction by just such a technique. See, e.g., WILLIAM GIBSON, *NEUROMANCER* 45 (1984) (“‘You needed a new pancreas. The one we bought for you frees you from a dangerous dependency.’ ‘Thanks, but I was enjoying that dependency.’”) As Case learned, such cures often turn out to be mixed blessings. *Id.* at 45-46 (learning of the cure, he is immediately told that, along with the new pancreas, he acquired “fifteen toxin sacs bonded to the lining of various main arteries” that his new employer implanted to ensure his loyalty).

⁹ See Schelling, *Enforcing Rules*, *supra* note 6, at 363.

Arizona Christian School Tuition Organization v. Winn highlights the inadequacy of the tax expenditure budget both in its original and undead incarnations.¹⁰ When the Supreme Court gave its constitutional blessing to a tax credit designed to subsidize private religious education — while conceding that a fiscally identical spending measure would have received closer scrutiny — it revealed the breadth of the challenge posed by tax expenditures.¹¹ Abuses can be driven by the flaws in the budget process that Surrey identified, but tax expenditures can just as easily provide policymakers with the means to flout constitutional safeguards, here the barrier between church and state. The tax expenditure budget was not designed to prevent — and therefore cannot measure — the constitutional harms that flow from the Court's distinction.¹²

Dissecting the stubbornly ambulatory tax expenditure budget reveals the source of both failures. A commitment device succeeds when it asks a question that can be readily answered.¹³ Accordingly, the tax expenditure budget asks a question that calls for a simple quantitative response: how expensive are tax expenditures? Unfortunately, although the tax expenditure budget asks a question that is easy to answer, those answers are inevitably halftruths, obscuring as much as they conceal.¹⁴ Rather than attempting to perfect a definition of tax expenditures, this Article offers a new vocabulary to facilitate constructive conversations on the nature of — and remedies for — tax expenditure abuse.

Although not strong enough to prevent tax expenditure abuse, the tax expenditure budget was created with strength in mind. As a result, it lacks the sensitivity to detect and distinguish among different sources of tax expenditure abuse. This Article describes a framework that uses the tax expenditure budget as its cornerstone, yet is capable

¹⁰ 131 S. Ct. 1436, 1447-49 (2011) (permitting Arizona to subsidize private religious schools with tax credits).

¹¹ See *id.* at 1447 (“The distinction between governmental expenditures and tax credits refutes respondents’ assertion of standing.”). *Winn* is only the latest in a long line of cases applying a more lenient standard for tax expenditures than for direct expenditures. See *id.* at 1442-45.

¹² See generally Linda Sugin, *Tax Expenditure Analysis and Constitutional Decisions*, 50 HASTINGS L.J. 407 (1999) (exploring constitutional implications of tax expenditure analysis).

¹³ See generally Schelling, *Enforcing Rules*, *supra* note 6 (describing the characteristics of successful commitment devices, including the presence of bright-line rules).

¹⁴ See Boris I. Bittker, *Accounting for Federal “Tax Subsidies” in the National Budget*, 22 NAT’L TAX J. 244, 259 (1969).

of assessing the varied threats presented by tax expenditures. That fiscal advantage framework offers a set of terms that make it possible to better understand the many forms of tax expenditure abuse and the impulses that motivate them.¹⁵

Part I of the Article introduces the tax expenditure budget along with two other ill-fated fiscal commitment devices: the E.U. effort to prevent deficits and the recent U.S. attempt to remedy its own. By highlighting the characteristics that set successful commitment devices apart, it identifies an unorthodox explanation for the tax expenditure budget's inability to prevent tax expenditure abuse. As described in detail in Part II, the Article shows that the tax expenditure budget's weakness derives not from its failure to precisely define tax expenditures but from its success in defining tax expenditure abuse as an accounting failure.

Viewing tax expenditure abuse as the product of accounting failure means blindness to the full spectrum of incentives that drive policymakers to abuse tax expenditures. Part III explains how understanding the limits of the tax expenditure budget — our zombie

¹⁵ As explained in detail in Parts II and III, that framework uses the concept of fiscal advantage as its lynchpin. That advantage, like the mechanical advantage provided by a pulley or lever, allows policymakers to achieve politically improbable feats. Fiscal advantage is possible, and perhaps inevitable, whenever tax expenditures receive more forgiving treatment than direct expenditures. See Edward D. Kleinbard, *The Hidden Hand of Government Spending*, 33 REG. 18, 22 (Fall 2010) [hereinafter *Hidden Hand*] (characterizing tax expenditures as having an “irresistible political attraction”). Often, just as Surrey believed, fiscal advantage is fueled by gaps in the budget process. See SURREY, PATHWAYS, *supra* note 8, at 3-4 (“When Congressional talk and public opinion turn to reduction and control of Federal expenditures, these tax expenditures are never mentioned. Yet it is clear that if these amounts were treated as line items on the expenditure side of the Budget, they would automatically come under . . . close scrutiny.”). Unfortunately, that budgetary advantage can be just the tip of the iceberg. See Steven A. Dean, *Tax Deregulation*, 86 N.Y.U. L. REV. 387, 423-24 (2011) (defining budgetary arbitrage, which is the exploitation of budgetary advantage). The procedural advantage in evidence in Winn exploits an entirely different set of vulnerabilities that are inherent in the rulemaking process. See Winn, 131 S. Ct. at 1447-49 (2011) (permitting Arizona to subsidize private religious schools with tax credits); see also Dean, *supra*, at 425 (defining procedural arbitrage, the exploitation of procedural advantage). Finally, cognitive advantage capitalizes on psychological weaknesses that cause individuals to systematically discount the costs of tax expenditures. See Dean *supra*, at 424 (defining cognitive arbitrage, the exploitation of cognitive advantage); Shavero, *Rethinking Tax Expenditures*, *supra* note 1, at 220-21 (discussing impact of heuristics and biases on use of tax expenditures). In concert, these three forms of fiscal advantage can make a mockery of the tax expenditure budget and its aim of promoting accountability. The extent to which a provision relies on fiscal advantage reveals where it falls on the spectrum between a prototypical and marginal vehicle for tax expenditure abuse. See *infra* note 145 and accompanying text.

accountant — leads to counterintuitive conclusions regarding the threats tax expenditures pose and produces a richer account of tax expenditure abuse.

1. UNTHINKABLE PUNISHMENTS

During fraught budget negotiations during the summer of 2011, Congress delegated extraordinary powers to a bipartisan committee.¹⁶ That committee, referred to as the Congressional Supercommittee, failed to reach a compromise despite the promise of universally painful consequences in the event of its failure. Faced with a looming budget impasse, Congress threatened itself with unthinkable punishments in the event of a failure of the Supercommittee process, only to watch the final deadline pass without the sought-after agreement to trim the deficit.¹⁷

Although dramatic, the Supercommittee's collapse serves as only the most recent example of government actors unsuccessfully attempting to harness the power of the commitment device.¹⁸ Like the apocryphal story of the Athenians' failed attempt to forestall a law's repeal by imposing the death penalty on anyone attempting to repeal it,¹⁹ the mere threat of harsh consequences could not relieve the underlying pressures impeding a resolution to the fiscal impasse.²⁰

¹⁶ See Mark Landler & Carl Hulse, *Obama Summons G.O.P. and Democratic Leaders for Deficit Reduction Talks*, N.Y. TIMES, July 6, 2011, at A12 (describing efforts to resolve a looming "budget impasse" triggered by the national debt limit).

¹⁷ See, e.g., Budget Control Act of 2011 § 302(a), 2 U.S.C. § 901a (2011) (providing that failure to meet deficit reduction targets will trigger draconian automatic reductions in "discretionary appropriations and direct spending").

¹⁸ See Michael Cooper, *Failure Is Absorbed With Disgust and Fear, But Little Surprise*, N.Y. TIMES, Nov. 21, 2011, at A19 ("The idea of the committee was, in part, to save Congress from itself. . . . It was Congress lashing itself to the mast, like Odysseus, to resist the siren calls of lobbyists and special interest groups. But in the end, the ship went nowhere."). Further examples, including the Federal Reserve and the European Growth and Stability Pact, are discussed below.

¹⁹ See Jon Elster, *Don't Burn Your Bridge Before You Come to It: Some Ambiguities and Complexities of Precommitment*, 81 TEX. L. REV. 1751, 1760 (2003) ("The ancient Athenians tried several times to entrench decrees by voting that anyone proposing to change them would suffer the death penalty, but as there was no death penalty attached to a proposal to remove the death penalty, these efforts were doomed to fail.").

²⁰ One dispiriting conclusion that could be drawn from the Supercommittee's failure is that Congress's embrace of fiscal rectitude is deeply insincere. Similar conclusions have been drawn in areas as far flung as politicians' support for balanced budget amendments and states' support for human rights treaties. See Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. CHI. L. REV. 469, 514-19 (2005) (concluding that states that join human rights and

A. Commitment Devices

Gamblers, smokers, alcoholics, and politicians have something in common: a weakness for cures.²¹ Just as there is no shortage of gimmicks guaranteed to break a smoker's dependence on cigarettes, perceived shortcomings in the democratic process have inspired an array of prophylactic mechanisms. Term limits, for instance, promise to neutralize the threat of entrenchment and all the ills that accompany it.²² Unfortunately, term limits themselves too often succumb to the desire of incumbents to remain in office.²³

Despite their flaws, commitment devices appear to be as popular as ever among individuals.²⁴ Governments and their observers likewise continue to put their faith in administrative machinery designed to guard against future actions.²⁵ While the allure of commitment devices is straightforward, creating a successful commitment device is not. This subpart introduces the theoretical backdrop against which these mechanisms operate by examining a rogues' gallery of three failed

environmental treaties often have no intention of complying with them); Nancy C. Staudt, *Constitutional Politics and Balanced Budgets*, 1998 U. ILL. L. REV. 1105, 1159 (1998) (suggesting that support for a constitutional balanced budget amendment allows members of Congress to "postur[e] as stern advocates of a balanced budget").

²¹ Of course, some addicts have no interest in shedding their addictions. Not even the most potent commitment device could help such an individual. See Thomas C. Schelling, *Self-Command in Practice, in Policy, and in a Theory of Rational Choice*, 74 AM. ECON. REV. 1, 4 (1984) [hereinafter Schelling, *Self-Command*] (explaining that "[a]nyone who is happily addicted to nicotine, benzedrine, valium, chocolate, heroin, or horse racing" cannot be helped by commitment devices).

²² See Christopher Serkin, *Public Entrenchment through Private Law: Binding Local Governments*, 78 U. CHI. L. REV. 879, 935-36 (2011) (describing costs of entrenchment).

²³ See, e.g., Whitney Cale, *Through the Russian Looking Glass: The Development of a Russian Rule of Law and Democracy*, 7 LOY. U. CHI. INT'L L. REV. 93, 113-14 (2010) (noting parallels between New York City's amendment of its term limits to permit Mayor Bloomberg to serve a third term and Vladimir Putin's complex relationship with term limits).

²⁴ The internet has provided individuals with new avenues to bolster their resolve. See Stephanie Rosenbloom, *I Resolve. World, Don't Fail Me Now*, N.Y. TIMES, Jan. 23, 2011, at ST8 (describing use of social media and specially tailored websites by individuals hoping to do everything from losing weight to avoiding pornography).

²⁵ See, e.g., Jonathan R. Macey & James P. Holdcroft, Jr., *Failure Is an Option: An Ersatz-Antitrust Approach to Financial Regulation*, 120 YALE L.J. 1368, 1370 (2011) (proposing the creation of a commitment device to prevent future bailouts of large financial institutions, "a bright-line rule that operationalizes the adage — once popular among regulators but never implemented — that 'any financial institution that is too big to fail is too big to survive'").

commitment devices: the tax expenditure budget, the E.U. Stability and Growth Pact, and the Supercommittee.

1. A Hierarchy of Potency

Commitment devices operate in different ways. Logically, commitment can occur “either by deleting elements in the set of feasible actions or by affecting the consequences of choosing them.”²⁶ Burning a bridge or a ship provides the paradigmatic illustration of the first, the restrictive “disabling” device.²⁷ The self-incriminating letter to be released or the distasteful donation to be made upon a violation of a commitment suggests the variety of ways that incentives to take or avoid particular actions can be altered.²⁸

A commitment device serves a goal, but inevitably does so in a second-best manner.²⁹ A compulsive gambler might, for example, move away from Atlantic City when merely embracing a rule to avoid its casinos would suffice.³⁰ The dramatic step of relocating to another city would be costly, but could pay enormous dividends by taming an addiction.

A simple “primary rule” prohibiting gambling would do the same at less cost, but might be impossible for the gambler to enforce on himself.³¹ “[S]upporting rules” — here, leaving Atlantic City — advance the same ends as primary rules, but lend themselves more readily to enforcement.³² But for that edge in enforceability, these supporting rules would not be worth the cost. Keeping your kitchen

²⁶ See, e.g., Elster, *supra* note 19, at 1754.

²⁷ See *id.* at 1761 (offering bridge and ship burning as the quintessential disabling devices); Schelling, *Enforcing Rules*, *supra* note 6, at 370 (defining a disabling rule).

²⁸ See Schelling, *Self-Command*, *supra* note 21, at 7 (describing a drug-rehabilitation clinic for physicians that uses “self-blackmail” as a form of therapy and suggesting a contribution of “\$100 payable to a political candidate you despise for any cigarette you smoke except on twenty-four hours’ notice” as a means of guarding against cravings).

²⁹ See Schelling, *Enforcing Rules*, *supra* note 6, at 365 (“At the top of the pyramid, above and beyond the rules, are what we might call goals or preferences. The purpose of rules is to help us reach our goals or satisfy our preferences.”).

³⁰ Such a move might have spared the taxpayer — a compulsive gambler living in Atlantic City — in a case beloved by tax professors millions of dollars in gambling losses over the course of several years. See *Zarin v. Comm’r*, 916 F.2d 110, 111-12 (3d. Cir. 1990).

³¹ See Schelling, *Enforcing Rules*, *supra* note 6, at 366 (“These rules expressing the way we wish ourselves to behave I shall call primary rules. These primary rules are the behaviors we want to abide by. If there were no problem of self-management, all we would need is primary rules.”).

³² See *id.* at 368.

bare serves as a “disabling” rule that prevents midnight snacking.³³ While much more likely to be effective than a simple vow not to indulge in a midnight snack, a permanently empty kitchen would also be extremely inconvenient.

Alternatively, an individual might be concerned about her smoking but not her drinking. Nevertheless, she might recognize drinking as a precursor to smoking. A “precautionary” rule against drinking may help her to break her smoking habit.³⁴ Neither a bare kitchen nor teetotaling have value in themselves, but both help to achieve a valuable end. Although a less burdensome rule would be more desirable, success demands the use of the more expansive supporting rule.

As the above examples suggest, there is a hierarchy of potency across commitment devices. Although both would be more reliable than a primary rule (a vow against midnight snacking), a disabling rule (keep the kitchen empty) is more difficult to violate than a precautionary rule (no eating after ten o’clock). In other words, “the precautionary rule merely draws a brighter line a safer distance away from the activity enjoined by the primary rule” while “the disabling rule would put the prohibited activity altogether beyond reach.”³⁵

Like a precautionary rule, a commitment device that merely imposes higher costs on an activity is less potent than a disabling rule.³⁶ Unlike a disabling device, both require an individual to affirmatively exercise restraint in the face of temptation. A precautionary device merely aims to weaken temptation’s attraction. Increasing the cost of indulgence does the same, raising the stakes of failure without diminishing the appeal or availability of the vice in question. At the risk of understatement, making it impossible to smoke, drink, or snack trumps tinkering with the desire to do so.

The tax expenditure budget, which publicizes spending measures that would otherwise remain hidden, exemplifies the most potent commitment mechanism: the disabling device. As burning a bridge or a ship makes retreat impossible, the tax expenditure budget pulled back a curtain that once allowed policymakers to surreptitiously use tax provisions as spending substitutes: they could effectively spend

³³ See *id.* at 370.

³⁴ See *id.* at 369 (noting that if the smoker is addicted to cigarettes but can resist them so long as he does not drink, refraining from drinking can be a crucial precaution against smoking).

³⁵ See *id.* at 370.

³⁶ Storing credit cards in a safe deposit box would make it more difficult to use them, but closing the accounts entirely would provide surer relief from high credit card bills.

vast sums of money without anyone noticing. With secrecy reduced to cinders, Surrey assumed that policymakers would have little use for tax expenditures and that tax expenditures would either be transformed into direct spending or simply go up in smoke.³⁷

2. Ambiguity

A second dimension along which commitment devices differ is the precision with which the targeted behavior can be identified. A smoker may, for example, distinguish between a “bummed” cigarette and one she purchases. Of course, the generous spirit in which that cigarette is given and received makes it no less toxic or addictive than any other. Because “[r]ules are best observed if you can easily tell the difference between compliance and violation,” bright-line rules work best.³⁸ If failure cannot be distinguished from success, the potential consequences of falling short mean little.³⁹

The European Union’s Stability and Growth Pact — along with the ongoing financial crisis it failed to prevent — highlight the importance of precision.⁴⁰ The Pact promotes the expansion of the European Union by helping “to stabilize and support the euro currency union.”⁴¹ It operates by monitoring economic data such as inflation and exchange rates. It also creates a punitive mechanism triggered whenever a state’s deficit exceeds three percent of its Gross Domestic Product.⁴²

Had the Pact functioned as designed, Greece would have been compelled to balance its budget in order to become and remain an E.U. member state. Instead, Greece consumed a steady stream of bummed cigarettes — here loans disguised as currency transactions — with a predictably negative impact on its economic health but with no

³⁷ See *supra* note 5 and accompanying text.

³⁸ See Schelling, *Enforcing Rules*, *supra* note 6, at 366.

³⁹ *Id.* at 367 (“[A] ‘bright line’ is a discontinuity, or a qualitative difference. I know whether or not I drank, smoked, ate dessert, turned on the television when I got home, or got up when the alarm went off.”).

⁴⁰ See *EU Economic Governance*, EUROPEAN COMMISSION, http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm (last visited Aug. 13, 2012).

⁴¹ Lisa Philipps & Miranda Stewart, *Fiscal Transparency: Global Norms, Domestic Laws, and the Politics of Budgets*, 34 *BROOK. J. INT’L L.* 797, 804 (2009).

⁴² See *id.* (“Article 104 of the Pact sets out the consequences for Member States that breach this requirement, which escalate in severity: completion of a confidential Commission report, a Council recommendation, publicity requirements, constraints on borrowing from the European Investment Bank, a required deposit with the Community, and fines.”).

impact on its deficit as measured by the Stability and Growth Pact.⁴³ A commitment device designed with the benefit of hindsight would have designated such ersatz loans a threat no less serious than ordinary debt. The failure to precisely define the financially harmful behavior the Pact aimed to prevent invited precisely the mischief that has left the Greek economy in ruins and that continues to weigh on global markets.⁴⁴

3. Enforcement

Enforcement is the third critical question in designing a commitment device. Enforcement requires the participation of a referee or, better yet, a judge.⁴⁵ A referee serves as a third party with “moral authority . . . to grant or withhold an exception” or “to make a discretionary judgment.”⁴⁶ A judge would have actual “authority or physical possession.”⁴⁷

Entrusting car keys to such a judge would provide greater assurance that a potential drunk driver will be kept from behind the wheel than relying on a mere referee, who would only be able to counsel an inebriated companion. In this regard, “collective” commitment devices stand at a distinct disadvantage to those targeted at individuals.⁴⁸ Taken to the extreme, while “the individual can . . . entrust his will to external institutions or forces, outside his control, that literally make it impossible for him to change his mind . . . there is nothing external to society.”⁴⁹ More generally, the broader the collective body attempting to bind itself, the fewer authoritative third parties capable of serving as judges or referees exist.

When governments create commitment devices to circumscribe their freedom of action, the absence of an external institution capable

⁴³ See Louise Story et al., *Wall St. Helped to Mask Debts Shaking Europe*, N.Y. TIMES, Feb. 14, 2010, at A1 (explaining that Greece characterized borrowing as “a currency trade rather than a loan”).

⁴⁴ The European financial crisis validates concerns that such “numerical restraints were frequently too rigid and were ignored, or worse, that they encouraged gaming, as governments tried to hide noncompliance through accounting changes or off-budget spending.” Philipps & Stewart, *supra* note 41, at 805.

⁴⁵ See Schelling, *Enforcing Rules*, *supra* note 6, at 373.

⁴⁶ See *id.*

⁴⁷ See *id.*

⁴⁸ See Elster, *supra* note 19, at 1758 (concluding that for this reason “the idea of collective precommitment emerges as quite fragile”).

⁴⁹ See *id.* at 1759-60.

of enforcing discipline becomes a critical limiting factor.⁵⁰ For example, the establishment of an independent central bank allows a government to credibly commit to the goal of monetary stability.⁵¹ Unfortunately, no government can absolutely prevent future governments from undermining or eliminating those constraints.⁵² Obviously, constitutions demonstrate that collective commitment devices can be used to bind governments.⁵³ At the same time, they show how far a government must go to impose meaningful constraints on its future behavior.⁵⁴

The Congressional Supercommittee suffered greatly from the absence of a judge.⁵⁵ Despite its failure to reach agreement on a combination of spending curbs and revenue increases sufficient to avoid “painful” spending cuts, neither the Supercommittee nor Congress flinched as the deadline approached and passed.⁵⁶ The result

⁵⁰ In some cases, that end is achieved through the separation of powers. *Id.* at 1759.

⁵¹ See Kyle D. Logue, *Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment*, 94 MICH. L. REV. 1129, 1189 (1996) (identifying the Federal Reserve as a particularly effective commitment device).

⁵² Ron Paul has famously argued that the Federal Reserve — itself a complex commitment device to guard against the political temptations of inflationary monetary policies — should be eliminated. See generally RON PAUL, *END THE FED* (2009) (providing a critique of central banking in general and the Federal Reserve in particular).

⁵³ See Elster, *supra* note 19, at 1759 (distinguishing between procedural and substantive constitutional commitments). The U.S. Constitution imposes increased procedural thresholds for alterations of constitutional mandates. Article V requires either two-thirds of the House and Senate or two-thirds of state legislatures to propose an amendment. Approving an amendment requires the consent of three-fourths of state legislatures. Combining those limitations with a separation of powers among multiple branches of government makes it even more difficult for government actors to overturn such preferences by allowing one branch of government to police another. See *id.* at 1773 (noting that “separation of powers can facilitate political precommitment”).

⁵⁴ Obligations or prohibitions embedded in a constitution can be entrenched in a number of ways. Amendment may, for example, take time or require a super-majority vote. See *id.* at 1783.

⁵⁵ Rebecca Kysar notes that the absence of an authoritative third party often hamstrings Congressional efforts to enforce self-discipline by using more temporary legislation. See Rebecca M. Kysar, *Lasting Legislation*, 159 U. PA. L. REV. 1007, 1009 (2011) [hereinafter Kysar, *Lasting Legislation*] (“Although Congress may adopt mechanisms — budget rules, for example — with lofty ambitions to legislate in the public interest and to promote fiscal responsibility, Congress is all but unfettered in its ability to sidestep these mechanisms when it sees fit.”).

⁵⁶ Although the deadline passed unmet, few seemed to feel that the promised consequences of failure were inevitable. Even the statement announcing the committee's failure “left open the possibility of a new stage of negotiations in the full

might have been far different if, for instance, the International Monetary Fund had the power to enforce the prescribed sanction.

B. *Disabling Tax Expenditure Abuse*

The failures of the tax expenditure budget, the Supercommittee, and the Growth and Stability Pact testify to the long odds governments face when they choose to bet on commitment devices. Together, they also highlight the variety of threats such a commitment device must navigate. As this Part explains, beyond the well-trodden questions of a device's potency, precision and enforcement lies the possibility that its designers might have fundamentally misunderstood the nature of the problem. In the case of the tax expenditure budget, conceiving of tax expenditure abuse as a mere accounting deficiency — to be addressed by fine-tuning the budget process — guaranteed the project's failure.

1. *Ambiguity*

Of the shortcomings that have made the tax expenditure budget such a poor bulwark against tax expenditure abuse, the absence of a bright-line definition of tax expenditures has consistently received the most attention.⁵⁷ Unfortunately, in the case of tax expenditures, precision has proven stubbornly elusive.⁵⁸

From the beginning, the tax expenditure budget has been heavily criticized for relying on a hopelessly ill-defined boundary between tax expenditures and favorable, but permissible, tax provisions.⁵⁹ Simply put, not every tax benefit is a tax expenditure. Without a consensus baseline — what Surrey invokes as the “income tax proper” — against

Congress, where lawmakers will try to hammer out an agreement on a tax overhaul, changes to entitlement programs and new revenues as a way to avoid automatic across-the-board cuts over 10 years.” Jennifer Steinhauer et al., *With Collapse of Panel's Work, Battleground Shifts to the Automatic Cuts*, N.Y. TIMES, Nov. 22, 2011, at A18.

⁵⁷ The tax expenditure budget's first critic focused on the ambiguous definition of tax expenditures, warning that even if the tax expenditure budget were to “succeed in bringing some issues to the fore” it would effectively “conceal others” so that “the claim that tax subsidies have been exposed to the pitiless glare of publicity will itself help to hide the undisclosed subsidies.” Bittker, *supra* note 14, at 259.

⁵⁸ Shaviro explains that such ambiguity is inevitable and argues that “[t]ax expenditure analysis ought to be more flexible and varied in its groupings than it is in the Surrey tradition, where each rule is canonically classified as a tax expenditure or not” Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 188.

⁵⁹ See Bittker, *supra* note 14, at 250 (listing provisions that a “consistent application” of tax policy principles would require to be included on a tax expenditure budget).

which deviations can be pinpointed,⁶⁰ drawing the line between permissible preferences and tax expenditures becomes difficult.⁶¹

Efforts to wring ambiguity from the definition of tax expenditures have produced an array of alternative approaches. Each offers advantages over the standard definition of tax expenditures, but none of them comes close to producing the bright-line result capable of anchoring an effective commitment device. Using the language of legislators to divine the presence of an abusive tax expenditure, for example, would go some way towards decoupling tax expenditure analysis from Surrey's protean baseline.⁶² Classifying provisions as tax expenditures only when they are "substitutable" would do the same.⁶³ Most recently, a short-lived effort by the influential Congressional Joint Committee on Taxation simply replaced the disputed baseline with a modestly idealized version of extant tax laws.⁶⁴ Perhaps inevitably,⁶⁵ each of these three alternatives fails to solve the precision problem.⁶⁶ None provides clarity that might finally produce "the one true tax expenditures list."⁶⁷

⁶⁰ SURREY, *PATHWAYS*, *supra* note 8, at 6.

⁶¹ That poses both direct and indirect obstacles to the success of the tax expenditure budget as a commitment device. Obviously, errors provide policymakers with opportunities to exploit budgetary advantage despite the existence of the tax expenditure budget. In addition, the lack of a consensus baseline erodes the legitimacy of the tax expenditure budget. The tax expenditure budget has long been criticized for its reliance on "implicit policy judgments" that can make tax expenditure analysis appear to be less a search for truth than a Trojan horse for an unstated — and therefore suspect — agenda. See David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 974 (2004).

⁶² See McIntyre, *supra* note 6, at 88-89 (proposing a rhetorical trigger for tax expenditure analysis).

⁶³ See Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1156, 1186 (proposing a definition of a tax expenditure "not based on the subjective idea of a normative income tax" but instead identifying "a 'substitutable tax provision' as a tax provision that can be replaced with a non-tax-based federal program that fulfills the current tax provision's purposes at least as effectively as does the current provision itself").

⁶⁴ See STAFF OF J. COMM. ON TAXATION, 110TH CONG., A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS 39 (2008) (defining tax expenditures as provisions "deliberately inconsistent with an identifiable general rule of the present tax law" producing "less revenue than does the general rule.").

⁶⁵ See *supra* note 58 and accompanying text.

⁶⁶ Thuronyi notes that McIntyre's solution fails to "liberate[] tax expenditures from the search for an elusive normative tax." Thuronyi, *supra* note 63, at 1182. Weisbach likewise notes that the "'substitutability' approach... is still problematic since, at least theoretically, every policy is substitutable." Weisbach & Nussim, *supra* note 61, at 977 n.63. Finally, Fleming and Peroni conclude that the "Joint Committee Staff's new approach did not effectively overcome" the baseline problem "that the Staff

Although its most obvious failing, ambiguity is not the tax expenditure budget's most important flaw. As considered in detail below, the tax expenditure budget's blindness to an array of pressures — from parliamentary to psychological — that encourage policymakers to use tax expenditures overshadows its ambiguity. Even if a bright line had been easy to draw, tax expenditures would still have flourished. If that were not the case, those tax expenditures included in the tax expenditure budget — thereby thrust into the daylight — would soon wither and die. With few exceptions, that has not occurred.⁶⁸

2. Enforceability

Enforcement is a challenge for every collective commitment device.⁶⁹ The mechanisms that protect against Congressional violations of constitutional protections provide a very potent form of enforcement.⁷⁰ They do not merely provide a referee possessing moral authority to evaluate compliance, but a judge (here a literal Supreme Court) possessing actual authority to police violations of constitutional protections.⁷¹

The tax expenditure budget has only referees, such as the many scholars who have critiqued the tax expenditure budget's shortcomings, to ensure that the tax expenditure budget is comprehensive and accurate.⁷² As with precision, that limitation is not as significant as one might expect. For those expenditures that do find their way onto the tax expenditure budget, enforcement becomes

sought to neutralize with its 2008-2010 construct." J. Clifton Fleming, Jr. & Robert J. Peroni, *Can Tax Expenditure Analysis be Divorced From a Normative Tax Base?: A Critique of the "New Paradigm" and its Denouement*, 30 VA. TAX REV. 135, 169 (2010) [hereinafter Fleming & Peroni, *Divorced*].

⁶⁷ See Weisbach & Nussim, *supra* note 61, at 977.

⁶⁸ Even in cases in which a tax expenditure disappears from the budget, the tax expenditure budget may be only part of the story. See Dean, *supra* note 15, at 402 n.61 (concluding that "press accounts of particular abuses" did more to end safe harbor leasing than "aversion to its design or concerns about its cost").

⁶⁹ See *supra* Part II.B.2.

⁷⁰ See *supra* text accompanying notes 53-54. Of course, flaws in the tax expenditure budget actually allow Congress to circumvent the constitutional barrier between church and state. See *supra* notes 10-11 and accompanying text.

⁷¹ See *supra* text accompanying notes 45-47.

⁷² Scholars could, for example, object to the omission of various provisions from the tax expenditure budget, but have no authority to force changes in the way the tax expenditure budget is formulated. See, e.g., Bittker, *supra* note 14 (criticizing incompleteness of list of tax expenditures).

largely irrelevant. Once publicized, tax expenditures can no more be made secret again than the proverbial bell can be un-rung. Unfortunately, inclusion on the tax expenditure budget seems to mean little, since even listed tax expenditures can thrive. Even if the tax expenditure budget accounted fully for each and every tax expenditure, abuse would still occur.⁷³

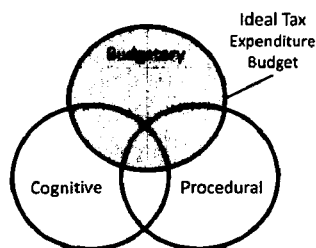
3. Completeness

Setting aside precision and enforcement — and notwithstanding the potency it enjoys as a disabling device — the tax expenditure budget would not have achieved Surrey's goal of containing tax expenditure abuse. Even a flawless tax expenditure budget would have been uncomfortably like a student blocking his laptop's internet connection only to find himself lost in his smart phone's small screen.⁷⁴ As explained in detail in Part II, that is because the tax expenditure budget targets only one of at least three engines of tax expenditure abuse.⁷⁵

⁷³ Taking a step back from the technical details, a never-ending cascade of debts and deficits suggests that in relying on norms of fiscal probity to promote accountability and to prevent abuse, the tax expenditure budget booked passage on a ship that, like the Titanic, was both unsinkable and doomed. Indeed the entire federal budget could be seen as a failed commitment device. In responding to criticisms of the tax expenditure budget, Roin draws a similar parallel between the two budgets. See Roin, *supra* note 4, at 614 (“If the objections to the tax expenditure budget warrant its elimination, they would also warrant ceasing publication of the remainder of the budget.”). Unfortunately, the “pitiless glare of publicity” that Surrey hoped would prevent tax expenditure abuse seems to have lost its bite. See Bittker, *supra* note 14, at 259.

⁷⁴ See *supra* note 7 and accompanying text.

⁷⁵ See Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 220-21 (concluding that cognitive advantage would persist even if budgetary advantage were eliminated). Using the diagram developed in Part II shows how even an idealized tax expenditure budget — entirely foreclosing the possibility of budgetary advantage — would fail to account for two of the three variants of fiscal advantage considered below. Focused only on budgetary advantage, it ignores both cognitive and procedural advantage.



Take, for example the recent Supreme Court decisions in *Winn*⁷⁶ and the challenge to President Obama's Patient Protection and Affordable Care Act.⁷⁷ Although the Arizona legislature classified the *Winn* credit as a tax expenditure and included its \$50 million annual cost on its tax expenditure budget, policymakers still had compelling reasons to substitute a tax credit for a direct expenditure.⁷⁸ Using a tax expenditure allowed Arizona legislators to circumvent constitutional roadblocks and to exploit psychological quirks that cause the public to draw false distinctions between tax and direct expenditures.⁷⁹

In its decision affirming the constitutionality of the healthcare legislation, the inadequacy of the tax expenditure budget proved even more striking. Although the Court found that the federal government lacked the power to directly compel the purchase of insurance under the Commerce Clause, the mandate survived as a tax measure. As Chief Justice Roberts put it, "Congress's power to tax is greater than its power to regulate commerce."⁸⁰ Unfortunately, the tax expenditure budget — the only tool available to assess the use of tax rules to achieve substantive ends — offers no insight on Congress's use of its taxing power to circumvent the limits of the Commerce Clause. Because it increases rather than decreases the federal government's revenues, the tax penalty it imposes will simply be ignored.⁸¹

Even if tax expenditure abuse were a purely quantitative phenomenon, our zombie accountant, the tax expenditure budget, would be poorly equipped to evaluate it. As *Winn* and the Court's healthcare decision illustrate, the use of tax expenditures has a significance that cannot always be reduced to dollars and cents. The

⁷⁶ 131 S. Ct. 1436 (2011).

⁷⁷ *Nat'l Fed. of Indep. Bus. v. Sebelius*, 132 S. Ct. 2566 (2012).

⁷⁸ Those legislators may have seen benefits as well as costs in the tax expenditure budget's highlighting of this credit. If the enthusiasm of supporters outweighs the skepticism of those who disapprove, the publicity provided by the tax expenditure budget may, on balance, prove favorable.

⁷⁹ The Arizona tax expenditure budget may have eliminated budgetary advantage, but it did not affect the tax credit's procedural advantage potential. See *Winn*, 131 S. Ct. at 1444.

⁸⁰ *Sebelius*, 132 S. Ct. at 2600.

⁸¹ Such tax penalties are presented as having no cost — that is, the tax expenditure budget lists the amount of revenue they contribute to the federal revenues — or are simply ignored. See J. COMM. ON TAXATION, 112TH CONGRESS, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2011-2015 4 (2012) (describing negative tax expenditures as "provisions that provide for treatment that is less favorable than normal income tax law" but excluding "provisions of the law the principal purpose for which is to . . . prevent the violation of other laws").

next Part describes a framework that can accommodate the complex dynamics that motivate the use of tax expenditures.

II. THE ZOMBIE ACCOUNTANT

Unfortunately, dragging tax expenditures into budgetary daylight has eliminated neither policymakers' opportunities nor incentives to exploit the fiscal advantage they provide.⁸² The blossoming of *listed* tax expenditures — that is, those tax provisions that are included in the tax expenditure budget — in addition to those that are excluded that followed the codification of the tax expenditure budget as a disabling device suggests that neither enforcement nor ambiguity is the most pressing problem.⁸³ More broadly, a half-century of experience with the tax expenditure budget offers little reason for optimism that commitment mechanisms — particularly those less potent than disabling devices — can succeed in curbing policymakers' bad habits.⁸⁴

⁸² In prior work, the exploitation of fiscal advantage has been labeled “fiscal arbitrage.” See Dean, *supra* note 15, at 392 (defining fiscal arbitrage as “reaping the political benefits of spending without investing the political capital that direct spending requires”). One advantage of using the term advantage is that in the tax context arbitrage has acquired a specialized meaning. Tax arbitrage, in particular suggests the use of offsetting positions that are treated asymmetrically by the tax law, producing favorable results for taxpayers. See, e.g., Daniel N. Shavero, *Selective Limitations on Tax Benefits*, 56 U. CHI. L. REV. 1189, 1231 (1989) (“Tax arbitrage may be defined as the reciprocal borrowing and lending of money to give at least one party tax-exempt interest income and deductible interest expense.”).

⁸³ As Shavero put it, “[t]ax expenditure analysis is like a hardy plant with shallow roots that spreads widely, resisting the occasional effort to extirpate it, while having little if any effect on the soils in which it sprouts.” Shavero, *Rethinking Tax Expenditures*, *supra* note 1, at 187. Kleinbard examined data regarding the prevalence of tax expenditures since the creation of the tax expenditure budget and concluded that “[t]ax expenditures have grown at rates much faster than explicit Government spending and at rates that exceed even increases in mandatory spending.” Kleinbard, *The Congress Within the Congress*, *supra* note 2, at 17.

⁸⁴ By contrast, some mechanisms used to promote a healthy tax system reward the faith that is placed in them. Third-party information reporting, for example, has a dramatic impact on taxpayer compliance. See Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695, 698 & n.13 (2007) (discussing importance of information reporting to taxpayer compliance). Information reporting is not, of course, a commitment device, but a legally enforceable obligation imposed on private parties.

A. Fiscal Superconductors

The traditional method of containing the risk posed by tax expenditures views them as nothing more than an accounting failure.⁸⁵ This Part provides an alternative with the power to recognize the many faces of tax expenditure abuse. It does so by developing a new vocabulary to describe the property that makes tax expenditures susceptible to abuse.

Tax expenditures are fiscal superconductors. Just as superconductivity allows electrical currents to flow without resistance, substituting tax expenditures for direct expenditures allows policymakers to neutralize impediments to spending. Fiscal advantage — the benefit offered by that superconductivity — is the phenomenon that motivates tax expenditure abuse.⁸⁶

This Part identifies three types of resistance — budgetary, cognitive, and procedural — that dissipate when tax expenditures are substituted for direct expenditures.⁸⁷ For those familiar with tax expenditure analysis, budgetary advantage will be the most recognizable form of fiscal advantage. Budgetary advantage is what policymakers seek to gain when they substitute tax expenditures for direct spending that would be fully captured by the ordinary budget process. It is, as the label suggests, the phenomenon targeted by the tax expenditure budget. Simply put, budgetary advantage defeats whatever resistance to spending the budget process generates. Even today, budgetary advantage retains its potency wherever there are gaps in the tax expenditure budget.⁸⁸

The other two forms of fiscal advantage considered here fall beyond the scope of the tax expenditure budget. In part because of that, they

⁸⁵ See Roin, *supra* note 4, at 608-10 (describing the evolution of the tax expenditure budget into its current form).

⁸⁶ Shavero proposed new fiscal language grounded in optimal tax theory to “rescue[]” tax expenditure analysis from “the vacuity of the distinction between taxes and spending.” Shavero, *Rethinking Tax Expenditures*, *supra* note 1, at 212-13. Using Shavero’s distinction between the two very different functions of the tax expenditure budget — “a purportedly objective descriptive tool and a weapon of political combat” — his fiscal language innovation was designed primarily to advance the former function while highlighting fiscal advantage serves to curtail the abuse of tax expenditures. See *id.* at 190.

⁸⁷ It would be possible to create a categorical definition of tax expenditures in fiscal advantage terms. For example, any provision exploiting significant quantities of at least two types of fiscal advantage might be labeled a tax expenditure. One of the primary advantages of the fiscal advantage concept is that it does not require a consensus on where such a line should be drawn.

⁸⁸ See *infra* note 115.

may be even more important than budgetary advantage. Cognitive advantage exploits psychological rather than accounting vulnerabilities — persuading voters to change their views by changing a measure’s form without altering its substance — but exhibits the same capacity for obscuring fiscal truths.⁸⁹ As scholars have demonstrated, individuals respond differently to identical fiscal policies when framed as tax and direct expenditures.⁹⁰ Capitalizing on that disparity could, for example, allow a subsidy to succeed as a tax provision even though a fiscally identical spending provision would fail.⁹¹

The third and final form of fiscal advantage described here, procedural advantage, is the least understood.⁹² It occurs when policymakers skirt procedural obstacles by substituting a tax rule for a spending provision.⁹³ The use of a tax credit to subsidize private religious education when a direct expenditure might violate the Establishment Clause or a tax penalty to avoid the strictures of the Commerce Clause need not implicate budgetary or cognitive advantage. Their procedural advantage potential is obvious and significant.⁹⁴

A prototypical vehicle for tax expenditure abuse exploits budgetary, cognitive, and procedural advantage.⁹⁵ For example, the bilateral

⁸⁹ See Shavero, *Rethinking Tax Expenditures*, *supra* note 1, at 220 (explaining that “people systematically under-weigh opportunity costs relative to equivalent out-of-pocket costs” and as a result respond differently to “substantively identical” tax and spending provisions).

⁹⁰ See Edward A. Zelinsky, *Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditure Analysis*, 24 VA. TAX REV. 797, 799 (2005) [hereinafter Zelinsky, *Framing Effects*] (explaining that in some cases “policies unacceptable when framed as direct expenditures become supportable when labeled as tax subsidies, even though the economic substance of the policies is the same”).

⁹¹ See *id.*

⁹² The Supreme Court Establishment Clause jurisprudence that preceded *Winn* inspired the most significant discussions of procedural advantage. See Edward A. Zelinsky, *James Madison and Public Choice at Gucci Gulch: A Procedural Defense of Tax Expenditures and Tax Institutions*, 102 YALE L.J. 1165, 1192-94 (1993) [hereinafter *Gucci Gulch*] (summarizing scholarly response to Establishment Clause procedural advantage). For his part, Zelinsky largely dismisses the threat of procedural advantage in this context, concluding that a tax expenditure “poses less threat to Establishment Clause values than a comparable direct outlay.” *Id.* at 1194.

⁹³ See Dean, *supra* note 15, at 425 (providing a brief description of the operation of procedural advantage).

⁹⁴ See *Ariz. Christian School Tuition Org. v. Winn*, 131 S. Ct. 1436, 1447-48 (2011).

⁹⁵ Likewise, a prototypical lie would possess each of a variety of relevant elements. See Linda Coleman & Paul Kay, *Prototype Semantics: The English Word Lie*, 57

double tax treaties considered below — an important tax expenditure rarely identified as such — draw strength from all three forms of fiscal advantage.⁹⁶ Another expenditure might exhibit two of the three. A marginal example might provide scant opportunity for any sort of fiscal advantage. Implicit in the fiscal advantage concept is the notion that each of the three elements is itself a gradient property.⁹⁷ In other words, a tax expenditure might provide little budgetary advantage but a great deal of cognitive advantage.

B. *The Anatomy of Fiscal Advantage*

Splintering a concept brings with it a host of risks. Fortunately, fragmenting the once-indivisible tax expenditure concept is a less dangerous proposition than, say, splitting the atom.⁹⁸ Undoubtedly, fiscal advantage could be disaggregated further or along different fault lines. Nevertheless, budgetary, cognitive, and procedural advantage provide a useful means of teasing apart the interrelated dynamics that fuel the exploitation of tax expenditures.⁹⁹

LANGUAGE 26, 28 (1981) [hereinafter Coleman & Kay, *Lie*] (“The notion of prototype definition suggests that utterances which have all three of the elements above would be considered full-fledged lies, and that utterances which lack one or more of the elements might still be classed as lies, but less clearly so. . .”).

⁹⁶ See *infra* Part II.B.

⁹⁷ The magnitude of the fiscal advantage associated with a particular policy is determined both exogenously and endogenously. Modifying a given tax expenditure can, for example, enhance or diminish its budgetary advantage potential, but similar results can also be achieved by altering the legal framework that governs tax expenditures generally. Still more broadly, social or cultural changes can affect the perception of a particular provision, significantly affecting its potential for fiscal advantage. To the extent society simultaneously has become more skeptical of direct spending and more welcoming of tax expenditures, a tax expenditure may be unchanged yet have become a better source of fiscal advantage.

⁹⁸ The word atom is derived from the Greek word meaning “indivisible.” See MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 73 (10th ed. 1998). Nuclear fission splits the atom “resulting in the release of large amounts of energy” in power plants and weapons. See *id.* at 439.

⁹⁹ The prototype view of meaning permits a more nuanced view of a word’s meaning than a simple checklist definition. See, e.g., Coleman & Kay, *Lie*, *supra* note 95, at 28 (“When we try to define lie, the first thing that comes to mind is probably the idea of saying something untrue. This, however, is not adequate. . . . Honest mistakes and innocent misrepresentations occur frequently, and are not labeled lies.”).

1. Budgetary Advantage

Budgetary advantage grants policymakers enormous power to obscure spending patterns.¹⁰⁰ The opportunity that unchecked budgetary advantage would provide can be understood by considering the roots of the Greek debt crisis. For years, Greece managed to borrow billions of dollars while keeping the attendant debts “hidden from public view” simply by mislabeling them.¹⁰¹ Although its consequences tend to be less dramatic, budgetary advantage involves the same fiscal sleight of hand. When successful, it hides spending in the same brash way.¹⁰²

Even today, decades after Congress embraced the use of the tax expenditure budget, tax laws still provide economic benefits to discrete groups of taxpayers while shielding the resulting costs from view. In the extreme, such changes are viewed as having no fiscal impact.¹⁰³ As with the Greek debt subterfuge, avoiding particular labels provides policymakers with the fiscal equivalent of Dorian Gray’s portrait.¹⁰⁴

¹⁰⁰ Without a tax expenditure budget, tax expenditures would have only an “implicit cost” that would be all too easily ignored. See Roin, *supra* note 4, at 608.

¹⁰¹ See Story et al., *supra* note 43, at A1.

¹⁰² Surrey hoped to prevent — or disable — budgetary advantage by forcing a public reckoning of tax expenditures’ cost. He explained that the tax expenditure budget would shield a “vulnerable” tax system from tax expenditures. See SURREY, PATHWAYS *supra* note 8, at 6 (“A tax system that is so vulnerable to this injection of extraneous, costly and ill-considered expenditure programs is in a precarious state. . . . It is therefore imperative that the process and substance of these tax expenditures be reexamined.”).

¹⁰³ For example, many corporate restructurings are, not without controversy, ignored by the tax expenditure budget. See Bittker, *supra* note 14, at 250 (criticizing the tax expenditure budget’s omission of corporate reorganization provisions). As a result, Congress can loosen the requirements taxpayers must satisfy to qualify for that favorable treatment without triggering application of the tax expenditure budget. In part because of that omission, such “spending” remains hidden and tends to be seen as “simplification” rather than largesse. See, e.g., 151 CONG. REC. 14, 734 (2005) (statement of Sen. Max Baucus) (labeling a loosening of the divisive reorganization requirements “simplification”).

¹⁰⁴ In Oscar Wilde’s novel, the consequences of Dorian Gray’s excesses are concealed, visible only in a portrait locked away from view.

Ah! in what a monstrous moment of pride and passion he had prayed that the portrait should bear the burden of his days, and he keep the unsullied splendour of eternal youth! All his failure had been due to that. Better for him that each sin of his life had brought its sure swift penalty along with it. There was purification in punishment.

Fortunately, not every fiscal sin can be hidden from the public eye so easily. The tax expenditure budget provides a public reckoning of the cost of a wide range of tax preferences.¹⁰⁵ Thanks in part to the tax expenditure budget, some of those once-obscure preferences receive quite a bit of attention.¹⁰⁶ The deduction for interest paid on a home mortgage, for example, absorbs ninety billion dollars of tax revenue per year.¹⁰⁷ Without the tax expenditure budget, there might be no official recognition of the cost of one of the largest homeownership subsidies.¹⁰⁸

Along with such high-profile tax expenditures, many others exist that receive less attention.¹⁰⁹ For example, the deduction for overnight-travel expenses of national guard and reserve members reduces tax revenues by a hundred million dollars per year.¹¹⁰ Compiling a long list of tax expenditures in a single document goes a long way towards defusing the threat of budgetary advantage.

Despite the existence of the tax expenditure budget, budgetary advantage remains problematic for two reasons. First, because of the

Co. 1957) (1890).

¹⁰⁵ See Roin, *supra* note 4, at 608 (explaining that the tax expenditure budget “estimates the revenue the government would have collected in the absence of those provisions, and thus the implicit cost of these provisions”).

¹⁰⁶ The tax expenditure budget has gained considerable attention in the context of recent budget crises. Its cost estimates draw particular attention to those tax expenditures linked to substantial revenue losses. See, e.g., Lori Montgomery, *Ending Tax Breaks Won't Fix Budget, Study Says*, WASH. POST, May 31, 2011, at A08 (“Known as ‘tax expenditures,’ the list includes dozens of popular credits, deductions and other policies that benefit many special interests, but also millions of ordinary taxpayers. The most expensive tax breaks from the government’s standpoint are the tax-free treatment of employer-provided health benefits and the mortgage-interest deduction for homeowners.”).

¹⁰⁷ See STAFF OF J. COMM. ON TAXATION, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010-2014, at 34-54 (Comm. Print 2010) [hereinafter ESTIMATES BY BUDGET FUNCTION].

¹⁰⁸ The exclusion for imputed income derived from the ownership of durable goods, including owner occupied real estate, by contrast, is excluded from the tax expenditure budget and typically goes unremarked upon. See *id.* at 6 (“The individual income tax does not include in gross income the imputed income that individuals receive from the services provided by owner-occupied homes and durable goods. However, the Joint Committee staff does not classify this exclusion as a tax expenditure.”) (footnotes omitted).

¹⁰⁹ Virtually any policy that could be supported with a direct expenditure of funds could be replaced with a tax subsidy. David Bradford even playfully suggested that weapons appropriations could be replaced with a “weapons supply tax credit.” David F. Bradford, *Tax Expenditures and the Problem of Accounting for Government*, in TAX EXPENDITURES AND GOVERNMENT POLICY 427, 432 (Neil Bruce ed., 1988).

¹¹⁰ See ESTIMATES BY BUDGET FUNCTION, *supra* note 107, at 34-54.

lack of precision considered above, some tax rules that provide opportunities for budgetary advantage fail to find their way onto the tax expenditure budget.¹¹¹ The U.S. network of bilateral double tax treaties illustrates that shortcoming. Surrey himself concluded that preferences provided through the tax treaty process should be considered tax expenditures, but they continue to be excluded from the tax expenditure budget.¹¹²

That failure could be viewed as a modest one, in which specific features of particular treaties permit fiscal advantage.¹¹³ Alternatively, it could be seen as a more profound structural weakness that permits states to conspire to surreptitiously undermine domestic laws through international law.¹¹⁴ Particularly under that broader view, by

¹¹¹ See *supra* note 108 and accompanying text.

¹¹² Surrey and McDaniel broadly distinguish between treaty benefits accorded to U.S. residents (tax expenditures) and those provided to foreign businesses and individuals (not tax expenditures), noting that:

[S]ome treaties do reduce the U.S. income tax on its citizens and residents. When such a reduction would result in a tax expenditure if legislated in a statute then a treaty provision producing the same effect should likewise be considered a tax expenditure. The U.S. tax expenditure lists, however, have not yet applied this analysis.

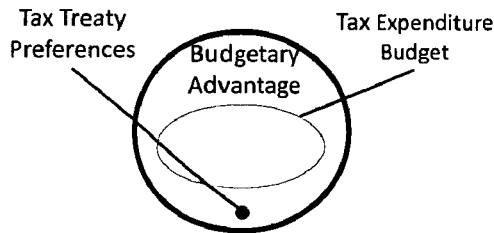
STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 168-70 (1985) [hereinafter SURREY & MCDANIEL, *TAX EXPENDITURES*]. See PAUL R. MCDANIEL & STANLEY S. SURREY, *INTERNATIONAL ASPECTS OF TAX EXPENDITURES: A COMPARATIVE STUDY* 59 (1985) [hereinafter MCDANIEL & SURREY, *INTERNATIONAL ASPECTS OF TAX EXPENDITURES*]. Surrey and McDaniel identify treaty provisions making contributions to foreign charities deductible and treating certain loans as "income taxes" for foreign tax credit purposes (even though the relevant statute would provide less favorable treatment) as improperly omitted tax expenditures. See SURREY & MCDANIEL, *TAX EXPENDITURES*, *supra*, at 169-70. They distinguish between those tax expenditures and a third treaty provision in part because analogous statutory rules "have never been listed as tax expenditures." *Id.* at 170.

¹¹³ See *ESTIMATES BY BUDGET FUNCTION*, *supra* note 107, at 34-54 (listing international tax expenditures such as "[e]xclusion of certain allowances for Federal employees abroad" but omitting tax treaty-based tax preferences).

¹¹⁴ In the tax treaty context McDaniel and Surrey disregard benefits accorded to nonresidents. See MCDANIEL & SURREY, *INTERNATIONAL ASPECTS OF TAX EXPENDITURES*, *supra* note 112, at 59 ("The lack of generally accepted normative principles precludes classification of provisions affecting foreign individuals and corporations in domestic legislation or tax treaties as either normative or tax expenditures . . ."). Nevertheless, because of the reciprocal nature of tax treaties any benefits provided to nonresidents indirectly accrue to residents. Although the mechanism is less direct than a direct Congressional grant of a tax benefit, the results (lost U.S. tax revenue paired with tax benefits for U.S. residents) is the same. The United States teams with its treaty partner to produce results that it would have difficulty achieving alone. A similar phenomenon can occur in the context of cross-border military intervention against a

expanding treaty benefits, policymakers can provide benefits to favored constituencies without observing the strictures of the tax expenditure budget process. In either case, as shown in the following diagram, although tax treaties benefit from fiscal advantage (here budgetary advantage), the tax expenditure budget blithely ignores these preferences.

Figure 1



Second, the tax expenditure budget systematically underestimates the cost of tax expenditures that are included on the tax expenditure budget.¹¹⁵ As a result, not even labeling tax treaty preferences as tax expenditures would reliably eliminate the risk that they might facilitate budget advantage.¹¹⁶ Producing even a rough cost estimate that might be included on a tax expenditure budget would represent a challenge.¹¹⁷

non-state actor, with one state acting militarily in the territory of a second state to address a threat that it is “unwilling or unable” to resolve on its own. See Ashley S. Deeks, *“Unwilling or Unable”: Toward a Normative Framework for Extraterritorial Self-Defense*, 52 VA. J. INT’L L. 483 (2012) (discussing need for greater clarity in when a state may invoke the “unwilling or unable” standard).

¹¹⁵ That is true, for example, when taxpayers change their behavior to capitalize on a tax preference, making it difficult to quantify its precise fiscal impact. In other words, repealing a tax on chocolate chip cookies that once generated \$100 in revenues may actually reduce revenues by more than \$100 as consumers abandon oatmeal cookies still subject to tax. See ESTIMATES BY BUDGET FUNCTION, *supra* note 107, at 28 (“[U]nlike revenue estimates, tax expenditure calculations do not incorporate the effects of the behavioral changes that are anticipated to occur in response to the repeal of a tax expenditure provision.”).

¹¹⁶ See Roin, *supra* note 4, at 613 (“[M]any suspect that the tax expenditure budget, as currently formulated, makes many [estimation] errors, perhaps enough to make the schedule worse than useless”).

¹¹⁷ For example, Surrey and McDaniel conclude that treaty reductions in gross-basis withholding rates (i.e., cross-border taxes that apply without any allowance for expenses) should not be treated as tax expenditures “because such reductions are

2. Cognitive Advantage

Budgetary advantage is the best understood of the three forms of fiscal advantage. For decades, it has been the object of both careful scrutiny and determined eradication efforts. Cognitive advantage has only recently begun to attract attention from scholars.¹¹⁸

In a sense, budgetary and cognitive advantage represent two sides of the same coin. Both presume a relatively high level of public engagement with fiscal policy issues. Cognitive advantage paints a more recognizably human portrait of consumers of fiscal policy information.¹¹⁹ It accounts for the fact that voters (but not policymakers) may be dismissive of the tax expenditure budget or simply fail to look beyond the ordinary budget. In addition, it acknowledges that both voters and policymakers might digest the

generally attempts to make the tax burden closer to what would be imposed if the regular tax rate schedule were applied to net investment income.” SURREY & MCDANIEL, *TAX EXPENDITURES*, *supra* note 112, at 168. In effect, they argue, reductions in gross basis withholding taxes amount to reductions in tax penalties, the converse of tax expenditures. It would be extremely difficult to determine when treaty-based rate reductions cease serving as tax penalty adjustments and become tax expenditures. For example, although by the above logic a treaty that entirely eliminates the statutory withholding tax should be viewed as giving rise to a tax expenditure, the dollar value of that benefit would be hard to estimate. See, e.g., Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains, U.S.-U.K., art. X, ¶ 3, July 24, 2001 U.S.T. 5668 (eliminating the withholding tax in cases in which a U.K. parent owns eighty percent of the shares of a U.S. subsidiary).

¹¹⁸ The first scholarship applying the insights of cognitive psychology to taxation appeared many years after the tax expenditure budget was enshrined in federal law. See, e.g., Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861, 1864 (1994) (“My central argument is that cognitive biases can help to explain major structural features of our existing tax system that are otherwise difficult to understand, and that such biases must be taken into account in developing any general normative theory of tax.”)

¹¹⁹ The traditional take on budgetary advantage makes two unrealistic assumptions about voters. First, it takes for granted that voters successfully digest all available budget information. Second, budgetary advantage works best when voters have no capacity to generate it themselves. In a world in which only budgetary advantage plays an important role, voters would respond rationally to the spending and subsidies that appear in the federal budget even though they are unable to look beyond that official reckoning. When the fiscal impact of a tax measure is revealed to them, they appreciate its significance, but the information must always be presented to them. A formal tax expenditure budget, translating tax rules into their spending equivalents, offers an easy antidote for budgetary advantage. Presented with its fuller fiscal picture, voters are able to appreciate the budget impact of tax preferences.

information it contains, but stubbornly reject the equivalence of substantively identical tax and spending provisions.¹²⁰

Cognitive advantage suggests the complexity of the channels through which fiscal advantage operates. It also highlights its unpredictability. Because it introduces an irrational element into the tax policy process, cognitive advantage produces surprising outcomes. For instance, cognitive advantage can create distributional quirks such as tax rules that benefit relatively high-income taxpayers.¹²¹ As Marjorie Kornhauser concisely put it, "the public might not tolerate handing out dollars to every hedge fund trader, but will not notice if these traders receive the money by means of favorable tax treatment."¹²² In other words, voters may tend to miss the forest (because of the types and amount of income they earn, the wealthy benefit disproportionately from favorable capital gains rates) by focusing on the trees (low-income taxpayers are entitled to an even lower rate).

Behavioral tax scholars offer a clear account of why such odd results might persist. Individuals engage in "disaggregation" and suffer from "isolation bias" when they evaluate a tax expenditure.¹²³ In other

¹²⁰ See Zelinsky, *Framing Effects*, *supra* note 90, at 801 ("For those who persist in viewing economically equivalent programs as different when framed as tax or as direct expenditure programs, disclosure is irrelevant. The essence of a framing effect is its persistence in the face of disclosure, such as that embodied in tax expenditure budgets."). Some have been skeptical of the impact of cognitive advantage. See, e.g., Weisbach & Nussim, *supra* note 61, at 971 ("Psychological problems may prevent individuals from properly processing information, but this does not mean that such cognitive biases are dominant, or even important, in this context."). Policymakers may also fall victim to the same cognitive failures they exploit in taxpayers, sincerely believing that fiscally identical tax and spending measures to be fundamentally different. See Kleinbard, *Framework*, *supra* note 5, at 354 ("Congress both operates through and capitalizes on the prism of fiscal illusion.").

¹²¹ On the other hand, tax expenditures may represent the only vehicle through which programs that benefit moderate-income recipients can be created. See Fleming & Peroni, *Reinvigorating*, *supra* note 5, at 485-86 ("[F]ollowing the 1994 Republican takeover of Congress, the Clinton administration and Congress collaborated in using tax expenditures to adopt governmental programs that could not be enacted via the direct expenditure approach in the then-prevailing political environment. Among these tax expenditures were higher education tax credits and a child tax credit. This history suggests that in certain circumstances, tax expenditures can be used to accomplish worthy governmental objectives that could not otherwise be done through the legislative system.").

¹²² Marjorie E. Kornhauser, *Cognitive Theory and the Delivery of Welfare Benefits*, 40 LOY. U. CHI. L.J. 253, 264 (2009).

¹²³ See Jonathan Baron & Edward J. McCaffery, *Masking Redistribution (or Its Absence)*, in BEHAVIORAL PUBLIC FINANCE 85, 85-87 (Edward J. McCaffery & Joel Slemrod eds., 2006) (describing implications of disaggregation and isolation bias).

words, they evaluate a tax measure on its own terms, failing to follow the ripples it disperses across the entire fiscal pond.¹²⁴ Tax expenditures heighten the impact of that mental mistake by using “goal framing” to emphasize benefits over costs.¹²⁵ As a result, not only is the nominally progressive capital gains preference Kornhauser alludes to considered in isolation from its ultimate distributional consequences, it also benefits by focusing attention on the goal of promoting investment and away from the costs of doing so.¹²⁶

Neutralizing budgetary advantage requires the publication of more comprehensive fiscal information, effectively dragging Dorian Gray’s portrait into the light. The antidote to cognitive advantage is less obvious.¹²⁷ A “nudge” might ameliorate the impact of other cognitive failures by, for example, guiding children towards healthier lunch choices.¹²⁸ Unfortunately, when they are exploiting — rather than suffering from — cognitive failure, dissuading policymakers from deploying cognitive advantage as a political tool would require more than a nudge.¹²⁹

¹²⁴ McCaffery and Baron offer an example that contrasts aggregation against isolation. In their example, a couple divorces and one former spouse dies, leaving all her property to the oldest child. The survivor believes in equality, so is left with the quandary of whether to pursue equality in isolation (leaving half of his estate to each child) or in the aggregate (by leaving his entire estate to the younger child). Edward J. McCaffery & Jonathan Baron, *The Humpty Dumpty Blues: Disaggregation Bias in the Evaluation of Tax Systems*, 91 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 230, 232 (2003).

¹²⁵ See Edward J. McCaffery & Jonathan Baron, *Framing and Taxation: Evaluation of Tax Policies Involving Household Composition*, 25 J. ECON. PSYCHOL. 679, 682 (2004).

¹²⁶ The rates applicable to capital gains are progressive (higher rates apply to taxpayers with higher incomes) but they are also preferential (lower than the rates that apply to ordinary income). See 26 U.S.C. § 1 (West 2008). As a result, if high income taxpayers earn a disproportionate share of that income from capital gains, the preference relative to ordinary income is likely be more important than that nominal progressivity.

¹²⁷ Shaviro suggests that tax expenditure analysis could partially defuse the threat of cognitive advantage. See Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 221 (“The big contribution that tax expenditure analysis potentially can make is to counter . . . perceptual bias through a reformulation of our fiscal language.”).

¹²⁸ See RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* 1-3 (2008) (describing a hypothetical scenario in which the director of food services for a public school system realizes that by arranging the way in which food is presented to students can encourage them to make healthier choices).

¹²⁹ Third parties could disseminate corrective information, such as a brief explanation as to why a provision should be — but is not — a direct expenditure. To the extent that it mirrors the role played by the tax expenditure budget does with respect to budgetary advantage, the utility of such information could be limited.

Returning to the tax treaty example, even a perfect tax expenditure budget would not strip tax treaties of their pedigree as the backbone of the international tax regime. Tracing their origins as far back as the League of Nations, tax treaties have long been perceived as the weapon that vanquished the scourge of double taxation.¹³⁰ Given that privileged status, it is easy for voters — and perhaps even policymakers — to draw a false distinction between a generous tax treaty provision and a cash subsidy.

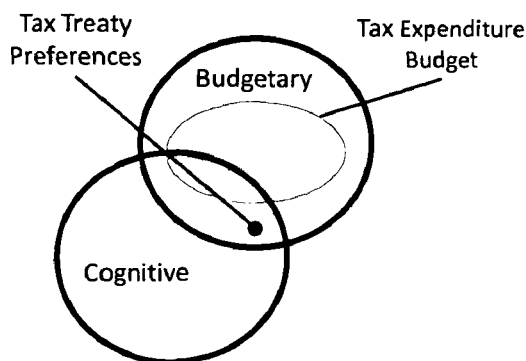
Each bilateral tax treaty in effect asks whether promoting trade and investment between the United States and a potential treaty partner is desirable, eliding the question of whether the cost and distributional implications of doing so are justified. The answer to the former may be yes, even if the answer to the latter would be no.¹³¹ The resulting cognitive advantage, particularly when coupled with the budgetary advantage that tax treaties make possible, allows policymakers to spend indirectly when direct spending would be very difficult.¹³² As illustrated in Figure 2, tax treaties draw strength from both forms of fiscal advantage while remaining absent from the tax expenditure budget.

¹³⁰ See Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT'L L. & POL. 939, 939 (2000) ("The prevailing view regarding tax treaties emphasizes their role as the indispensable mechanism for alleviating double taxation of international transactions.").

¹³¹ The result is a "preference reversal" in which voters find themselves supporting a policy they do not actually favor. See Edward J. McCaffery & Jonathan Baron, *Tax Policy in an Era of Rising Inequality: The Political Psychology of Redistribution*, 52 UCLA L. REV. 1745, 1772 (2005) (using the phrase "preference reversal" to describe that phenomenon).

¹³² See Zelinsky, *Framing Effects*, *supra* note 90 at 799.

Figure 2



3. Procedural Advantage

Whenever two paths from idea to enactment diverge, procedural advantage can take root. Those differences may be the product of parliamentary rules that govern the legislative process.¹³³ For example, both tax expenditures and direct appropriations can be enacted as temporary measures. However, for budget purposes only the temporal limitations applied to tax expenditures are given effect.¹³⁴ Direct expenditures of sufficient size are deemed to be permanent rather than temporary.¹³⁵ The procedural advantage gained by turning temporary cash subsidies into temporary tax expenditures may have helped make “the use of sunset provisions in the tax context . . . rampant.”¹³⁶

The disparities procedural advantage exploits tend to be idiosyncratic. As a result, even if Congress were to eliminate the difference in the treatment of temporary tax and direct expenditures,

¹³³ See Rebecca M. Kysar, *Listening to Congress: Earmark Rules and Statutory Interpretation*, 94 CORNELL L. REV. 519, 525 (2009) [hereinafter Kysar, *Listening to Congress*] (noting that “each house may choose from several different procedural frameworks in enacting legislation”).

¹³⁴ See Kysar, *Lasting Legislation*, *supra* note 55, at 1018-19 (observing that sunset provisions applicable to tax measures are taken into account in producing budget estimates while direct expenditure sunsets are ignored).

¹³⁵ See *id.*

¹³⁶ See *id.* at 1010 (“At the beginning of the most recent century, for example, more than one hundred sunset provisions threatened tax legislation with automatic cessation, including some of the largest tax cuts in American history . . . [I]n the early 1990s, less than two dozen relatively inconsequential tax provisions were set to expire.”).

the procedural advantage evidenced in *Winn* would be unaffected.¹³⁷ A generic pledge by policymakers to extend any procedural constraint on direct spending to tax expenditures would provide a comprehensive remedy for procedural advantage.¹³⁸ Unfortunately, it would rely on a capacity for self-restraint that has long proven elusive.¹³⁹

In addition to generating budgetary and cognitive advantage, as represented in Figure 3, tax treaties also capitalize on a dramatic form of procedural advantage. Quite simply, because they are treaties, they bypass the House of Representatives on their road to ratification.¹⁴⁰ Unlike every other type of tax measure, treaty-based tax expenditures need not originate in the House. Negotiating and ratifying treaties require only the participation of the Senate and the Executive. According to longstanding practice, the House plays no role in the creation of tax treaties.¹⁴¹

¹³⁷ See *Ariz. Christian School Tuition Org. v. Winn*, 131 S. Ct. 1436, 1447-49 (2011). Surrey and McDaniel provide a comprehensive examination of the constitutional aspects of procedural advantage. See SURREY & MCDANIEL, *TAX EXPENDITURES*, *supra* note 112, at 122-41 (tracing relevance of tax expenditure concept in racial and sex discrimination, religious freedom and free speech cases).

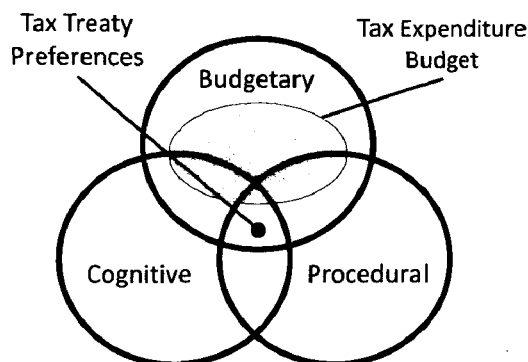
¹³⁸ Such a pledge might require that tax expenditures “be presented as spending in future budgets” so that they “would go through the same legislative processes as do explicit spending proposals, including referral to the appropriate authorization committee.” Kleinbard, *Hidden Hand*, *supra* note 15, at 22 (proposing that “tax expenditures” be made “explicitly on-budget spending programs” so that “the size of government would no longer be hidden” and “all uses of government funds would compete on an open, level playing field”).

¹³⁹ To help provide Congress with the discipline it has long lacked, Kysar suggests a rule of statutory interpretation that would limit the availability of “earmarks.” See generally Kysar, *Listening to Congress*, *supra* note 133 (concluding that Congress lacks the capacity for self-restraint necessary to make its internal anti-earmark rules effective).

¹⁴⁰ See Rebecca M. Kysar, *On the Constitutionality of Tax Treaties*, 38 *YALE J. INT’L L.* (forthcoming 2012), available at <http://ssrn.com/abstract=2034904>.

¹⁴¹ See *id.*

Figure 3



III. REQUIEM FOR A ZOMBIE

Death did nothing to slow the tax expenditure budget's rise as a bureaucrat.¹⁴² As it has for years, it assigns values that, ironically, become more important as the tax expenditure budget's inability to prevent tax expenditure abuse becomes more obvious. This Part offers an alternative to the tax expenditure budget's pursuit of a mathematical solution to the threat of tax expenditure abuse.¹⁴³

Like any autopsy, a detailed examination of the tax expenditure budget's flaws provides valuable insights.¹⁴⁴ One insight applies broadly. Demonstrating not merely that the tax expenditure budget failed to accomplish Surrey's goal, but that it did so despite being a disabling device, urges caution in deploying less robust commitment devices to curb policymakers' bad habits. If the equivalent of burning the ships fails, it would be folly to expect a better result from moving them just a bit further from the shore.

¹⁴² As a commitment device, the tax expenditure budget has been dead for years. See *supra* Part I.B.1.

¹⁴³ Its approach is one answer to the call for a richer, more nuanced means of analyzing tax expenditures that can account for, by way of example, their distributional impact. See Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1, 6 (2011) [hereinafter Sugin, *Distributive Justice*] ("Today's tax reform debate needs a new kind of tax expenditure budget that would better inform policymakers about the nature of the benefits that individuals obtain from tax expenditures, who really enjoys benefits, and who would bear the economic loss that would follow their repeal.").

¹⁴⁴ Admittedly, conducting an autopsy on a zombie may seem a bit cruel.

The other insight relates more narrowly to the question of tax expenditures. Simply put, the tax expenditure budget's demise reflects the failure of a concept rather than its execution. The *attempt* to define tax expenditures — rather than a failure to adequately define them — doomed the tax expenditure budget.¹⁴⁵

To acknowledge that sobering reality without sacrificing vigilance against fiscal advantage, this Part rejects the categorical (“yes or no”) in favor of the gradient (“more or less”).¹⁴⁶ That shift makes it possible to place “the proper choice of emphasis”¹⁴⁷ on the complex motivations driving tax expenditure abuse, producing a “more varied and informative tax expenditure analysis.”¹⁴⁸ Abandoning the effort to craft a one-size-fits-all definition of a tax expenditure (or, for that matter, tax expenditure abuse) represents a tactical retreat rather than a surrender. Like replacing a contested rule with a consensus standard, embracing fiscal advantage analysis facilitates a particularized discourse among those with different perspectives in place of a theoretical foodfight.¹⁴⁹

¹⁴⁵ The “blurry edges” of the tax expenditure category leave little room for hope that a perfect “checklist” definition of tax expenditures could ever serve as a lynchpin for a commitment device. See Coleman & Kay, *Lie*, *supra* note 95, at 27.

¹⁴⁶ Rejecting the checklist for the prototype allows for “degrees of membership” in a given category. See *id.* Put differently, it concedes that just as a table may be a better example of furniture than a lamp or one untrue statement may be considered more of a lie than another, there are both prototypical and marginal vehicles for tax expenditure abuse. See *id.* at 28 (concluding that a “prototypical lie . . . is characterized by (a) falsehood, which is (b) deliberate and (c) intended to deceive”).

¹⁴⁷ See Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 218 (“Tax expenditure analysis is too inherently flexible a tool to have only one or a single set of narrowly defined purposes. . . . The proper choice of emphasis may depend on where one’s interests lie . . .”).

¹⁴⁸ *Id.* at 219 (arguing that a more flexible and informative approach is important but “verges on the radical” in light of “the aftershocks from Surrey’s initial decision to present it as a purely budgetary tool”).

¹⁴⁹ A standard can provide a platform for a subsequent debates, eliminating the need to reach an *ex ante* consensus on a politically or conceptually thorny topic. See Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953, 965 (“Sometimes people can agree on a standard when they cannot agree on its specification. An incompletely specified provision may be the best the political (or judicial) system can do.”). If distributional concerns were paramount, a less formulaic approach would, for example, allow observers to distinguish among tax expenditures with different distributional implications even if their revenue cost were identical.

A. Failure by Definition

Tax policy experts have seen this horror movie before. In the “first great tax shelter war,”¹⁵⁰ faced with the daunting definitional challenge tax shelters presented, tax authorities decided not to try.¹⁵¹ That apparent capitulation cleared a path towards the government’s greatest victory against tax shelters.¹⁵²

Authorities shrank from the fight to define tax shelters and instead identified a characteristic glaringly absent in prototypical shelters and also lacking in more marginal examples. By doing so, they brought an end to a wave of shelters that spanned the 1970s and 1980s.¹⁵³ The passive loss rules made a definition unnecessary by stripping tax benefits from far-away doctors and dentists when they inevitably failed to “materially participate” in the business at the core of the tax shelter.¹⁵⁴

¹⁵⁰ Martin J. McMahon Jr., *Beyond a GAAR: Retrofitting the Code to Rein in 21st Century Tax Shelters*, 98 TAX NOTES 1721, 1737 (2003) (describing the period preceding the adoption of § 469 as “the first great tax shelter war”). The passive loss limitations of § 469 rejected the checklist approach to identifying tax shelters. 26 U.S.C. § 469 (West 2005) (limiting deductions attributable to passive activities). Rather than attempting to create such a checklist, Congress seized on an essential characteristic of tax shelters — the passive involvement of those seeking deductions — to identify the most serious abuses. Generally, the passive loss rules limit the deductions related to activities in which a taxpayer’s involvement is not “regular, continuous, and substantial.” *Id.* § 469(h). The statute makes no attempt to define a tax shelter.

¹⁵¹ A robust definition of a tax shelter has proven elusive. Michael Graetz provides the pithiest: a “deal done by very smart people that, absent tax considerations, would be very stupid.” Tom Herman, *Tax Report*, WALL ST. J., Feb. 10, 1999, at A1. Despite that, identifying a prototypical tax shelter is child’s play. When seven doctors and a dentist overpay for a dusty motel they have never seen in order to cut the tax bills associated their respective practices, it is hard *not* to see the transaction as an abusive tax shelter. See *Estate of Franklin v. Comm’r*, 64 T.C. 752, 767-68 (1975), *aff’d*, 544 F.2d 1045 (9th Cir. 1976) (rejecting taxpayers’ characterization of transaction as a purchase entitling them to deduct interest and depreciation on the Thunderbird Motel).

¹⁵² See Leandra Lederman, *A Tisket, a Tasket: Basketing and Corporate Tax Shelters*, 88 WASH. U. L. REV. 557, 568 (2011) (“The passive activity loss rules were in fact highly effective in combating this breed of shelters because the high-income taxpayers who invested in them did not participate in the underlying activities; they simply invested passively.”).

¹⁵³ A prototypical tax shelter may be best described as a transaction that produces benefits for investors without any effort on their part. The passive loss limitations use that characteristic to identify — and segregate losses produced by — such tax shelters. See 26 U.S.C. § 469 (segregating “passive activity losses” that do not involve the “material participation” of would-be beneficiaries from other income).

¹⁵⁴ Section 469’s success is driven by the fact that it employs tax shelters’ key

Like authorities' early efforts to define a tax shelter,¹⁵⁵ attempts to define a tax expenditure employ what linguists refer to as a "checklist" approach.¹⁵⁶ Both rely on a "list of features" to describe the "set of necessary and sufficient conditions which a thing must satisfy in order to be an instance of the category labeled by the word."¹⁵⁷ Fortunately, the need for that bright-line checklist definition of a tax expenditure is merely an artifact of the doomed effort to prevent tax expenditure abuse with a disabling device.¹⁵⁸

characteristic — investor passivity — to identify tax shelters. Fiscal advantage replicates that feat with respect to tax expenditure abuse. Just as policymakers value tax expenditures for their fiscal advantage potential, busy doctors and dentists prized tax shelters like the Thunderbird Motel purchase precisely because they did not need to devote time to them. Unlike the spirited advertising executive and aspiring farmer in *Nickerson*, most taxpayers wanted no part of the hours of manual labor required to operate a farm or motel. See generally *Nickerson v. Comm'r*, 700 F.2d 402 (7th Cir. 1983) (holding that the Tax Court's finding that profit was not the taxpayer's primary goal in owning a dairy farm was clearly erroneous). Both target abuse without providing a checklist definition of the abusive behavior in question.

¹⁵⁵ See, e.g., Robert J. Peroni, *A Policy Critique of the Section 469 Passive Loss Rules*, 62 S. CALIF. L. REV. 1, 16 (1988) (describing 1973 proposal to impose a "limitation on artificial accounting losses," which were "defined as 'that portion of any loss, attributable to an activity or related activities, which would disappear if the taxpayer had no accelerated deductions in the current year'").

¹⁵⁶ See Coleman & Kay, *Lie*, *supra* note 95, at 26-27. Tax expenditures present a similar line-drawing dilemma. Traditionally, tax expenditures have been described as subsidies "grafted on to the structure of the income tax proper. . . ." SURREY, *PATHWAYS*, *supra* note 8, at 6. While an easy definition to apply to prototypical tax expenditures, this definition spawns endless disagreements in other cases. The lack of consensus regarding the contours of an ideal — subsidy-free — income tax makes it hard to distinguish interloper from unwitting host. See Bittker, *supra* note 14, at 249 (noting that to calculate a tax expenditure budget "we must first construct an ideal or correct income tax structure").

¹⁵⁷ Coleman & Kay, *Lie*, *supra* note 95, at 26. The category may be expansive or may only refer to a "single 'sense'" of a concept. *Id.* at 26. The traditional definition is broad while newer approaches define tax expenditures in various senses. The original formulation wielded rhetorical firepower but served as a Rorschach test for an observer's attitude towards tax incentives. See Thuronyi, *supra* note 63, at 1158 ("In a rhetorically brilliant move, Surrey argued that certain tax provisions should not be considered tax provisions. Rather, these provisions, which Surrey defined as 'tax expenditures,' were in the nature of government spending programs that happened to be administered through the tax laws."). Alternative formulations have attempted to obviate that failure by calving more tightly focused definitions from the generic version. That approach renders the tax expenditure concept so technical as to deepen rather than dissipate the fog of confusion that has long surrounded the concept. See *supra* notes 62-64 and accompanying text.

¹⁵⁸ See Weisbach & Nussim, *supra* note 61, at 976 ("Surrey's arguments . . . generally condemn tax expenditures, so such labeling becomes extremely important. Being put on the tax expenditures list indicates that a provision is a subsidy or

B. *An End to the Foodfight*

Ending the first great tax shelter war did not require policymakers to distill the entire universe of potential tax shelters — from dusty motels to chinchilla farms — down to a single definition. Instead, the answer proved to be the identification of an attribute that made tax shelters objectionable.¹⁵⁹ For tax shelters, the solution was sloth. Taxpayers failing to satisfy a material participation threshold sacrificed their ability to offset tax shelter losses against unrelated income.

Fiscal advantage may not be one of the seven deadly sins, but in the tax expenditure context it might be even worse. Voters can identify and, should they choose to do so, punish politicians guilty of pride, greed, or envy, but the power of fiscal advantage derives from its capacity to bamboozle the public. Policymakers exploit fiscal advantage to camouflage fiscal largesse, robbing voters of their ability to enforce fiscal discipline, violating notions of distributional fairness or even skirting constitutional barriers.

1. Tax Apps

In recent years, the question of why tax expenditures deserve to be condemned has become an important subtext of the scholarly debate over whether tax expenditures deserve to be condemned. The orthodox view among tax scholars has long denigrated tax expenditures.¹⁶⁰ That skepticism can be traced to Surrey.¹⁶¹ In Surrey's view, tax expenditures were misbegotten government programs that policymakers would not "be willing to defend in substantive terms were the programs cast as direct expenditure programs"¹⁶² For Surrey the tax expenditure label was not neutral, but pejorative. That view remains dominant — but not universal — among tax experts.

government largesse, while staying off that list indicates that a provision has the patina of good tax policy.").

¹⁵⁹ See Steven A. Dean & Lawrence M. Solan, *Tax Shelters and the Code: Navigating Between Text and Intent*, 26 VA. TAX REV. 879, 880-81 (2007) (describing process by which passive loss rules identified non-prototypical tax shelter transactions in order to disallow tax shelter losses).

¹⁶⁰ See Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison With Direct Government Expenditures*, 83 HARV. L. REV. 705, 737 (1970) [hereinafter Surrey, *Tax Incentives*] (arguing that "existing tax incentives represent expenditures of funds that in many cases should be dispersed directly").

¹⁶¹ See Shaviro, *Rethinking Tax Expenditures*, *supra* note 1, at 187-88 (describing Surrey as tax expenditure analysis's "original U.S. proponent").

¹⁶² Surrey, *Tax Incentives*, *supra* note 160, at 727.

At its core the tax expenditure concept merely highlights the equivalence between the two basic instruments of fiscal policy. Spending and taxation represent two distinct valves on the flow of funds between government and the public. Loosely speaking, adjustments made to one could offset changes made in the other. That means a jurisdiction could compensate for a \$1,000 increase in the tax burden on each citizen by increasing per capita spending by the same amount.

Obviously, tax and spending policies are fraternal rather than identical twins. They have much in common, but few would be fooled by a substitution of one for the other. Differences in timing and in the distribution of burdens and benefits, for instance, make it clear that the relationship between tax and spending policies is complex.¹⁶³ The more difficult question is whether those differences give one fiscal instrument an inherent edge over the other.

In theory, the answer is a simple no. One could, for example, imagine a substantively identical college tuition subsidy assuming either the form of a tax incentive administered by the Internal Revenue Service or a direct expenditure administered by the Department of Education.¹⁶⁴ In the real world, structural differences across bureaucracies produce significantly different results for tax and direct expenditures.¹⁶⁵

A resonant example of such a difference is that social welfare agencies typically measure a potential beneficiary's eligibility over short intervals rather than the annual periods traditional in the tax context.¹⁶⁶ For a would-be recipient, even the potential for a brief delay in the availability of subsistence aid produced by relying on the

¹⁶³ See Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 582 (1995) (noting tension between tax and spending programs reflected in efforts to reconcile the annual period employed in the tax context and the shorter periods traditional in poverty relief programs); *Federal Spending Received Per Dollar of Taxes Paid by State, 2005*, TAX FOUND. (Oct. 9, 2007), <http://www.taxfoundation.org/research/show/266.html> (showing the dramatic geographic differences in federal spending per dollar of federal tax paid — in 2005, New Mexico, for example, received more than twice as much in spending for each dollar of federal tax paid than New Jersey).

¹⁶⁴ See Weisbach & Nussim, *supra* note 61, at 962-63 (describing alternative tax and direct spending strategies for implementing a college subsidy).

¹⁶⁵ Alstott notes that concerted efforts have been made to alleviate the timing problem she describes, but that the mechanism designed to alleviate the hardship was "rarely used". See Alstott, *supra* note 163, at 581.

¹⁶⁶ See *id.* at 581-84 (observing difficulty of ameliorating differences arising from this type of "underlying institutional dilemma").

tax bureaucracy could be significant. Eliminating those asymmetries can be surprisingly difficult.¹⁶⁷

Returning to the hypothetical college subsidy, the tax system is likely to be an administratively suboptimal tool for aiding needy students. On the other hand, piggybacking on the existing tax infrastructure creates the potential for significant efficiencies. In an extreme case, a tax expenditure could replace two bureaucracies with one.¹⁶⁸ From one point of view, which approach would best serve the needs of students — and the public interest — would depend on an objective comparison of the institutional alternatives. Here, borrowing a leaky bucket (i.e., the tax system) to subsidize education in order to minimize administrative costs might be the better option. Depending on the rate of the leaks and the likely costs of creating a bespoke bucket, using a tax expenditure might represent a sound policy choice.¹⁶⁹

From this institutional choice perspective, a policymaker is presented with the same banal choice as a stargazer deciding whether to add an “app” to her smartphone or to buy an equivalent, single-purpose product. Obviously, a celestial navigation app takes up less space in a pocket than a spiral-bound sky atlas.¹⁷⁰ Nevertheless, even if ideal for the casual user, the app might not be the right fit for a serious stargazer, particularly if her favorite spot lacks reliable mobile phone service or convenient outlets. Likewise, a policymaker may choose or reject a tax expenditure as a tool for implementing a given policy after weighing the costs and benefits of each alternative.

¹⁶⁷ See *supra* note 165 and accompanying text.

¹⁶⁸ See Weisbach & Nussim, *supra* note 61, at 962 (explaining that “[s]etting up” a direct college subsidy “program would be complex and would take significant resources” but that “a similar program could be implemented through the tax system by allowing individuals to subtract or add the same amounts to their taxes”).

¹⁶⁹ See *id.* at 981 (characterizing the choice between a direct spending welfare program and a similar tax program as a “tradeoff . . . between the simplicity benefits of” bureaucratic economies of scale and “the accuracy benefits of” creating a dedicated administrative infrastructure).

¹⁷⁰ The popular SkyVoyager iPhone application could replace an old-fashioned spiral-bound sky atlas by “accurately show[ing] the sky from anywhere on Earth, at any time up to 100 years in the past or future.” *Compare Products, SkySafari 3- for iPhone, iPad, and iPod Touch*, SOUTHERN STARS, <http://www.southernstars.com/products/skysafari/index.html> (last visited Aug. 27, 2012) (star chart application for iOS), with ROGER SINOTT, *SKY & TELESCOPE'S POCKET SKY ATLAS* (2006) (spiral bound sky atlas).

2. Tax Expenditure Abuse

Although it was offered in part as a refutation of Surrey's position, Weisbach and Nussim's app view of tax expenditures — seeing tax expenditures as just another arrow in policymakers' quiver — is not irreconcilable with “Surrey's substantive argument . . . that tax expenditures are an inferior method of implementing policy.”¹⁷¹ Read differently, Surrey's skepticism might not insist that they are inherently harmful, but that these tax apps represent an avenue through which inferior policies are too easily and therefore too often implemented.¹⁷² In other words, because they are fiscal superconductors they lend themselves all too easily to abuse in the hands of policymakers, frequently producing policies that would not survive as direct expenditures. The result is a tax code left as cluttered as an app-filled smartphone.¹⁷³

While the tax expenditure budget has stoked a great deal of controversy over the years, few have challenged Surrey's skepticism with respect to tax expenditures. Weisbach and Nussim's insistence that each potential tax expenditure be judged objectively on its own merits represents the most recent noteworthy challenge.¹⁷⁴ A decade before, Zelinsky went further, arguing that tax expenditures might actually be less prone to abuse than direct expenditures.¹⁷⁵ He noted that funneling a wide variety of fiscal choices through one narrow gateway — i.e., the Congressional tax writing committees — would facilitate improved oversight by the media and the public.¹⁷⁶

¹⁷¹ See Weisbach & Nussim, *supra* note 61, at 973. The authors concede that tax expenditures “possess . . . traits that tend to make them open to inefficiency or abuse.” *Id.* at 978.

¹⁷² See Surrey, *Tax Incentives*, *supra* note 160, at 726-27 (“The whole approach to tax incentives — one of rather careless or loose analysis, failure to recognize that dollars are being spent, or to recognize the defects inherent in working within the constraints of the positive tax system — has produced very poor programs.”). Even if these tax “apps” are not always inferior, some tax apps would fare poorly as direct expenditures. Likewise, many popular smartphone apps would fail as stand-alone products. There is no reason that the same song-identifying capacity that has made Shazam and SoundHound so popular could not have been produced independent of smartphone technology. Such a device might even be better suited to the task. Nevertheless, the expense of producing it — and the bother of carrying it with us — would make it immensely impractical.

¹⁷³ See Weisbach & Nussim, *supra* note 61, at 981.

¹⁷⁴ See *id.* at 974.

¹⁷⁵ See Zelinsky, *Gucci Gulch*, *supra* note 92, at 1194 (speculating that the procedural advantage facilitated by the Supreme Court decisions preceding *Winn* may pose little threat to the Establishment Clause).

¹⁷⁶ See *id.* (“Because of the more numerous and diverse interests to which they are

More often, scholars have concluded that tax expenditures should be presumed suspect.¹⁷⁷ Tax policy purists take an even stronger position than Surrey himself.¹⁷⁸ While Surrey argued that “many” tax subsidies should be replaced with direct expenditures,¹⁷⁹ others see tax subsidies as “almost always . . . inferior to analogous cash outlays.”¹⁸⁰ By introducing extraneous provisions into the tax law, they argue, even a tax expenditure that withstands Weisbach and Nussim’s institutional choice scrutiny has a detrimental impact on compliance and enforcement.¹⁸¹

The thread that unites these disparate views of tax expenditures is a shared conviction that tax expenditures can be — and are — abused. Of course, these differing perspectives on tax expenditures do ultimately part ways. The point at which they diverge most dramatically is in their assessment of the urgency of the threat tax expenditures pose.¹⁸² As detailed in the next subpart, the fiscal

subject and their greater visibility to the public, the committees and agencies that design and administer tax subsidies are less prone to capture by clientele groups, conform more closely to pluralist norms, and are better positioned to make decisions informed by expertise than their direct expenditure counterparts.”).

¹⁷⁷ That suspicion is a function of the “indefensible consequences that result when Congress uses special deductions, exemptions and other tax mechanisms to achieve its spending goals.” McIntyre, *supra* note 6, at 79-80.

¹⁷⁸ Those purists may be more a straw man than a reality. Zelinsky, for example, invokes the “Surrey school’s invariable preference for direct government outlays” but does not provide specific evidence of that invariable preference. See Zelinsky, *Gucci Gulch*, *supra* note 92, at 1165.

¹⁷⁹ See Surrey, *Tax Incentives*, *supra* note 160, at 737.

¹⁸⁰ Fleming & Peroni, *Reinvigorating*, *supra* note 5, at 441 (attributing that vehemence to Surrey).

¹⁸¹ See Fleming & Peroni, *Divorced*, *supra* note 66, at 179 (concluding that tax expenditure analysis provides “a much needed restraining effect on the strong impulse by Congress to enact governmental programs in the form of tax incentives and subsidies that would not pass muster under a cost/benefit analysis as direct spending programs and that would have a detrimental effect on income tax compliance and enforcement”).

¹⁸² At the risk of overgeneralization, commenters can be divided into two camps. The first insists that Congress must somehow be “restrain[ed]” and that the tax expenditure budget is the mechanism to provide that restraint. See Fleming & Peroni, *Reinvigorating*, *supra* note 5, at 561 (concluding that the tax expenditure budget is “meant to have a salutary restraining effect on the strong impulse by many members of Congress to engage in obfuscation by enacting governmental programs in the form of tax incentives that they would never advocate as direct expenditure programs”). The second sees the tax expenditure budget primarily as an informational tool. See, e.g., Roin, *supra* note 4, at 608 (“The tax expenditure budget was developed as . . . an informational aid.”).

advantage concept permits skeptics and true believers alike to articulate their profoundly different views.

C. *Prototypical and Marginal Fiscal Advantage Vehicles*

The tax budget expenditure budget lacks the capacity to produce an accurate assessment of the risk of tax expenditure abuse, instead offering a crude cost estimate. In its original incarnation, no more precision would have been needed. After all, a truly successful tax expenditure budget would have been a blank page!

The two illustrations offered below demonstrate just how poorly suited the (undead) tax expenditure budget is for its new life. Fiscal advantage analysis delivers neither a bright-line test for tax expenditure abuse nor a precise estimate of the costs of their misuse. Unlike the tax expenditure budget, it does not labor under the delusion that it can. The tax expenditure budget falsely ascribes no risk to the use of tax treaties while reaching the dubious conclusion that the mortgage interest deduction presents a high risk of abuse. Neither assessment holds water.

1. Double Tax Treaties

It may be credulous to believe that our political process generally produces laws that serve the public interest.¹⁸³ A prototypical beneficiary of fiscal advantage provides even more reason for skepticism.¹⁸⁴ To paraphrase a tongue-in-cheek definition of a tax shelter, an abusive tax expenditure is one created by smart people that, stripped of the benefits fiscal advantage, would be politically stupid.¹⁸⁵ Buoyed by an abundance of fiscal advantage, even the most abusive tax expenditure may stand a disconcertingly good chance of being enacted.

The political tailwind that fiscal advantage provides increases the risk that, in Surrey's words, government actors will create tax rules that they would not "defend in substantive terms were the programs cast as direct expenditure programs."¹⁸⁶ One particularly striking

¹⁸³ See Roin, *supra* note 4, at 605 ("Some amount of rent-seeking is endemic to all societies and all political systems, and perhaps to all human relationships.").

¹⁸⁴ This was Surrey's core observation with respect to budgetary advantage. As Weisbach and Nussim put it, budgetary advantage can "skew outcomes." Weisbach & Nussim, *supra* note 61, at 977.

¹⁸⁵ See *supra* note 151 and accompanying text.

¹⁸⁶ Surrey, *Tax Incentives*, *supra* note 160, at 727.

example of that phenomenon is the double tax treaty.¹⁸⁷ In the years since Surrey concluded that treaty-based tax preferences deserved to be classified as tax expenditures,¹⁸⁸ the drive to strengthen the U.S. tax treaty network has continued unabated.¹⁸⁹ Had his view gained traction — it unequivocally did not — it is possible to imagine a less auspicious trajectory for double tax treaties.

Because of their exclusion from the tax expenditure budget, the double tax treaty's fiscal advantage is great. Since treaty-based tax preferences fall entirely outside the tax expenditure budget, viewed from that traditional vantage point treaties appear wholly innocuous.¹⁹⁰ Whereas the tax expenditure budget blithely ignores tax treaties, as detailed in Part II and depicted in Figure 3, even Surrey's conservative take on tax treaties reveals not only budgetary, but also cognitive and procedural advantage.¹⁹¹

2. The Mortgage Interest Deduction

The tax expenditure budget starkly understates the threat of abuse posed by treaty-based tax preferences. It also overstates the risk of tax expenditure abuse posed by others. The deduction for home mortgage interest exemplifies that tendency. The tax expenditure budget's treatment of the deduction for home mortgage interest presents the mirror image of the occlusive dynamic described above, transforming the deduction into a fiscal scapegoat.

¹⁸⁷ Double tax treaties aid multinational business by alleviating the multiple national taxes that might apply to cross-border income. See Dagan, *supra* note 130, at 981.

¹⁸⁸ See *supra* note 112 and accompanying text.

¹⁸⁹ That relentless drive to expand treaty preferences has unfolded in the absence of evidence that double taxation remains a threat. In fact, while the "original problem of international taxation" was "double taxation . . . nowadays the decisive issue is . . . the enforcement problem inherent in double non-taxation." THOMAS RIXEN, *THE POLITICAL ECONOMY OF INTERNATIONAL TAX GOVERNANCE* 200 (2008).

¹⁹⁰ As Weisbach & Nussim put it, their exclusion from the tax expenditure budget gives them the "patina of good tax policy." Weisbach & Nussim, *supra* note 61, at 976.

¹⁹¹ See *supra* Figure 3. In the years since McDaniel's call to heed the costs of tax treaty preferences went unanswered, the consequences of that failure have become evident. Policymakers of all stripes have long lamented the impact of the relatively high U.S. corporate tax rate on U.S. competitiveness. More recently, the focus has fallen on the disproportionate impact of those high nominal rates on primarily domestic enterprises (e.g., Walmart) relative to global businesses (e.g., Google). Had the fiscal advantage — budgetary, cognitive, and procedural — associated with treaty-based preferences not gone unacknowledged, a lower corporate rate might have trumped treaties. If the concerns described above have any merit, that would have meant a more pro-competitive and equitable corporate tax.

Although it is often seen as the embodiment of all the ills associated with tax expenditures, when compared with treaties, the fiscal advantage it enjoys seems surprisingly modest.¹⁹² The tax expenditure budget itself is partly to blame. Because the revenue loss linked to the deduction has long been identified and quantified, the home mortgage interest deduction provides a poor vehicle for budgetary advantage.¹⁹³ Viewed solely in terms of budgetary advantage, one could reasonably ask whether the home mortgage interest deduction provides any fiscal advantage.¹⁹⁴ It is certainly inappropriate to conclude that the dollar figure the tax expenditure budget assigns to it provides an accurate measure of the mischief it represents.¹⁹⁵

Beyond budgetary advantage, the mortgage interest deduction seems to derive relatively little benefit from the remaining two forms of fiscal advantage. As a practical matter, cognitive advantage does not seem particularly important. It is not as difficult, in other words, to imagine a direct subsidy for homeowners as it would be to envision Kornhauser's hypothetical checks-to-hedge-fund-managers program. Because it draws such a spotlight on the measure, one could even argue that the deduction's scapegoat status has eliminated any conceivable cognitive advantage.

Finally — particularly when compared to tax treaty preferences — the mortgage interest deduction provides scant opportunity for procedural advantage. Because it resides in an ordinary statute rather than a treaty, making the home mortgage interest deduction more

¹⁹² To an extent, it provides precisely the sort of regressive subsidy that troubled Surrey. See Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347, 1361 (2000) ("The home mortgage interest deduction thus constitutes an upside-down subsidy — the greater the need, the smaller the subsidy."). The precise distributional impact of the mortgage interest deduction is, of course, complicated. See, e.g., Sugin, *Distributive Justice*, *supra* note 143, at 22 (exploring distributional consequences of repealing the mortgage interest deduction).

¹⁹³ The prominence granted this particular tax expenditure by the tax expenditure budget gives it a uniquely high profile. See Weisbach & Nussim, *supra* note 61, at 970 ("In many cases, it is hard to believe that tax expenditures are less visible than other government programs. For example, there is little reason to believe that the home mortgage interest deduction is less visible than, say, the implicit guarantee the government provides to Fannie Mae and Freddie Mac to lower mortgage costs.").

¹⁹⁴ Although imperfections in the tax expenditure budgeting process inevitably create opportunities for some fiscal sleight-of-hand, many years of experience both with the deduction itself and in accounting means that such opportunities should be limited.

¹⁹⁵ It would be disingenuous, for example, to argue that the home mortgage interest deduction represents ninety billion dollars worth of rent-seeking in 2010. See ESTIMATES BY BUDGET FUNCTION, *supra* note 107, at 34-54.

generous would require the approval of both the House and the Senate. Moreover, its very popularity forecloses other opportunities for procedural advantage. It would take a brave legislator indeed to impose a sunset on the home mortgage interest deduction.¹⁹⁶

D. *Gauging the Risks of Tax Expenditure Abuse*

Tax treaties present a more prototypical source of fiscal advantage — and a greater risk of abuse — than the home mortgage interest deduction. The tax expenditure budget concludes — and, not coincidentally, conventional wisdom holds — just the opposite. Rather than merely being impotent, that contrast suggests that the tax expenditure budget does affirmative harm.¹⁹⁷ As the tax expenditure budget's earliest critic put it: "Halftruths are often more deceptive than silence."¹⁹⁸ Twisting tax expenditure analysis into a commitment device may have hurt the cause of limiting tax expenditure abuse more than it helped.¹⁹⁹

1. *Lies and Halftruths*

The line item represented by the home mortgage interest deduction, for example, tells us less than nothing about the mischief it causes. As described above, although the large dollar figure the tax expenditure budget attributes to the deduction hints at an unusually high threat of abuse, it actually ensures that just the opposite is true. At the other end of the spectrum, the advantage permitted by the Winn tax expenditure may have a cost that far exceeds the dollar amount listed on Arizona's tax expenditure budget.²⁰⁰

¹⁹⁶ By sunseting the mortgage interest deduction, legislators could understate its long-term cost in the way they could not with a direct expenditure. In doing so, they would also stand a good chance of abbreviating their political careers. See Mann, *supra* note 192, at 1348 ("The home mortgage interest deduction is America's favorite itemized deduction.").

¹⁹⁷ Even the most zealous deficit hawks might, for example, ignore tax expenditures merely because the tax expenditure budget omits them. That is true even though they might prefer to impose higher taxes on cross-border transactions rather than reducing or eliminating the home mortgage interest deduction.

¹⁹⁸ See Bittker, *supra* note 14, at 259.

¹⁹⁹ In other words, in weaponizing tax expenditure analysis, Surrey sacrificed a significant amount of clarity. See Shavero, *Rethinking Tax Expenditures*, *supra* note 1, at 189 ("Unfortunately, Surrey, in promoting his version of tax expenditure analysis, undermined this clarifying function by also enlisting the analysis as a weapon in battles over what the government's distribution should look like — in particular, his support for progressivity and comprehensive income taxation.").

²⁰⁰ See *supra* text accompanying note 78.

The tax expenditure budget's fixation on budgetary advantage and on a checklist definition of a tax expenditure has proven counterproductive. Ultimately, it is just as unsatisfying as defining a "lie" as "the idea of saying something that is untrue."²⁰¹ Adopting the same narrow view of tax expenditure abuse cannot help but lead to similarly unsatisfying results. Although budgetary advantage poses a serious threat to fiscal accountability, procedural and cognitive advantage can pose a greater danger. Embracing a prototype view of tax expenditure abuse makes it possible to more accurately and comprehensively describe the risks fiscal advantage presents.

2. Three Dimensions are Better than One

Burdened with the disadvantages of being both an accountant and dead, the tax expenditure budget hardly seems the right tool for the complex task of measuring tax expenditure abuse risks. In the same vein, plunging a chain into a pool of water may reveal its depth, but that information must be supplemented to accurately calculate the volume it contains.²⁰² The tax expenditure budget likewise only provides a crude measure of the risk of tax expenditure abuse, taking account of only one of three — or more — relevant dimensions of fiscal advantage.²⁰³

In a perfect world, flawed gimmicks like the tax expenditure budget could be discarded. In our decidedly second-best world, it would be rash to throw away any tool of budgetary accountability that might be productively recycled. Fortunately, the fiscal advantage concept bridges the gap between the rudimentary tool available and the demanding task of measuring the abuse potential posed by a diverse array of tax expenditures.

Put differently, the fiscal advantage concept offers the equivalent of a simple formula that allows a chain to measure volume as well as distance.²⁰⁴ The above discussion of tax treaties and the mortgage interest deduction illustrates how that might be accomplished. The tax

²⁰¹ See Coleman & Kay, *Lie*, *supra* note 95, at 28 (noting that "people frequently say things that are not true but which nonetheless are not called lies — e.g., when the speaker is sincerely trying to convey what he believes to be true information. Honest mistakes and innocent misrepresentations occur frequently, and are not labeled lies.").

²⁰² If that pool is cylindrical, the relevant formula would be $\text{volume} = \pi r^2 h$. That formula makes it possible to determine the amount of water the cylinder contains even if no volume measurement device is available.

²⁰³ This Article only describes three forms of fiscal advantage. Other takes on fiscal advantage could slice it up along different lines or even into more slices.

²⁰⁴ See *supra* text accompanying note 202.

expenditure budget provides a point of departure, presenting data that can then be manipulated along with the additional information revealed through fiscal advantage analysis to provide a comprehensive picture of tax expenditure abuse risks.

The resulting assessments would be more ordinal than cardinal, indicating for example whether a tax expenditure is a relatively prototypical or marginal vehicle for tax expenditure abuse. Tax treaties would be categorized as posing a high risk of abuse while the mortgage interest deduction poses only a modest threat. Far less precise than the measures offered by the tax expenditure budget (\$90 billion worth of malfeasance for the mortgage interest deduction and \$0 for tax treaties), such an approach would nevertheless present a much more accurate indication of where accountability gaps exist.

3. Assessing Reform Proposals

No less important, fiscal advantage provides a vocabulary for comparing the relative advantages of potential alternatives to the tax expenditure budget.²⁰⁵ For example, scholars have proposed eliminating the stand-alone tax expenditure budget along with all budgetary distinctions between tax and direct expenditures.²⁰⁶ The result would be a unitary budget that includes tax expenditures, accounting for them no differently than cash outlays by the federal government.

Such a change would further limit budgetary advantage by making some shortcomings of the tax expenditure budget irrelevant.²⁰⁷ A unitary approach would curb opportunities for procedural advantage. For example, incorporating tax expenditures in the budget proper would cause tax expenditure sunset provisions to be ignored just as

²⁰⁵ At the same time, reforms of the tax expenditure budget could make fiscal advantage analysis more useful. For example, the renewed emphasis on the distributional impact of tax expenditures that Linda Sugin has called for could help observers identify instances in which cognitive advantage has produced particularly unappealing results. See Sugin, *Distributive Justice*, *supra* note 143.

²⁰⁶ See, e.g., Elizabeth Garrett, *Rethinking The Structures of Decisionmaking in the Federal Budget Process*, 35 HARV. J. ON LEGIS. 387 (1998) (suggesting a revised “functional” budget mechanism that would treat tax expenditures no different than direct expenditures); Kleinbard, *Hidden Hand*, *supra* note 15, at 22 (“The most important step would be to require that all tax expenditures be recorded as spending for all budget purposes.”).

²⁰⁷ For example, the ordinary budget takes behavioral responses into account while the tax expenditure budget does not. Moving tax expenditures from what are essentially the footnotes into the text of the budget would produce a more accurate estimate of their budgetary cost. See *supra* note 115 and accompanying text.

they are when imposed on direct expenditures.²⁰⁸ Likewise, injecting tax expenditures directly into the budget could make them even more difficult to ignore, making strides towards taming cognitive advantage.²⁰⁹ That said, profound flaws would persist.²¹⁰

The vocabulary of fiscal advantage does not offer a road map to eliminating tax expenditure abuse. Instead, it presents a set of tools that make it possible to clearly perceive and articulate the threat posed by individual tax expenditures and to assess the promise of alternatives to the tax expenditure budget. Here, fiscal advantage offers a means of gauging the benefits of a unitary budget, suggesting that it addresses some, but not all, of the shortcomings of the tax expenditure budget.

CONCLUSION

Preoccupation with the tax expenditure budget has itself become a bad habit. Breaking free of the false precision offered by the tax expenditure budget is essential, but will by no means be easy. Acknowledging that no tax expenditure budget can, on its own, contain tax expenditure abuse represents an important first step. The next, developing a more complete understanding of the unique properties these fiscal superconductors possess and the abuses they facilitate, demands a new vocabulary.

Embracing fiscal advantage analysis would go a long way towards providing fiscal accountability. Budgetary, cognitive, and procedural advantage permit a more nuanced approach to examining tax expenditure abuse that will never produce the clear picture in dollars and cents that the tax expenditure budget purports to provide. Fiscal advantage analysis would, however, focus attention on the tax rules that pose the gravest threats to accountability and restraint.

²⁰⁸ See Kysar, *Lasting Legislation*, *supra* note 55, at 1009.

²⁰⁹ See *supra* note 120 and accompanying text.

²¹⁰ Tax treaties would remain budget phantoms. See *supra* note 112 and accompanying text.