



July 2016

# TAX EXPENDITURES

## Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight

Accessible Version

# GAO Highlights

Highlights of [GAO-16-622](#), a report to congressional requesters

## Why GAO Did This Study

Tax expenditures—special credits, deductions, and other tax provisions that reduce taxpayers’ tax liabilities—represent a substantial federal commitment. If Treasury’s estimates are summed, an estimated \$1.23 trillion in federal revenue was forgone from the 169 tax expenditures reported for fiscal year 2015, an amount comparable to discretionary spending. Tax expenditures are often aimed at policy goals similar to those of federal spending programs.

GAO was asked to identify the extent to which tax expenditures are incorporated into federal budget processes. This report (1) compares the treatment of tax expenditures and other spending in federal budgeting processes; (2) evaluates the extent to which OMB and agencies have identified tax expenditures’ contributions to agency goals; and (3) examines options to further incorporate tax expenditures in federal budgeting processes. To address these objectives, GAO reviewed agency budget documents, OMB guidance, prior GAO reports, and performance plans and reports available as of January 2016 for all 24 CFO Act agencies. GAO also held a roundtable discussion with budget and tax experts to examine options for further incorporating tax expenditures into budgeting processes.

## What GAO Recommends

GAO recommends that OMB, in collaboration with Treasury, work with agencies to identify which tax expenditures contribute to agency goals. OMB generally agreed with GAO’s recommendation.

View [GAO-16-622](#). For more information, contact Heather Krause at (202) 512-6806 or [krauseh@gao.gov](mailto:krauseh@gao.gov).

July 2016

## TAX EXPENDITURES

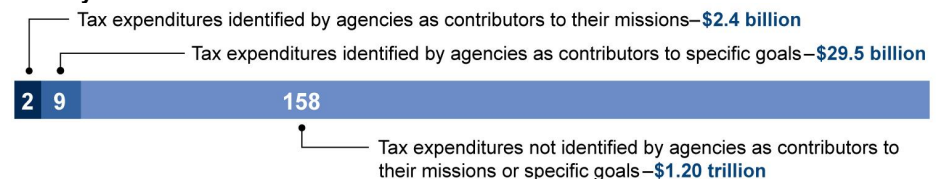
### Opportunities Exist to Use Budgeting and Agency Performance Processes to Increase Oversight

## What GAO Found

Federal budget formulation processes include fewer controls and reviews, and provide less information on tax expenditures—which represented an estimated \$1.23 trillion in forgone revenues in fiscal year 2015—than for discretionary or mandatory spending. For example, in the President’s budget, tax expenditure revenue loss estimates are presented separately from related spending, making their relative contributions toward national priorities less visible than spending programs. Likewise, only proposed tax expenditures or those that expire are subject to review within congressional budget processes, similar to mandatory spending. Existing, non-expiring tax expenditures are not subject to such review.

The Office and Management and Budget (OMB) and agencies have made limited progress identifying tax expenditures’ contribution to agency goals. As of January 2016, 7 of the 24 Chief Financial Officer (CFO) Act agencies identified tax expenditures as contributors to their agency goals—as directed in OMB guidance—or agency missions. The tax expenditures they identified accounted for only 11 of the 169 tax expenditures included in the President’s Budget for Fiscal Year 2017, representing an estimated \$31.9 billion of \$1.23 trillion in forgone revenues for fiscal year 2015. Based on interviews with agencies and reviewing past GAO work, GAO found that a lack of clarity about agencies’ roles leads to inaction in identifying tax expenditures that contribute to agency goals. To address this, OMB guidance previously stated that it would work with the Department of the Treasury (Treasury) and other agencies to identify where tax expenditures align with agency goals. OMB removed that language in June 2015, citing capacity constraints. Without additional OMB and Treasury assistance, agencies may continue to have difficulty identifying whether, or which of, the remaining 158 tax expenditures—representing \$1.20 trillion in forgone revenues—contribute to their goals.

**Tax Expenditures Identified by Agencies As Contributing to Agency Goals or Missions, As of January 2016**



Source: GAO review of Chief Financial Officer Act agency performance documents. | GAO-16-622

Based on an assessment of budget and tax experts’ input and prior GAO work, GAO found that options to further incorporate tax expenditures into budgeting processes could help achieve various benefits; but policymakers would need to consider challenges and tradeoffs in deciding whether or how to implement them. For example, one option is to require that all, or some subset of, tax expenditures expire after a finite period. This option could result in greater oversight, requiring policymakers to explicitly decide whether to extend more or all tax expenditures. However, this option could lead to frequent changes in the tax code, such as from extended or expired tax expenditures, which can create uncertainty and make tax planning more difficult, as GAO has reported previously.

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## Abbreviations

APG	Agency Priority Goal
CAP	Cross-Agency Priority
CDFI	Community Development Financial Institution
CFO	Chief Financial Officer
DATA Act	Digital Accountability and Transparency Act of 2014
DOE	Department of Energy
EZ	Empowerment Zone
GPRA	Government Performance and Results Act
GPRAMA	GPRA Modernization Act of 2010
HFA	Housing Finance Agency

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HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
JCT	Joint Committee on Taxation
OMB	Office of Management and Budget
OTA	Office of Tax Analysis
PAYGO	Pay-As-You-Go
PIC	Performance Improvement Council
Treasury	Department of the Treasury
USDA	United States Department of Agriculture

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July 7, 2016

The Honorable Bernard Sanders  
Ranking Member  
Committee on the Budget  
United States Senate

The Honorable Patty Murray  
Ranking Member  
Committee on Health, Education, Labor and Pensions  
United States Senate

Tax expenditures—special credits, deductions, and other tax provisions that reduce taxpayers’ tax liabilities—represent a substantial federal commitment. According to the Department of the Treasury (Treasury), in fiscal year 2015 there were 169 tax expenditures. These tax expenditures represented an estimated total of \$1.23 trillion in forgone revenue, an amount similar to total discretionary spending.<sup>1</sup> Tax expenditures often aim to achieve policy goals similar to those of federal spending programs. For example, some tax expenditures are intended to encourage economic development in disadvantaged areas, finance postsecondary education, or stimulate research and development. If well designed and effectively implemented, tax expenditures can be an effective tool to further national priorities.

Our prior work has shown that tax expenditures deserve greater scrutiny. In 1994, we reported that policymakers have few opportunities to make explicit comparisons or trade-offs between tax expenditures and federal spending programs.<sup>2</sup> In 2005, we reported that the entire set of tools the federal government can use to address national objectives—including tax expenditures—should be subject to periodic reviews and reexamination to

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<sup>1</sup>Aggregate tax expenditure estimates must be interpreted carefully because of inherent limitations in the meaning of the summed estimates. The sum of the specific tax expenditure estimates is useful for gauging the general magnitude of revenue forgone through provisions of the tax code, but does not take into account interactions between individual provisions.

<sup>2</sup>GAO, *Tax Policy: Tax Expenditures Deserve More Scrutiny*, [GAO/GGD/AIMD-94-122](#) (Washington, D.C.: June 3, 1994).

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ensure they are achieving their intended purposes, and are designed in the most efficient and effective manner.<sup>3</sup> In that report, we recommended that the Office of Management and Budget (OMB) take several actions to help ensure that policymakers and the public have the necessary information to make informed decisions, and to improve the progress made toward exercising greater scrutiny of tax expenditures; OMB has implemented one recommendation from the report, but has made limited progress on the others.<sup>4</sup>

More recently, the GPRAMA Modernization Act of 2010 (GPRAMA) enhanced the framework to help inform congressional and executive branch decision making in addressing challenges the federal government faces, including the allocation of scarce resources across spending programs and tax expenditures.<sup>5</sup> Key to implementing GPRAMA are the goals that OMB and agencies are to establish to reflect the outcomes or management impact they are trying to achieve. Once established, under GPRAMA or OMB guidance, agencies are also to identify the various federal programs and activities—including tax expenditures—that contribute to these goals.

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<sup>3</sup>GAO, *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined*, [GAO-05-690](#) (Washington, D.C.: Sept. 23, 2005).

<sup>4</sup>Specifically, we recommended that OMB, in consultation with Treasury, (1) resume presenting tax expenditures in the budget alongside other spending to show a truer picture of spending within a mission area; (2) develop and implement a framework for conducting performance reviews of tax expenditures; (3) require that tax expenditures be included in any current or future budget and performance review processes so that tax expenditures are considered along with related outlay programs in determining the adequacy of federal efforts to achieve national objectives; and (4) develop clear and consistent guidance to agencies on how to incorporate tax expenditures in strategic plans, annual performance plans, and performance and accountability reports. Only the final recommendation was implemented. OMB has told us that presenting information on tax expenditures together with related outlay programs is not useful for budgeting, and such a presentation is not part of the congressional budget process. In the President's fiscal year 2012 budget, the administration noted that it planned to focus on addressing some challenges with data availability and analytical constraints so it can work toward crosscutting analyses that examine tax expenditures alongside related spending programs, but subsequent budgets have not provided an update on these efforts.

<sup>5</sup>Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

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You asked us to examine how federal budgeting processes can be improved to provide better information on the fiscal effects of tax expenditures, and to further incorporate tax expenditures into controls over federal budgeting processes. This report (1) describes the extent to which tax expenditures have been incorporated into federal budgeting processes, as compared to discretionary and mandatory spending programs; (2) evaluates the extent to which OMB and agencies have identified the contributions of tax expenditures toward progress made on agency goals; and (3) examines options for further incorporating tax expenditures into federal budgeting processes.

To accomplish our first objective, we reviewed OMB budget guidance, the President's budget for fiscal year 2017, agency and congressional budget documents, and our past work to assess the requirements and treatment of tax expenditures in federal budgeting processes relative to discretionary and mandatory spending. We interviewed OMB staff and Treasury officials about the extent to which tax expenditures are included in federal budget processes. We also conducted interviews with budget officials from three Chief Financial Officer (CFO) Act agencies—the United States Department of Agriculture (USDA), the Department of Energy (DOE), and the Department of Housing and Urban Development (HUD)—that we selected based on the agencies' mission areas aligning with the purposes of selected tax expenditures, and based on our past work. These agency interviews are not generalizable to all 24 CFO Act agencies.<sup>6</sup>

To accomplish our second objective, we analyzed 2014-2018 strategic plans, 2014 performance reports, 2016 performance plans, and 2013 program inventories for all 24 CFO Act agencies. These 80 documents were the most recent available in January 2016, when we conducted this analysis. We used qualitative analysis software to identify whether tax

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<sup>6</sup>The 24 CFO Act agencies, generally the largest federal agencies, are the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, the Interior, Justice, Labor, State, Transportation, the Treasury, and Veterans Affairs, as well as the Agency for International Development, Environmental Protection Agency, General Services Administration, National Aeronautics and Space Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management, Small Business Administration, and Social Security Administration. These agencies are subject to the strategic planning and reporting requirements under the GPRA Modernization Act of 2010.



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expenditures were discussed in each of the 80 documents, and coded whether the agencies identified contributions of tax expenditures to strategic objectives or agency priority goals (APGs) described in their most recent strategic plan, or to their overall mission.<sup>7</sup> We also coded the extent to which agencies measured the impact of tax expenditures on their strategic objectives, APGs, or overall mission. Our coding process for the review involved one coder and an independent reviewer who verified the material coded regarding tax expenditures. Further, we interviewed performance officials at USDA, DOE, and HUD to serve as illustrative examples of agencies' efforts to identify the contributions of tax expenditures toward progress made on agency goals.

To accomplish our third objective, we reviewed our past work and other literature identifying relevant options to further incorporate tax expenditures into budget processes.<sup>8</sup> We also interviewed budget and tax experts, including current Treasury officials and OMB staff, former congressional and OMB staff, former congressional budget directors, and other experts from a range of policy research organizations that represented a wide range of political views. We selected experts for our interviews based on their published literature or having testified to Congress on tax expenditures and federal budgeting, as well as referrals from other experts. We considered options for further incorporating tax expenditures into federal budgeting processes to be within scope if they resulted in greater information or controls over tax expenditures in processes related to executive budget formulation, congressional budget processes, or federal evaluations that inform budget decisions. Based on our review of the literature and interviews, as well as our previous work, we identified five executive and five congressional budgeting options for further review.

To obtain greater insights into these and other options, we conducted a one-day roundtable discussion with eleven experts on the broad benefits and challenges of further incorporating tax expenditures into federal

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<sup>7</sup>APGs are to reflect agencies' highest priorities. The keywords used were credit, deduction, deferral, exclusion, exemption, expenditure, and preferential, as well as the names of specific tax expenditures.

<sup>8</sup>For our literature review, we conducted keyword searches of academic and government literature and other scholarly materials using databases such as ProQuest and ABI/Inform.

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budgeting processes, as well as the benefits and limitations of specific options and issues that members of Congress would need to consider when evaluating their merits. We selected experts for the roundtable discussion based on their professional experiences with budget and tax issues in various capacities, as well as on their knowledge on budget and tax issues, as demonstrated through published articles, congressional testimonies, and referrals from other experts. Experts voted on which of the ten options they wanted to discuss, and also identified other potential options during the discussion. We conducted a thematic analysis of the transcript of the roundtable discussion and summaries of our expert interviews to identify common patterns and ideas. Although these results are not generalizable to all experts with relevant expertise, and do not necessarily represent the views of all the experts that attended our roundtable, this discussion provided greater insight on the potential benefits, challenges, and design considerations of each option. Based on this analysis, our prior work, and agency interviews, we identified six options and related design considerations that we discuss in this report.

We conducted this performance audit from August 2015 to July 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### Definition and Objectives of Tax Expenditures

Tax expenditures are tax provisions that are exceptions to the normal structure of individual and corporate income tax necessary to collect federal revenue.<sup>9</sup> They represent revenue losses—the amount of revenue that the government forgoes—resulting from federal tax provisions that grant special tax relief for certain kinds of behavior by taxpayers or for taxpayers in special circumstances. For example, some tax expenditures

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<sup>9</sup>The concept of tax expenditures extends beyond the income tax. Tax expenditures also exist for other types of taxes, such as excise and payroll taxes.

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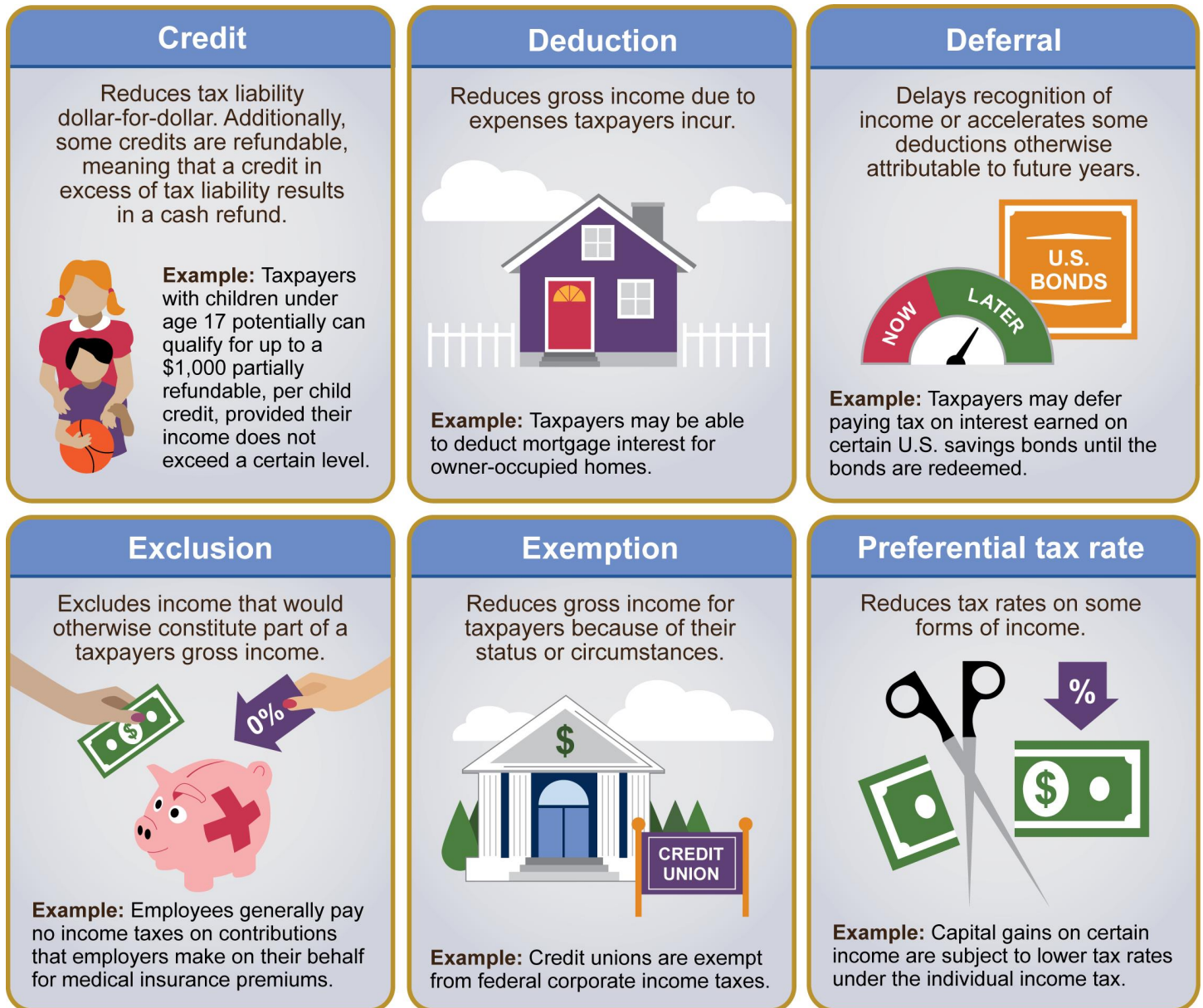
are used to provide economic relief to selected groups of taxpayers, such as the elderly, the blind, and parents or guardians of children. Policymakers have also long used tax expenditures as a tool to accomplish national social and economic goals, such as encouraging people to save for retirement, promoting home ownership or investments, and funding certain research and development. Such goals are often similar to those of mandatory and discretionary spending programs, and tax expenditures may be used in combination with these types of spending to achieve national objectives.

The Congressional Budget and Impoundment Control Act of 1974 identified six types of tax provisions that are considered tax expenditures when they are exceptions to the normal tax structure, as described in figure 1.<sup>10</sup>

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<sup>10</sup>Pub. L. No. 93-344, § 3, 88 Stat. 297, 299 (July 12, 1974) *at* 2 U.S.C. § 622(3).

**Figure 1: Examples of Six Types of Tax Expenditures**



Source: GAO. | GAO-16-622

Note: These are the six types of tax expenditures identified in the Congressional Budget and Impoundment Control Act of 1974.

The term tax expenditure has been used in the federal budget for four decades, and the tax expenditure concept is a tool that the federal

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government uses to allocate resources and achieve national priorities. In effect, many tax expenditures can be viewed as spending channeled through the tax code in that the federal government “spends” some of its revenue by forgoing taxation on some income. Many tax expenditures are comparable to mandatory spending programs, for which spending is determined by rules for eligibility, benefit formulas, and other parameters.<sup>11</sup> Other tax expenditures, such as the low-income housing tax credit, resemble discretionary spending programs, for which Congress appropriates specific funding each year.<sup>12</sup> Nonetheless, deciding whether a specific tax provision should be characterized as a tax expenditure is a matter of judgment, and disagreements about classification stem from different views about what should be included in the normal income tax structure. For example, some argue that the distinction between tax provisions labeled as tax expenditures, and provisions that are not, is arbitrary; thus, labeling some provisions as tax expenditures implies that all income inherently belongs to the government and could be taxed.<sup>13</sup>

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## Fiscal Effect of Tax Expenditures

Tax expenditures have a significant effect on overall tax rates as well as the budget outlook. The revenue the federal government forgoes from tax expenditures reduces the tax base and requires higher tax rates to raise any given amount of revenue.<sup>14</sup> In addition, tax expenditures, like any federal program spending, reduce the amount of funding available for other federal activities, increase the budget deficit, or reduce any budget surplus. In recent fiscal years, revenue losses from tax expenditures have been similar to discretionary spending levels (see figure 2).

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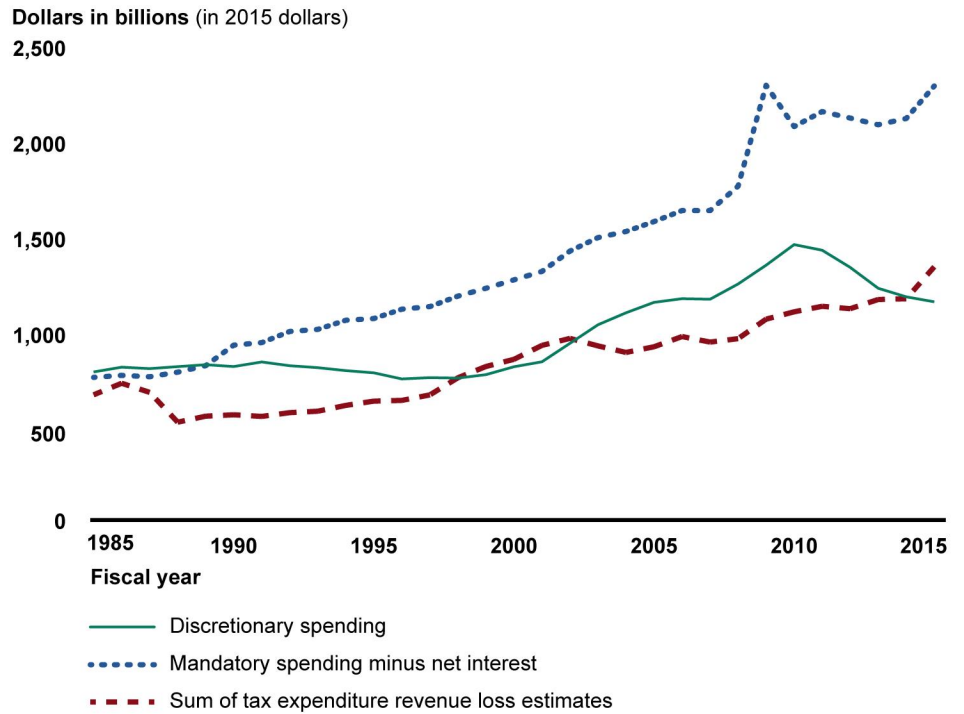
<sup>11</sup>Examples of mandatory spending programs include Medicaid, Medicare, Social Security, and the Supplemental Nutrition Assistance Program.

<sup>12</sup>The low-income housing tax credit was created by the Tax Reform Act of 1986 (Pub. L. No. 99-514) to provide an incentive for the development or rehabilitation of affordable rental housing.

<sup>13</sup>See, for example, Joint Economic Committee, *Tax Expenditures: A Review and Analysis* (Washington, D.C.: August 1999).

<sup>14</sup>The broader the tax base, the lower that tax rates need to be to raise a given amount of revenue.

**Figure 2: Estimated Revenue Losses from Tax Expenditures Compared to Mandatory and Discretionary Spending**



Source: GAO analysis of Department of the Treasury and Office of Management and Budget data. | GAO-16-622

Note: While summing tax expenditure estimates may provide a sense of the overall magnitude, the total change in tax liability from repeal of all tax expenditure provisions could be smaller or larger than the sum of the amounts shown for each item separately as a result of interactions among the tax expenditure provisions and interactions with other provisions of the tax law.

Treasury’s Office of Tax Analysis and the congressional Joint Committee on Taxation (JCT) each annually compile their own lists of tax expenditures and estimates of their revenue losses.<sup>15</sup> They estimate revenue losses for a specific tax expenditure by comparing the revenue

<sup>15</sup>Treasury’s tax expenditure estimates are included as an informational supplement to the President’s budget and JCT’s estimates are prepared for the Senate Committee on Finance and the House Committee on Ways and Means. The Congressional Research Service also compiles a compendium of tax expenditures that includes, among other things, a description of every tax expenditure, the rationale for the tax expenditure at the time it was enacted, and major issues surrounding the tax expenditure.

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raised under current law with the revenue that would have been raised if that provision did not exist, assuming all other parts of the tax code remain constant and taxpayer behavior is unchanged.<sup>16</sup> However, tax expenditures' revenue loss estimates do not necessarily represent the exact amount of revenue that would be gained if a specific tax expenditure was repealed, since repeal of the tax expenditure could change taxpayer behavior in some way that would affect revenue.<sup>17</sup> While, in general, the tax expenditures lists Treasury and JCT publish annually are similar, Treasury and JCT also have different methods for estimating tax expenditures, which can result in differing estimates.<sup>18</sup>

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## Federal Budgeting Processes

Federal budgeting processes provide the means for the government to make informed decisions about priorities across competing national needs and policies, and to allocate resources to those priorities. For the purposes of this report, federal budgeting processes can be broken down into three major phases: executive budget formulation, congressional budgeting processes (during which Congress adopts its budget and enacts laws appropriating funds for the fiscal year), and evaluation.<sup>19</sup>

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<sup>16</sup>For more detailed descriptions of how Treasury and JCT measure and report tax expenditures, see OMB, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2017* (Washington, D.C.: February 2016), JCT, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019*, JCX-141R-15 (Washington, D.C.: Dec. 7, 2015), respectively, and appendix III of [GAO-05-690](#).

<sup>17</sup>Treasury and JCT take potential changes in taxpayer behavior into account when evaluating proposed changes to tax expenditures.

<sup>18</sup>The Treasury and JCT lists differ somewhat in the number of tax expenditures reported and the estimated revenue loss for particular expenditures because the organizations use different (1) income tax baselines; (2) *de minimis* amounts, which are the minimum amount of revenue loss thresholds for Treasury and JCT to report a tax expenditure; and (3) economic and technical assumptions. For example, for the fiscal year 2016 budget, Treasury identified the exclusion of imputed rental income from taxation as a tax expenditure and estimated revenue losses of around \$956 billion over 10 years. In contrast, JCT did not classify imputed rental income to be a tax expenditure because the exclusion may be an administrative necessity given measurement challenges.

<sup>19</sup>As part of federal budgeting processes, we also generally include a budget execution and control phase—during which time the budget authority made available by appropriations remains available for obligation—and an auditing phase (see GAO, *A Glossary of Terms Used in the Federal Budget Process*, [GAO-05-734SP](#) (Washington, D.C.: Sept. 2005)). However, we did not review those phases, or aspects of phases, as part of our audit work. Thus, we do not describe them here.

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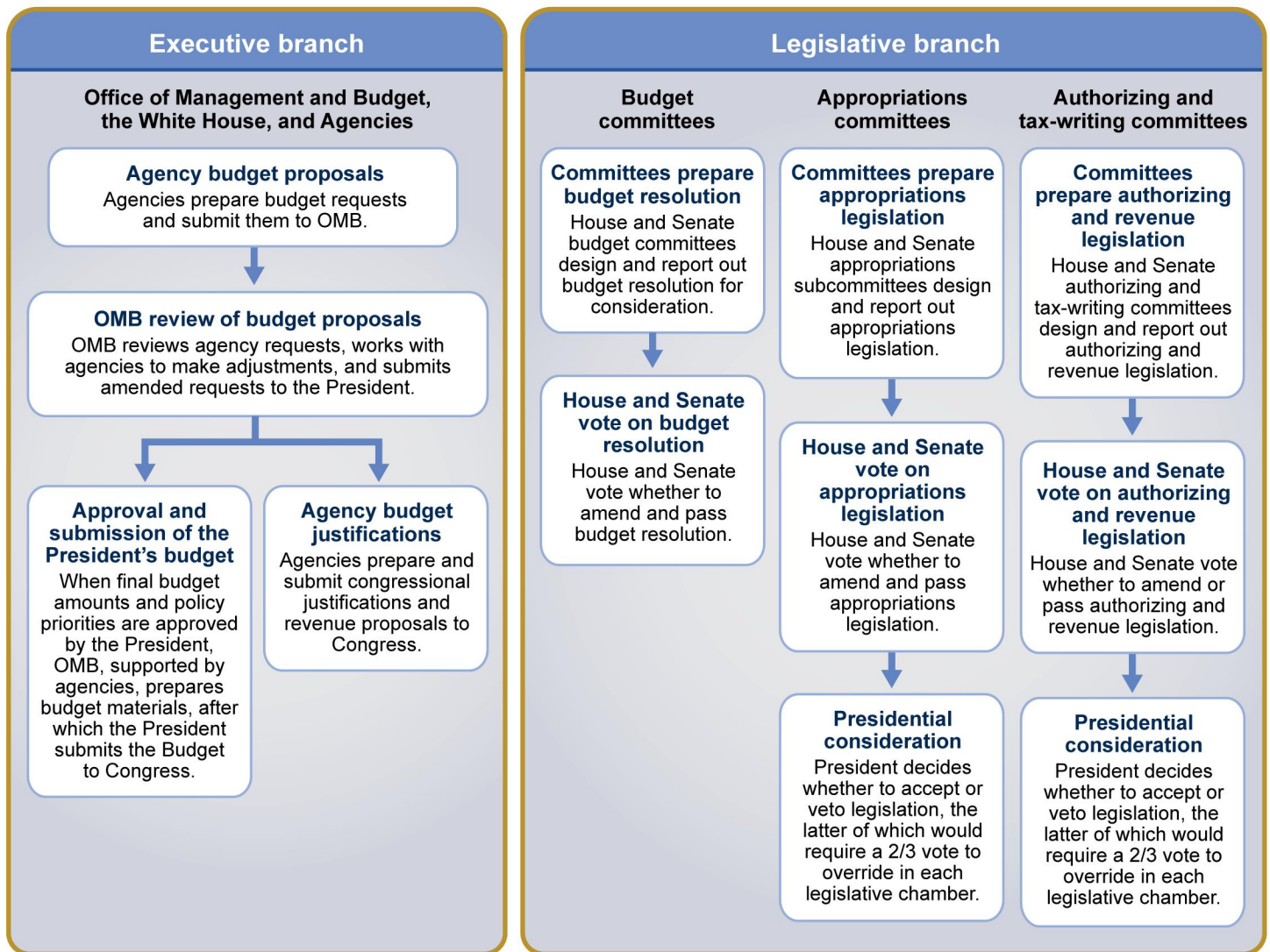
**Executive budget formulation.** Every year, the President is required to compile and submit a budget to Congress for consideration, a process which OMB manages with the assistance of agencies. During the formulation of the President's budget, discretionary spending is reviewed in detail and funding levels are proposed for existing and new discretionary programs. In addition, mandatory spending or new revenue provisions may be proposed.

**Congressional budgeting processes.** Once Congress receives the President's budget request, it begins its own process to enact a budget for the U.S. government. This process includes developing appropriations legislation for discretionary spending; proposing authorizing legislation to establish or continue the operation of federal programs or agencies; and proposing revenue measures, including tax expenditures, which can be either permanent or temporary.

Two of the major phases of federal budgeting—executive budget formulation and congressional budgeting processes—are further described in figure 3.



**Figure 3: Key Steps in Federal Budgeting Processes**



Source: GAO. | GAO-16-622

Note: This figure represents the key steps taken by different actors in federal budget processes, but not the time frames of those steps or interactions of those steps between committees or the executive branch.

**Evaluation.** GPRA and subsequently GPRAMA established a performance planning and reporting framework for the federal government. This framework provides important tools that can help inform congressional and executive branch decision making to address challenges the federal government faces, including the allocation of

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scarce resources across different policy tools.<sup>20</sup> GPRAMA requires that OMB and agencies establish different types of government-wide and agency goals, including:

- Cross-agency priority (CAP) goals. These are government-wide, outcome-oriented goals—for example, improving science, technology, engineering and math education—that cover a limited number of policy areas, as well as goals for management improvements needed across the government, such as delivering world-class customer service. OMB develops these goals in coordination with agencies.
- Strategic objectives. These are long-term agency goals that reflect the outcome or management impact an agency is trying to achieve, and express the results or direction the agency will work toward. To illustrate, one of the strategic objectives identified in HUD’s 2014-2018 strategic plan is to ensure sustainable investments in affordable rental housing.
- Agency priority goals (APG). These are near-term goals to reflect agencies’ highest priorities and represent an achievement that agency leaders want to accomplish within 2 years through focused leadership attention. They are to have clear completion dates, targets, and indicators that can be measured or marked by a milestone to gauge process. GPRAMA requires that agencies identify how their respective APGs contribute to their long-term strategic goals. To illustrate, one of HUD’s APGs is to preserve and expand affordable rental housing to serve around 135,000 more households in fiscal years 2016 and 2017 than the baseline 5.5 million households already served.

Under GPRAMA, OMB is to develop a federal government performance plan that sets the level of performance needed to achieve the CAP goals. In doing so, OMB is to identify the organizations, programs, and activities—including tax expenditures—that contribute to those goals.<sup>21</sup> In

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<sup>20</sup>In addition to evaluation processes conducted by agencies in adherence with GPRAMA, agencies also conduct evaluations at the request of committees to assess the effect of legislative changes or demonstration projects to inform the design of a new program. Other agencies may also evaluate government programs to help inform budget decisions.

<sup>21</sup>GPRAMA requires that OMB coordinate with agencies to identify the agencies, organizations, program activities, regulations, tax expenditures, policies, and other activities contributing to each CAP goal. 31 U.S.C. § 1115(a)(2).

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addition, OMB is to periodically review and report on progress toward these goals. As part of these reviews, OMB is to assess whether the programs and activities—including tax expenditures—are contributing to the goals as planned. We have previously reported on OMB’s implementation of these requirements.<sup>22</sup> OMB has tasked agencies with responsibility for identifying applicable tax expenditures for reporting progress on agencies’ priority goals and strategic objectives in GPRAMA guidance.<sup>23</sup>

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<sup>22</sup>See GAO, *Managing for Results: OMB Should Strengthen Reviews of Cross-Agency Goals*, [GAO-14-526](#) (Washington, D.C.: June 10, 2014) and *OMB Improved Implementation of Cross-Agency Priority Goals, But Could Be More Transparent About Measuring Progress*, [GAO-16-509](#) (Washington, D.C.: May 20, 2016).

<sup>23</sup>OMB guidance states that agencies are to identify, as appropriate, tax expenditures among the various federal programs and activities that contribute to their agency goals—specifically strategic objectives and APGs—for the purposes of public reporting.

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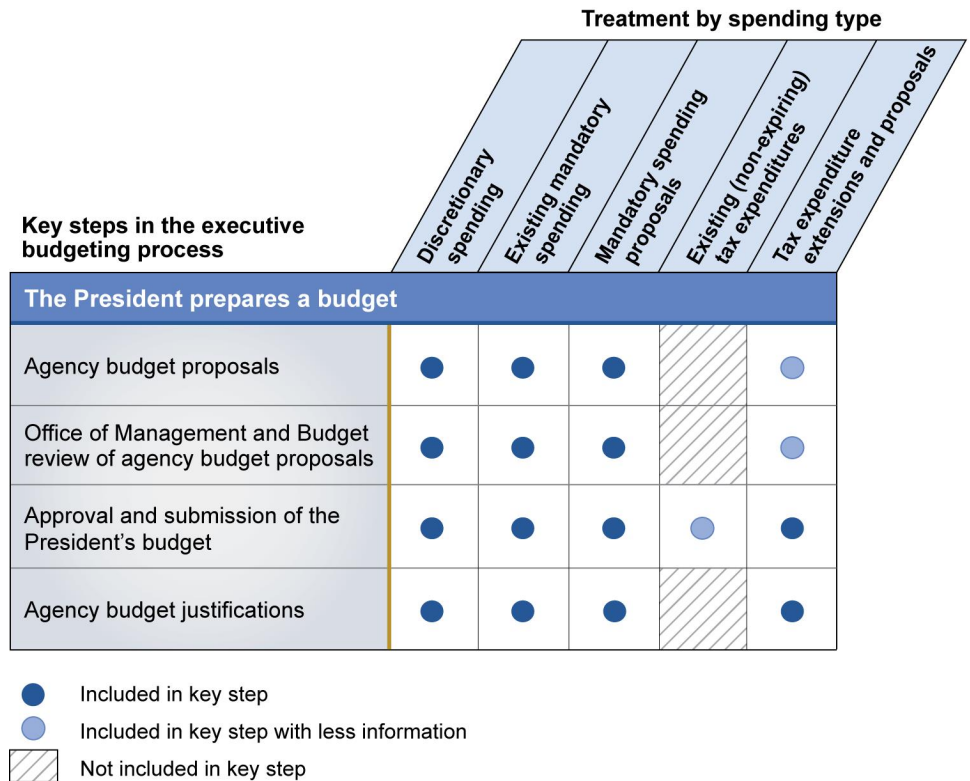
Federal Budget Processes Include Fewer Budgetary Controls, Fewer Reviews, and Less Information for Tax Expenditures Than Other Types of Spending

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OMB and Agencies Conduct Fewer Reviews and Provide Less Information on Tax Expenditures Than Other Spending in Formulating the President's Budget

While tax expenditures are included in the development of the President's Budget, they are subject to fewer reviews, and less information is required to be provided on them. See figure 4 for a summary of key steps and how tax expenditures compare to spending in the executive budget formulation process.

**Figure 4: Tax Expenditures Compared to Spending in the Executive Budgeting Process**



Source: GAO and analysis of agency and congressional documents. | GAO-16-622

## Agency Budget Proposals

Tax expenditures and spending are treated differently in the first key step of the executive budget formulation process, where agencies prepare budget proposals to submit to OMB.

OMB Circular No. A-11 requires that agencies provide written justifications for all discretionary and mandatory spending programs and activities of an agency, but does not require such written justification for existing tax expenditures.<sup>24</sup> Further, under OMB Circular No. A-11,

<sup>24</sup>OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget (Washington, D.C.: June 2015).

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agencies are directed to submit less detailed information to justify new or modified tax expenditures than when they propose new spending programs to OMB. For example, OMB Circular No. A-11 directs agencies to provide, among other things, an analysis of financial and personnel resources required to enact a program, a comparison of total program benefits and costs, and supporting information from outside evaluation and analyses for spending programs. In contrast, for tax expenditure proposals, agencies are not directed to provide such detailed analyses in their written justifications. Instead, they are directed to generally justify why a tax expenditure is needed and why it is preferable to a spending program.

#### OMB Review of Budget Proposals

After agencies submit their budget proposals, OMB and the President review them and decide what proposals and programs will be submitted to Congress. Because agencies are not directed to include a written justification of existing tax expenditures in their budget proposals, such information is not included in this step.

OMB staff told us that tax expenditures are one of several policy tools considered when discussing new legislative proposals for the President's budget. Treasury officials reported that an extensive process is conducted with OMB annually to develop the President's revenue proposals, including tax expenditures, with a particular focus on expiring provisions. We asked OMB staff the extent to which tax expenditures are included in its budget-related discussions with Treasury officials, but staff declined to respond, stating that such information was predecisional.

#### Approval and Submission of the President's Budget

OMB then prepares the President's budget, which presents aggregate spending and revenue levels and contains the President's spending and revenue proposals. The President then approves the budget and submits it to Congress. Although tax expenditures contribute to budget functions, the tax expenditure estimates are not presented alongside summaries of other spending levels by functional category in the budget. Instead, tax expenditure revenue loss estimates are presented separately from other types of spending in the budget's Analytical Perspectives. We have reported in the past that this presentation makes their relative

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contributions toward achieving national priorities less visible than spending programs.<sup>25</sup>

Tax expenditure proposals, which include both new tax expenditures and amendments to existing tax expenditures, are included in a separate chapter alongside other revenue proposals, though the budget does not identify which proposals are tax expenditures. The budget includes a short description of the proposal, along with a revenue estimate of each particular proposal. Descriptions of discretionary and mandatory spending and the President's requests for those funds are also included in the budget Appendix, along with the outlays from refundable tax credits.<sup>26</sup>

## Agency Budget Justifications

Agencies also submit agency budget justifications and revenue proposals, including tax expenditure extensions or proposals, to Congress. Treasury submits the "General Explanations of the Administration's Revenue Proposals" report to Congress, and the information required for those proposals is different than the information provided on spending programs in their congressional budget justifications. For all revenue proposals, including tax expenditures, the report generally provides a description of the current law related to each proposal, the reason the administration is proposing that law be changed, and a description of the proposal. It also includes a table of revenue estimates for each proposal, which is also included in the President's Budget. Agency congressional budget justifications also provide information on their programs. While the form and content of budget justifications may vary by agency and appropriations subcommittee, these justifications may contain specific outputs of the spending program, agency performance measures that the spending supports, and the number of people taking advantage of a particular program.

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<sup>25</sup>[GAO-05-690](#).

<sup>26</sup>A nonrefundable tax credit can be used to reduce current-year tax liability to zero, and a refundable credit in excess of tax liability results in a cash refund. The cash refund portion of a refundable tax credit is not reported as a revenue loss, but as an outlay.

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**Similar to Mandatory Spending, the Congressional Budget Process Does Not Require Annual Reapproval or Review of Non-expiring Tax Expenditures**

As part of the congressional budget process, tax expenditures are treated similarly to mandatory spending in that expiring tax expenditures being considered for extension and new proposals are subject to standard congressional controls for new legislation; but existing, non-expiring tax expenditures are not subject to annual congressional budget processes. In addition, while discretionary and mandatory spending are included in the Concurrent Resolution on the Budget (budget resolution), existing tax expenditures are not explicitly included, though the budget resolution may propose changes to tax expenditures or mandatory spending at Congress's discretion. See figure 5 for a summary of key steps and how tax expenditures compare to spending in the congressional budget process.



**Figure 5: Tax Expenditures Compared to Spending in the Congressional Budget Process**

Key steps in the congressional budgeting process	Treatment by spending type				
	Discretionary spending	Existing mandatory spending	Mandatory spending proposals	Existing (non-expiring) tax expenditures	Tax expenditure extensions and proposals
<b>Budget committees</b>					
Committees prepare budget resolution	●	●	●	▨	●
House and Senate vote on budget resolution	●	●	●	▨	●
<b>Appropriations committees</b>					
Committees prepare appropriations legislation	●	▨	▨	▨	▨
House and Senate vote on appropriations legislation	●	▨	▨	▨	▨
Presidential consideration	●	▨	▨	▨	▨
<b>Authorizing and tax-writing committees</b>					
Committees prepare authorizing and revenue legislation	●	▨	●	▨	●
House and Senate vote on authorizing and revenue legislation	●	▨	●	▨	●
Presidential consideration	●	▨	●	▨	●

● Included in key step  
 ● May be included in key step  
 ▨ Not included in key step

Source: GAO and analysis of congressional documents. | GAO-16-622

Note: The Congressional Budget Act establishes the steps of the budget process but Congress can and does make exceptions to this process.

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## Budget Committees

As part of the annual budget process, House and Senate Budget committees develop a budget resolution, which sets budget authority in aggregate and by functional category, as well as target aggregate revenues.<sup>27</sup> Unlike with mandatory and discretionary spending, tax expenditures' fiscal effects are not explicitly included in the budget resolution. Rather, the aggregate revenue targets takes into account that revenue will be forgone because of tax expenditures.<sup>28</sup> Through reconciliation instructions, the resolution may direct committees to propose legislation to meet the spending and revenue targets set by the budget resolution.<sup>29</sup> The resolution is not required to propose adjustments to tax expenditures or mandatory spending through these instructions to meet those targets, though it may do so. The proposal is voted on by both budget committees and the full House and Senate. As a plan for Congress, the resolution is not presented to the President for signature and does not have the force of law, but guides the work of the appropriations, authorizing, and tax-writing committees, whose legislation is evaluated against the resolution's targets.

## Appropriations Committees

After a budget resolution is passed, appropriations subcommittees in the House and Senate review the budget requests from their related executive agencies and develop appropriations acts that provide agencies the legal authority to incur obligations to fund discretionary spending programs. Appropriations acts do not apply to tax expenditures

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<sup>27</sup>While a budget resolution is required by law to establish enforceable budget levels, Congress does not always choose to pass a budget resolution. Instead, at times Congress has chosen other resolutions or legislation to act in place of a budget resolution. These resolutions or bills are referred to informally as deeming resolutions, and at minimum provide spending allocations to appropriations committees. They may also enact aggregate budget levels, revenue levels, or provide for other related purposes.

<sup>28</sup>The Congressional Budget Office is required to produce a detailed list of tax expenditures for Congress annually, and relies on JCT for the production of that publication. These estimates are not included in any specific budget step.

<sup>29</sup>Reconciliation instructions are provisions in the budget resolution directing one or more committees to report (or submit to the House and Senate Budget Committees) legislation changing existing laws or pending legislation to bring spending, revenues, or debt limit into conformity with the budget resolution.

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or, generally, to mandatory spending, and are considered by Congress on an annual basis.<sup>30</sup>

#### Authorizing Committees

Separate from the annual appropriations process, the House and Senate authorizing committees develop authorizing legislation that establishes and continues the operation of federal programs or agencies. Authorizing committees have jurisdiction over specific policy areas, and both discretionary and mandatory spending programs must be authorized. For mandatory spending programs, authorizing legislation can define program eligibility and set benefit or payment rules, which then are paid automatically without the need for an annual appropriation.

#### Tax-writing Committees

Also separate from the annual appropriations process, tax-writing committee legislation includes tax expenditure extensions and proposals. Revenue legislation may establish a tax expenditure indefinitely or for specific periods. Tax expenditures are not required to be reapproved unless they are set to expire, though changes may be proposed in any year.

Currently, there are budget controls both in statute and in congressional rules that apply to spending and tax expenditure legislation. Pay-as-you-go (PAYGO) rules generally require that any law that would increase mandatory spending or decrease revenues make an additional change in spending or revenues so that the new law does not increase the deficit. For example, the Statutory PAYGO Act of 2010 requires OMB to record the budget effects of all of the revenue and direct spending legislation on scorecards to project budgetary effects of the legislation over 5- and 10-year periods.<sup>31</sup> Sometimes this control is exempted by law, as was done in the Protecting Americans from Tax Hikes Act of 2015, which made various tax expenditures permanent.<sup>32</sup> Both the House and the Senate have PAYGO rules. While the House's PAYGO rule addresses only direct spending, the Senate PAYGO rule prohibits consideration of direct

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<sup>30</sup>Mandatory (or direct) spending refers to budget authority provided in laws other than appropriation acts.

<sup>31</sup>Pub. L. No. 111–139, § 4(d), 124 Stat. 8 (Feb. 12, 2010).

<sup>32</sup>Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. Q, § 601, 129 Stat. 2242, 3127 (Dec. 18, 2015).

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spending or revenue legislation that could increase the deficit in current and future years.<sup>33</sup>

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## OMB and Agencies Have Made Limited Progress Identifying Tax Expenditures' Contributions to Agency Goals

OMB Circular No. A-11 directs agencies to identify tax expenditures, as appropriate, among the various federal programs and activities that contribute to their agency goals, specifically strategic objectives and agency priority goals (APG).<sup>34</sup> Agencies are also required to review progress toward their goals. For strategic objectives, reviews are to occur annually in order to inform annual planning and budget formulation, among other things. For APGs, agency leaders are required to review APG progress in quarterly, data-driven performance reviews. In its guidance, OMB states that tax expenditures should be subject to the same level of review as spending programs, and often complement or substitute for agencies' spending programs that contribute to their strategic objectives. OMB also directs agencies to work with Treasury's Office of Tax Analysis (OTA) to develop data and methods to evaluate the effects of tax expenditures that affect, or are directed toward, the same goals as agency programs.

Our review of agencies' performance planning and reporting documents found that most agencies did not identify tax expenditures as contributors to agency goals, consistent with what we have reported previously.<sup>35</sup> We found that 7 of the 24 CFO Act agencies identified tax expenditures as contributors to their missions (two instances) or to specific goals (five instances). The tax expenditures these seven agencies identified accounted for 11 of the 169 tax expenditures included in the President's Budget for Fiscal Year 2017, representing an estimated \$31.9 billion of

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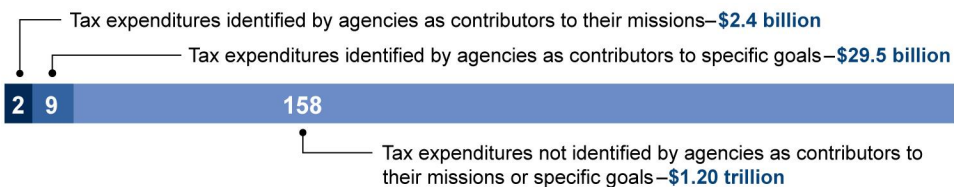
<sup>33</sup>S. Con. Res. 11, 114<sup>th</sup> Congress.

<sup>34</sup>OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget* (Washington, D.C.: June 2015).

<sup>35</sup>GAO, *Managing for Results: Enhanced Goal Leader Accountability and Collaboration Could Further Improve Agency Performance*, [GAO-14-639](#) (Washington, D.C.: July 22, 2014) and *Managing for Results: Agencies Should More Fully Develop Priority Goals under the GPRA Modernization Act*, [GAO-13-174](#) (Washington D.C.: Apr. 19, 2013).

\$1.23 trillion in forgone revenues for fiscal year 2015.<sup>36</sup> In addition, three of these seven agencies developed performance measures to gauge the contributions of tax expenditures towards progress on agency goals. See figure 6 for a summary of the tax expenditures identified as contributing to agency goals or missions.

**Figure 6: Tax Expenditures Identified by Agencies as Contributing to Agency Goals or Missions, as of January 2016**



Source: GAO review of Chief Financial Officer Act agency performance documents. | GAO-16-622

One commonality among agencies that linked tax expenditures to performance measures is that many of these agencies have a defined role in administering the related tax expenditures, and therefore collect data on the tax expenditures. See table 1 for a summary of the agencies that identified tax expenditures contributing to agency missions and goals in their performance documents as of January 2016.

<sup>36</sup>We did not assess which of the 169 tax expenditures in the President’s Budget for Fiscal Year 2017 appear to relate to agency goals. Our prior work has shown that agencies have not always identified tax expenditures that we found to be related to agency goals in their performance reporting. See [GAO-14-639](#).

**Table 1: Agencies That Identified Tax Expenditures Contributing to Agency Missions, Goals, and Related Performance Measures in Their Performance Documents as of January 2016**

Agency	Agency goal	Tax expenditures identified	Performance measure
<b>Department of Housing and Urban Development (HUD)</b>	Preserve quality affordable rental housing, where it is needed most, by simplifying and aligning the delivery of rental housing programs (strategic objective) and increase the health and safety of homes and embed comprehensive energy efficiency and healthy housing criteria across HUD programs (strategic objective)	Low-income housing tax credit Exclusion of interest on rental housing bonds	Number of units using low-income housing tax credits and/or tax exempt rental housing bonds
<b>Department of the Treasury</b>	Promote savings and increased access to credit and affordable housing options (strategic objective)	New markets tax credit	Number of affordable housing units created by Community Development Financial Institutions (CDFI) Fund programs <sup>a</sup>
<b>Department of the Interior</b>	Protect America’s cultural and heritage resources (strategic objective)	Historic rehabilitation tax credit	Number of completed historic rehabilitation tax credit projects
<b>Department of Education</b>	Increase college degree attainment (agency priority goal)	American opportunity tax credit	None identified
<b>Department of Health and Human Services</b>	Make coverage more secure for those who have insurance, and extend affordable coverage to the uninsured (strategic objective)	Premium tax credit Small business health care tax credit	None identified None identified
	Promote economic and social well-being for individuals, families, and communities (strategic objective)	Earned income tax credit	None identified
<b>Department of Labor</b>	Provide marketable skills and knowledge to increase workers’ incomes and help them overcome barriers to the middle class through partnerships among business, education, labor, community organizations, and the workforce system (strategic objective)	Work opportunity tax credit	None identified
<b>Department of Energy</b>	No specific goal identified; tax expenditures contribute to agency mission	Production tax credit	None identified
		Renewable energy efficient property credit	None identified

Source: GAO analysis of agency performance documents. | GAO-16-622

<sup>a</sup>CDFIs are financial institutions that provide credit and financial services to underserved communities.

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## A Lack of Clarity about Agencies' Roles Leads to Inaction in Identifying Tax Expenditures That Contribute to Agency Goals

As we have previously reported, one key impediment to including tax expenditures in agency performance reviews is the continuing lack of clarity about the roles of different federal agencies in conducting reviews of tax expenditures.<sup>37</sup> This lack of clarity can lead to inaction in identifying tax expenditures' contributions to agency goals.

- **Office of Tax Analysis (OTA).** Treasury's OTA provides economic and policy analyses leading to development of the President's tax proposals. It also assesses major congressional tax proposals, which can include tax expenditures. OTA prepares Treasury's revenue and revenue loss estimates for tax proposals and tax expenditures, respectively. According to OTA officials, OTA does not conduct systematic reviews of tax expenditures, but may conduct them when policymakers are considering changes to tax policy.
- **Internal Revenue Service (IRS).** As Treasury's bureau responsible for determining, assessing, and collecting taxes, IRS administers and supervises the execution and application of internal revenue laws or related statutes, including for tax expenditures. However, IRS is not responsible for managing federal housing, energy, or any of the many other policies to which tax expenditures may contribute. At times, this can lead to insufficient oversight of tax expenditures. For example, in July 2015, we reported that IRS conducted minimal oversight of state housing finance agencies (HFA), on which IRS relies to administer and oversee the low-income housing tax credit.<sup>38</sup> We found that IRS conducted minimal oversight in part because the tax credit is a peripheral program for IRS, in terms of its compliance responsibilities, mission, and priorities for resources and staffing. As part of that report, we suggested Congress consider designating HUD as a joint administrator of the program, including responsibilities for HFA oversight.
- **Other agencies.** If agencies do not have a defined role in administering a tax expenditure, they may choose not to identify the tax expenditure's contributions to agency goals. At the three agencies

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<sup>37</sup>[GAO-05-690](#).

<sup>38</sup>IRS oversight responsibilities for the program include monitoring state housing finance agencies and taxpayer compliance. See GAO, *Low-Income Housing Tax Credit: Joint IRS-HUD Administration Could Help Address Weaknesses in Oversight*, [GAO-15-330](#) (Washington, D.C.: July 15, 2015).

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we selected to interview—USDA, DOE, and HUD—officials reported that they sometimes do not include tax expenditures as contributors to goals in their performance processes or reporting, because the agencies do not have a defined role in administering the tax expenditures. For example, in HUD’s fiscal year 2016 Performance Plan and fiscal year 2014 Performance Report, the agency describes a strategic objective involving “green and healthy homes.” Though HUD does not identify related tax expenditures, agency officials told us they understood that many homeowners and residential property owners who undertake energy efficiency retrofits or install solar panels take advantage of, or benefit from, energy-related tax credits, particularly for solar investment. Agency officials explained that HUD publishes resources on its web portal on renewable energy to help owners walk through the steps of financing options, some of which include tax credits. Officials at all three agencies we spoke to said that their performance conversations focused on programs they administer, which was why tax expenditures were not always included.

OMB staff told us they give agencies flexibility to determine the appropriate programs and tax expenditures that should be identified as contributors to agency goals. They also said that it is the agencies’ responsibility to incorporate tax expenditures, as appropriate, in their progress updates for agency goals, and that they do not provide any further clarity on agencies’ roles. Further, OMB staff told us that they do not track agencies’ identification of tax expenditures that contribute to agency goals. As a consequence, OMB does not have a process in place to determine the extent to which agencies are capturing the contributions of all federal commitments, including tax expenditures, toward agency goals.

Given OMB’s government-wide purview and Treasury’s familiarity with administering the tax code, these agencies are well positioned to assist other agencies in identifying tax expenditures that contribute to their goals. To assist agencies, OMB’s 2013 and 2014 Circular No. A-11 guidance noted that OMB would work with Treasury and agencies to identify where tax expenditures align with their goals, and that this information was to be published on Performance.gov and included in relevant agency plans, beginning in February 2014. However, OMB subsequently removed the language about working with Treasury and agencies to align tax expenditures with agency goals in the June 2015 update to its guidance. OMB staff told us they removed the language because the agency had no immediate plans for focusing on this effort, nor did they have the capacity to consider it, despite seeing the benefit of



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such an effort. Without additional OMB and Treasury assistance, agencies may continue to have difficulty identifying whether, or which, tax expenditures contribute to their goals.

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OMB Has Not Addressed Long-Standing Performance Measurement Challenges That Affect Agencies' Ability to Evaluate How Tax Expenditures Contribute to Agency Goals

We have reported previously that challenges with performance measurement limit agencies' ability to identify the contributions of tax expenditures to agency goals, and our work found that those challenges for agencies continue to exist.

- In September 2005, we found that a lack of performance information was a challenge in assessing the performance of tax expenditures.<sup>39</sup> We recommended that OMB, in consultation with Treasury, identify ways to address the lack of credible tax expenditure performance information. The President's fiscal year 2012 budget stated that the administration planned to focus on addressing some of these data-availability challenges and analytical constraints so it can work toward crosscutting analyses that examine tax expenditures alongside related spending programs; however, as of February 2016, OMB had not provided an update on these efforts.
- In June 2013, we found that agencies face difficulties in measuring performance across various program types, including tax expenditures.<sup>40</sup> We recommended that OMB work with the Performance Improvement Council (PIC) to develop a detailed approach to examine difficulties agencies face in measuring the performance of these various types of federal programs and activities, including identifying and sharing any promising practices from agencies that have overcome difficulties in measuring the performance of these program types.<sup>41</sup> While OMB and PIC officials reported that they have taken some steps to address this recommendation in a few areas, as of June 2016, they have not yet

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<sup>39</sup>[GAO-05-690](#).

<sup>40</sup>GAO, *Managing for Results: Executive Branch Should More Fully Implement the GPRA Modernization Act to Address Pressing Governance Challenges*, [GAO-13-518](#) (Washington, D.C.: June 26, 2013).

<sup>41</sup>The PIC is a council made up of agency performance improvement officers of federal agencies and chaired by OMB. It is designed to improve the performance of federal programs through facilitating information exchange among agencies. [GAO-13-518](#).

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developed a comprehensive and detailed approach to address these issues as envisioned in our report, and these efforts have not included tax expenditures.

We continue to believe that implementing these recommendations would help agencies evaluate how tax expenditures contribute to agency goals.

One factor that continues to impede agencies' abilities to assess the contributions of tax expenditures to their goals is the limited availability of tax expenditure data.

- Officials from Treasury and the three agencies—USDA, DOE, and HUD—that we selected to interview told us that limited tax data can be a barrier to conducting performance reviews or analyzing tax expenditures.
- We reported in April 2013 that tax forms did not capture who claimed a tax expenditure and how much they claimed for 63 percent of tax expenditures in 2011.<sup>42</sup> Likewise, we have reported that tax expenditure data that are collected on tax forms are not always sufficiently detailed to assess or describe tax expenditure results. For example, in April 2015, we found that IRS data did not include key project-level information on the Investment Tax Credit and Production Tax Credit, which is necessary to describe how many projects these credits supported and to evaluate the credits' effectiveness.<sup>43</sup>

We reported in April 2013 that these data challenges can be remedied to some extent by data from other agencies or other sources, such as public records, state agency records, and surveys.<sup>44</sup> However, these solutions do not completely overcome the data challenges associated with evaluating tax expenditures. For example, we reported that HUD community level data can be used to partially remedy limited IRS tax data on Empowerment Zone (EZ) employment tax credits, which did not identify which specific communities received EZ tax credits. However, HUD only tracks a portion of EZ employment tax credits, and thus its data

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<sup>42</sup>GAO, *Tax Expenditures: IRS Data Available for Evaluations Are Limited*, [GAO-13-479](#) (Washington, D.C.: Apr. 30, 2013).

<sup>43</sup>GAO, *Electricity Generation Projects: Additional Data Could Improve Understanding of the Effectiveness of Tax Expenditures*, [GAO-15-302](#) (Washington, D.C.: Apr. 28, 2015).

<sup>44</sup>[GAO-13-479](#).

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do not completely mitigate the limitations of tax form data in identifying which communities benefit from EZ tax credits.

For some tax expenditures, evaluating performance may require collecting additional tax form data. For example, in April 2015, we reported that because basic information on the Investment Tax Credit and Production Tax Credit is unavailable, it will be difficult for Congress to evaluate the effectiveness of these tax credits or compare them with spending or loan programs as it considers reauthorizing or extending them.<sup>45</sup> We suggested that Congress consider directing IRS to collect additional tax form data to help evaluate the effectiveness of the credits.

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## Options to Further Incorporate Tax Expenditures into Federal Budgeting Processes Have Various Potential Benefits and Challenges

Further incorporating tax expenditures into federal budgeting processes could help achieve various broad benefits, based on our assessment of the roundtable discussion we held with budget and tax experts and on our prior work (see figure 7).

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<sup>45</sup>[GAO-15-302](#).

Figure 7: Examples of Broad Benefits to Further Incorporating Tax Expenditures into Budgeting Processes



**Increasing information transparency of resource allocation**

Additional information on tax expenditures in the federal budget process could increase transparency to policymakers and the public on the levels of resources associated with national priorities (budget functions) each year.<sup>a</sup> Options to increase transparency generally only require incremental changes in existing processes.



**Creating further opportunity to review effectiveness and outcomes**

Additional reviews could help ensure that tax expenditures are achieving their intended goals, and help assess their effectiveness in absolute, or as compared to other policy tools, while taking into account the level of resources allocated to each.



**Exercising greater control over resources**

Further incorporating tax expenditures into congressional budgeting controls could help policymakers better adapt the government to shifting environments, evolving demands, changing risks, and new priorities. Moreover, certain changes in budgetary controls may allow Congress more flexibility in allocating federal resources to the most efficient programs.

Source: GAO analysis. | GAO-16-622

Note: To identify these examples of broad benefits to further incorporating tax expenditures into budgeting processes, GAO assessed a transcript of the roundtable discussion with budget and tax experts and prior GAO work.

<sup>a</sup>Federal spending is generally classified by budget function; these are 17 broad areas—for example, national defense, agriculture, transportation, community and regional development—that align with national priorities.

Below we discuss options that may help achieve these broad benefits. We identified the options based on insights from experts during our roundtable discussion and interviews—as well as related literature—and our prior work.<sup>46</sup> For each option, we indicate the broad benefit—

<sup>46</sup>The roundtable discussion was not designed to reach a consensus and all options were not necessarily supported by all roundtable participants. The potential benefits, challenges, and design considerations of the options are described in this section. See our earlier description of our methodology for details on how we analyzed themes from the roundtable discussion.

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additional transparency, opportunity for review, or greater control—that could be achieved, and issues that policymakers would need to consider when evaluating the merits of each option (which we present below as design considerations). We do not assess the relative feasibility of these options, nor do we recommend implementing any of these options in this report. Finally, these options are not exhaustive, nor are they mutually exclusive, as some options could be implemented together and may even complement each other.

While these options offer a range of potential benefits, there are challenges and tradeoffs for policymakers to consider in whether or how to implement any policy to further incorporate tax expenditures into federal budgeting processes. For example, agency officials and experts said that implementing these options—in particular those requiring additional information on, or reviews of, tax expenditures—would require resources. Moreover, as previously mentioned, and as experts told us, there is not always a consensus on which tax provisions constitute tax expenditures. Finally, it is difficult to measure the size of some tax expenditures that are only loosely linked to actual tax filing data. While the JCT and Treasury use modeling to estimate tax expenditure revenue losses, in some cases little data are available and assumptions are made. These broad challenges would need to be considered when assessing how to approach the different options for further incorporating tax expenditures into federal budgeting processes.



### Information transparency

**Option 1:** Report tax expenditures alongside related spending in the congressional budget resolution and in the President's Budget

Tax expenditures could be presented, for informational purposes, in the congressional budget resolution alongside other spending by budget function. A similar presentation could be included in the President's Budget. Currently, tax expenditure estimates are presented in congressional budget documents and the President's Budget separate

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from other types of spending. Moreover, they are not included within, or shown alongside, summaries of spending levels by functional category; rather, they are an undifferentiated component of total federal revenues, which obscures their size.<sup>47</sup>

OMB previously presented tax expenditure revenue loss totals alongside outlays and credit activity for each budget function in the federal budget from fiscal year 1998 through fiscal year 2002, in response to one of our prior recommendations.<sup>48</sup> However, it discontinued the practice in fiscal year 2003. In 2005, when we recommended that OMB resume presenting tax expenditures in the budget together with related spending programs, OMB told us that the current presentation of tax expenditure information—that is, presenting tax expenditures separately from other spending in the budget—was sufficient for providing the public and policymakers with what is useful to know about these provisions of the tax code.<sup>49</sup> In our roundtable, experts noted that tax expenditure estimates by functional category were already included in budget documents, but also acknowledged that having the information in different parts of budget documents does not facilitate a side-by-side comparison. As we have previously reported, presenting tax expenditure estimates alongside discretionary and mandatory spending levels could increase transparency and better communicate to the public the levels of spending being allocated to national priorities.<sup>50</sup>

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<sup>47</sup>While JCT publishes estimates of individual tax expenditures by budget function, the totals are not aggregated by function and the results are not shown alongside new budget authority and outlays. Similarly, in the President's budget, though Treasury estimates of revenue losses associated with tax expenditures are available in the Analytical Perspectives chapter, generally, tax expenditures are not shown alongside summaries of discretionary and mandatory spending by function.

<sup>48</sup>In 1994 we recommended that OMB, in consultation with Treasury, revise the budgetary presentation of tax expenditure information to highlight the fiscal and other consequences associated with tax expenditures for the public and policymakers. We further recommended that a revised presentation include the combined federal resources allocated in functional areas, including both outlays and tax expenditures and, to the extent possible, information that could be used in assessing their effectiveness, distributional equity, and economic efficiency. See [GAO/IGD/AIMD-94-122](#).

<sup>49</sup>[GAO-05-690](#). OMB disagreed with this recommendation and it has not been implemented.

<sup>50</sup>[GAO-05-690](#).

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## Design Consideration

- **What methodology would Treasury and JCT use to estimate aggregated tax expenditures by budget function?** Tax expenditure estimates represent the revenue losses associated with particular tax provisions, assuming the rest of the tax code and taxpayer behavior remain unchanged. If all tax expenditures within a budget function were removed at once, there would be interactions among the tax expenditures that would change the estimates. As a result, aggregating current tax expenditure estimates for a budget function would likely result in an imprecise estimate.<sup>51</sup> However, Treasury and JCT officials told us that it was methodologically feasible to prepare aggregated revenue loss estimates representing those tax expenditures related to a specific budget function that would account for these interactions.



### Review

**Option 2:** Systematically evaluate the outcomes of some or all tax expenditures

This option would institute a systematic approach to evaluating tax expenditures on an ongoing basis. Evaluations are studies that use research methods to address specific questions about program performance. In particular, evaluations can be designed to isolate the causal impacts of programs from other external economic or environmental conditions to assess a program's effectiveness. Treasury does not regularly conduct evaluations of tax expenditures; rather, it

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<sup>51</sup>One study found that taking interactions between provisions into account increases the estimated total cost of individual income tax expenditures by 5 to 8 percent, depending on whether the alternative minimum tax is accounted for or not. See Burman, Leonard, Toder, Eric, and Geissler, Christopher. *How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?* (The Urban Institute, Washington, D.C.: December 2008).

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conducts some evaluations on an ad hoc basis.<sup>52</sup> Other researchers and organizations may also conduct evaluations of tax expenditures on an ad hoc basis. OMB has previously encouraged agencies to strengthen their program evaluations and expand their use of evidence and evaluation in budget, management and policy decisions to improve government effectiveness.<sup>53</sup>

In 2005, we reported that the results of tax expenditure evaluations could help identify how well tax expenditures are working, both to identify ways to better manage specific tax expenditures and to decide how best to ensure prudent stewardship of taxpayers' resources.<sup>54</sup> As previously discussed, we recommended that OMB develop and implement a framework for conducting performance reviews of tax expenditures, but OMB has not reported on progress made on this recommendation since the President's fiscal year 2012 budget.<sup>55</sup> Moreover, since fiscal year 2011, the President's budget has recognized that a comprehensive evaluation framework that examines incentives, direct results, and spillover effects would benefit the budgetary process by informing

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<sup>52</sup>Treasury officials said the tax expenditure evaluations it conducts generally relate to specific tax policy proposals under consideration, or areas of tax policy under potential reform. For example, Treasury officials noted that they assessed specific tax expenditures for a report on business tax reform, originally published in 2012 and updated in 2016, which described tax policy proposals reflected in the President's budget request. See *The President's Framework for Business Tax Reform: An Update* (Washington, D.C.: April 2016).

<sup>53</sup>GAO, *Program Evaluation: Some Agencies Reported that Networking, Hiring, and Involving Program Staff Help Build Capacity*, [GAO-15-25](#) (Washington, D.C.: Nov. 13, 2014). We similarly reported on the potential usefulness to Congress, agencies, and the public of conducting retrospective analyses of regulations—another type of policy tool used to achieve national priorities—to help evaluate how well existing regulations work in practice and determine whether they should be modified or repealed. See, for example, GAO, *Reexamining Regulations: Agencies Often Made Regulatory Changes, but Could Strengthen Linkages to Performance Goals*, [GAO-14-268](#) (Washington, D.C.: Apr. 11, 2014).

<sup>54</sup>[GAO-05-690](#).

<sup>55</sup>A program evaluation is one type of review that could be conducted within this framework. As noted in the President's fiscal year 2012 budget, the administration planned to focus on addressing challenges in conducting evaluations due to limited data availability and analytical constraints so it can work toward analyses that examine tax expenditures alongside related spending programs, but subsequent budgets have not provided an update on these efforts.



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decisions on tax expenditure policy. Finally, this option may improve the information available to policymakers on the effectiveness of specific tax expenditures, which policymakers could then use in deciding how to best allocate resources to achieve national priorities. Tax expenditure evaluations could also complement ongoing GPRAMA-related performance measurement and reporting by measuring results that are too difficult or expensive to assess annually, explaining the reasons why performance goals were not met, or assessing whether one approach is more effective than another.<sup>56</sup>

## Design Considerations

- **Which tax expenditures would be evaluated and how frequently?**  
We have previously identified options for selecting tax expenditures for evaluation, including: (1) selecting on a judgmental basis, (2) selecting based on established criteria, and (3) evaluating an existing temporary tax expenditure before it is extended.<sup>57</sup> Some state and foreign governments conduct tax expenditure evaluations grouped by policy focus or industry, or focus evaluations on tax expenditures with the largest revenue losses. For example, Germany focuses on its largest tax expenditures, with one budget-related document reporting that 27 of 102 tax expenditures—accounting for 75 percent of the value of all tax expenditures—were evaluated between 2011 and 2014.<sup>58</sup> Meanwhile, the Netherlands established a 5-year schedule to review all tax expenditures and makes the goals and standards of the reviews publicly available.<sup>59</sup>
- **Who would be responsible for conducting the evaluations?**  
Executive branch agencies could conduct these evaluations within the

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<sup>56</sup>For example, an evaluation might assess the effect of a tax expenditure on economic growth or the distributional effect of a tax expenditure—the result of which may then be compared to outlay programs for which similar data were available (see option 3 below on comparing tax expenditures and outlay programs with similar purposes).

<sup>57</sup>We have published a guide for policymakers to be used when considering how and when to evaluate tax expenditures. See GAO, *Tax Expenditures: Background and Evaluation Criteria and Questions*, [GAO-13-167SP](#) (Washington, D.C.: Nov. 29, 2012).

<sup>58</sup>Germany's Federal Ministry of Finance, *24th Subsidy Report of the Federal Government* (Berlin: August 2013).

<sup>59</sup>Organization for Economic Cooperation and Development, *Tax Expenditures in OECD Countries* (Paris: 2010).

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GPRAMA framework.<sup>60</sup> We have previously recommended that OMB develop and implement a framework for conducting performance reviews of tax expenditures, though OMB has not reported on progress made on this recommendation since the President's fiscal year 2012 budget, as previously mentioned.<sup>61</sup> Experts also suggested that Treasury would be well equipped to analyze available taxpayer data related to specific tax expenditures. However, they also noted the potential for political influence in having any executive branch agency conduct the evaluations, and that hiring nongovernmental organizations to conduct these evaluations could be an alternative to executive branch reviews. One expert suggested that a tax expenditure commission with appointees from a balance of political parties could identify which of these organizations would conduct each review.

- **How might policymakers address data challenges?** Agencies may not have access to confidential taxpayer data that they might need to conduct evaluations, and existing IRS data may not be sufficient for evaluating the efficiency, equity, and other effects of specific tax expenditures. For these challenges with lack of access to data, Congress has allowed some exceptions to laws limiting the disclosure of taxpayer information to third parties.<sup>62</sup> For the challenge of lack of tax expenditure data, any party conducting an evaluation could, to some extent, use data from other agencies or other sources, such as public records, state agency records, and surveys, as previously discussed. IRS could also be directed to collect more data that could

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<sup>60</sup>Sometimes agencies conduct formal program evaluations of federal programs in conjunction with GPRAMA reporting. We have previously reported that a third of the CFO Act agencies have evaluation coverage of half or more of their performance goals. Similarly, over a third of the CFO Act agencies reported using evaluations to a moderate or greater extent as evidence in support of budget or policy changes or program management. See [GAO-15-25](#).

<sup>61</sup>[GAO-05-690](#).

<sup>62</sup>In considering proposals for exceptions to confidentiality, Congress has generally attempted to balance the expectation of taxpayer privacy with the competing policy goals of efficient use of government resources, the public health and welfare, and law enforcement. Our taxpayer privacy guide provides questions for Congress to consider when assessing whether to expand disclosure of tax information. See GAO, *Taxpayer Privacy: A Guide for Screening and Assessing Proposals to Disclose Confidential Tax Information to Specific Parties for Specific Purposes*, [GAO-12-231SP](#) (Washington, D.C.: Dec. 14, 2011).

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be used to evaluate a given tax expenditure, although such an effort could increase taxpayer burden.<sup>63</sup> Policymakers could also weigh the availability of data on specific tax expenditures when deciding which tax expenditures should or should not be evaluated.<sup>64</sup>



### Review

**Option 3:** Conduct portfolio reviews of federal policy tools, including tax expenditures, with similar objectives

OMB could conduct reviews of portfolios of programs and other policy instruments—including tax expenditures—used to help pursue similar objectives.<sup>65</sup> Currently, OMB generally reviews spending by agency rather than by policy area. We have previously reported that while the evaluation of spending programs in isolation may be revealing, it is often critical to understand how federal spending programs fit within a broader portfolio of tools and strategies—such as regulations, direct loans, and tax

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<sup>63</sup>IRS is obligated under the Paperwork Reduction Act of 1995 (44 U.S.C. chapter 35) to keep the administrative burden on taxpayers as low as possible, while still fulfilling its mission. Tax expenditure data generally would not be collected on tax returns unless IRS needs the information to know the correct amount of taxes owed, or is legislatively mandated to collect or report the information. In considering additional data requirements, it is important that Congress weigh the need for more information with IRS's other priorities because such requirements likely would increase, to some degree, the administrative costs for IRS and the compliance burden on taxpayers.

<sup>64</sup>For example, the Evidence-Based Policymaking Commission Act of 2016 establishes a commission tasked with, among other things, evaluating how administrative data on federal programs and tax expenditures, survey data, and related statistical data series may be integrated and made available to facilitate program evaluation, continuous improvement, policy-relevant research, and cost-benefit analyses.

<sup>65</sup>For more information on portfolio budgeting, see Steve Redburn and Paul Posner, *Portfolio Budgeting: How a New Approach to the Budget Could Yield Better Decisions* (Washington, D.C.: The Brookings Institution, September 2015), accessed February 16, 2016. <http://www.brookings.edu/research/papers/2015/09/30-portfolio-budgeting-new-approach-redburn-posner>.

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expenditures—to advance federal missions and achieve federal performance goals.<sup>66</sup>

Likewise, such an analysis could help Congress and executive agencies identify whether a program complements and supports other related programs, whether it is duplicative or redundant, or whether it actually works at cross-purposes to other initiatives. For example, we previously reported that 20 federal government entities administered 160 programs, tax expenditures, and other tools that supported homeownership and rental housing in fiscal year 2010.<sup>67</sup> We have also previously reported that coordinated reviews of tax expenditures with related spending programs could help policymakers reduce overlap and inconsistencies and direct scarce resources to the most effective or least costly methods to deliver federal support.<sup>68</sup> Experts identified federal aid for higher education as another example of an area for which portfolio review could be valuable, as there are multiple federal grants, loans, and tax expenditures that serve this policy area.

## Design Considerations

- **How would policy areas be selected for review?** One expert noted that the selection of policy areas for review could be accomplished in Congress, either by the leadership in consultation with the President or by a budget committee as a part of the congressional budget process.<sup>69</sup> Alternatively, GPRAMA could serve as the framework for selecting areas for review, specifically through CAP goals—the long-term, outcome-oriented crosscutting priority goals for the federal

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<sup>66</sup>GAO, *21st Century Challenges: Performance Budgeting Could Help Promote Necessary Reexamination*, [GAO-05-709T](#) (Washington, D.C.: June 14, 2005).

<sup>67</sup>GAO, *Housing Assistance: Opportunities Exist to Increase Collaboration and Consider Consolidation*, [GAO-12-554](#) (Washington, D.C.: Aug. 16, 2012).

<sup>68</sup>GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, [GAO-11-318SP](#) (Washington, D.C.: Mar. 1, 2011).

<sup>69</sup>Posner, Paul. *Federal Budget Process Reform. Testimony to U.S. House of Representatives Committee on the Budget* (Washington, D.C.: July 28, 2015).

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government.<sup>70</sup> In September 2015, OMB staff told us that OMB had determined that there were no tax expenditures that were critical to support achievement of current CAP goals.<sup>71</sup> However, as new CAP goals are established, tax expenditures may support their achievement. Further, we have previously reported that OMB and agencies are required to consult with Congress when establishing or adjusting CAP goals, which could provide Congress with opportunities to encourage further incorporation of tax expenditures into the goals, if desired.<sup>72</sup>

- **How would the federal resources that contribute to a policy area be identified?** As we have reported previously, creating a comprehensive list of federal programs along with related funding information is critical for identifying potential duplication, overlap, or fragmentation among federal programs or activities.<sup>73</sup> GPRAMA requires OMB to publish a list of all federal programs on a central government-wide website. In October 2014, we reported that although OMB and agencies have taken some initial steps to develop program inventories with related budget and performance information, the ensuing result has not produced a useful tool for decision making.<sup>74</sup> We made various recommendations to OMB to better present a more coherent picture of all federal programs and ensure that the information agencies provide in their inventories is useful to federal decision makers. For example, one of our recommendations was that OMB, in coordination with Treasury, develop a tax expenditure inventory that identifies each tax expenditure and describes its

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<sup>70</sup>GPRAMA requires OMB to coordinate with agencies to develop CAP goals for a limited number of crosscutting policy areas and management improvement areas every 4 years. OMB is to annually identify the federal agencies, organizations, program activities, tax expenditures, regulations, policies, and other activities that contribute to each CAP goal, along with crosscutting performance measures and quarterly performance targets. GPRAMA also requires that OMB, with the agencies, develop a federal government performance plan defining the level of performance to be achieved.

<sup>71</sup>[GAO-16-509](#).

<sup>72</sup>[GAO-13-167SP](#).

<sup>73</sup>GAO, *Government Efficiency and Effectiveness: Inconsistent Definitions and Information Limit the Usefulness of Federal Program Inventories*, [GAO-15-83](#) (Washington, D.C.: Oct. 31, 2014).

<sup>74</sup>[GAO-15-83](#).

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definition, purpose, and related performance and budget information; as of November 2015, no action had been taken on that recommendation.<sup>75</sup> Such information could help agencies identify the contributions of tax expenditures to achieving national priorities.



### Review and Control

**Option 4:** Directly involve authorizing committees in the development of tax expenditures related to their areas of expertise

Policymakers could help ensure greater coordination between the tax-writing and authorizing committees by having authorizing committees consider new or modified tax expenditure legislation for which they have program-related expertise. When proposed legislation is introduced in the House or Senate, it is generally referred to the committee with subject-matter expertise—thus, in the case of tax expenditures, tax-writing committees are referred proposed tax legislation that can span national priorities across the government.<sup>76</sup> Authorizing committees, on the other hand, are referred proposed legislation for policy areas within their jurisdiction, but generally do not provide direct and formal input on legislation of related tax provisions in those policy areas.

By being involved in developing or modifying tax expenditure legislation, authorizing committees would have a broader picture of federal resources being allocated to national priorities. This may further help policymakers identify potential duplication between spending programs and tax

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<sup>75</sup>Although OMB published an initial inventory covering the programs of 24 federal agencies in May 2013, OMB decided to postpone further development of the inventory to coordinate with the implementation of the Digital Accountability and Transparency Act of 2014 (DATA Act). In July 2015, we recommended that OMB accelerate efforts to merge DATA Act purposes with the production of a federal program inventory.

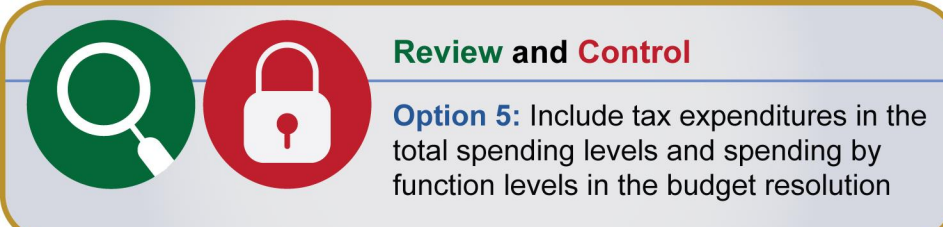
<sup>76</sup>The tax-writing committees also have jurisdiction over some health programs and aspects of Social Security.

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expenditures, and may allow for greater comparison of how well specific policy tools help achieve a national priority. While bringing other committees into the process of reviewing tax expenditures could be institutionally cumbersome, having tax-writing and authorizing committees review tax legislation may still be appropriate when a provision has both programmatic purposes, like stimulating an activity, and tax policy purposes, like taking into account taxpayers' ability to pay taxes.

## Design Consideration

- **What path through committees would new tax legislation take?** Proponents of this option suggested various ways that both tax-writing and authorizing committees could provide input when considering proposed tax legislation. For example, some proponents suggested that tax-writing committees could continue to draft new tax legislation, but that authorizing committees would then need to approve the legislation before it goes to the full House or Senate for a vote—a process similar to the sequential referral.<sup>77</sup> Under this option, policymakers would also need to consider how to account for tax expenditures serving varied purposes that fall within the jurisdiction of multiple committees.



The graphic features two circular icons on the left: a green magnifying glass and a red padlock. To the right of these icons, the text reads: **Review and Control** (with 'Review' in green and 'Control' in red), followed by **Option 5:** Include tax expenditures in the total spending levels and spending by function levels in the budget resolution.

Congress could authorize the Senate and House Budget Committees to include tax expenditures with other spending, both in total and by functional category, in budget resolution levels. Currently, the budget committees—via the budget resolution—set forth revenue and spending

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<sup>77</sup>House and Senate rules allow for the referral of legislation to more than one committee in certain instances. For example, legislation addressing the Highway Trust Fund is referred primarily to the House Committee on Transportation and Infrastructure, which addresses policy issues, and sequentially to the House Committee on Ways and Means, which considers revenue issues.

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targets, including spending targets for each major functional category of the budget. Tax-writing committees then decide how to achieve revenue targets through, if needed, changes to overall tax rates or to specific tax expenditures. Meanwhile, appropriations and authorizing committees decide how to achieve spending targets for discretionary and mandatory spending, respectively. Depending on how it was designed, this option would either result in the budget committees setting targets for tax expenditure levels, or it would give authorizing (and potentially appropriating) committees greater or full control over determining the appropriate levels of spending for tax expenditures and other programs within a specific budget function.

Broadly speaking, some experts said that options that further integrate tax expenditures into congressional budgetary controls, such as the budget resolution, could result in the greatest change in how Congress approaches decisions on federal investments. Depending on how policymakers designed this option, it could potentially allow for this movement of federal resources across policy instruments. Moreover, some experts noted it was important for policymakers to have increased flexibility to budget across policy instruments—moving resources toward the most efficient and effective means of making progress toward a national priority.

## Design Considerations

- **How would tax expenditure estimates be allocated to committee(s)?** From our expert interviews and roundtable discussion, and within the literature we reviewed, experts identified various ways to further integrate tax expenditures into the budget resolution, each of which would result in a different shift in committee powers. For example, tax expenditures could be (1) allocated to the tax-writing committees; (2) allocated to, or shared between, both the tax-writing and relevant authorizing (and potentially appropriating) committees; or (3) allocated to the relevant authorizing (and potentially appropriating) committee to determine how to achieve those spending levels across multiple policy instruments.<sup>78</sup> The first design alternative would continue to leverage the expertise of tax-

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<sup>78</sup>The appropriations subcommittees may also play a role in this process, as the appropriations committees in each house distribute spending authority and outlays to their relevant subcommittees of jurisdiction based on the levels contained in the budget resolution.



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writing committees in deciding tax policy. While the third design alternative would likely be complex to design and implement, it would potentially allow for the movement of federal resources across policy instruments. The second design alternative may help achieve both those benefits, but would also be complex to design and implement.

- **How might this change affect committee powers?** This option could result in a substantial change in congressional committee jurisdictional powers, depending on how it was designed. The budget committees, and potentially authorizing and appropriations committees, would have greater input into tax policy decisions than previously, while tax-writing committees would have less input.<sup>79</sup> One expert noted that dispersing tax expenditure decisions across multiple committees could impede any opportunity for fundamental tax reform, since the powers to make such changes would be distributed among more congressional actors. Whether or not this change in committee powers is an optimal outcome is a policy decision.
- **Could policymakers overcome tax expenditure measurement challenges?** Policymakers would need to overcome the challenges of treating tax expenditures on the same footing as spending programs—particularly with respect to budget controls that are enforced. Specifically, some tax expenditure estimates are only loosely linked to actual tax filing data. Thus, any prior-year levels of spending for these tax expenditures are only estimates. In contrast, spending programs are measured in obligations and outlays, which are generally measured by the specific amounts of cash committed and disbursed by the government, respectively. However, this measurement challenge is not unique to tax expenditures. For example, experts noted that credit programs are also difficult to measure, but policymakers have made progress in measuring the costs of these types of programs through increased scrutiny and requirements for agencies.<sup>80</sup>

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<sup>79</sup>The House Ways and Means and Senate Finance Committees are both tax-writing committees and authorizing committees for some spending programs, such as Medicare and Temporary Assistance for Needy Families.

<sup>80</sup>According to a Treasury official, certain types of tax expenditures, such as income exclusions, might still be more difficult to estimate than credit programs. The exclusion of interest on life insurance savings, where the taxpayer is not asked to report the amount of the exclusion anywhere on a tax form, may be one such example.



## Control

**Option 6:** Require that tax expenditures expire periodically

Policymakers could require that all, or some subset of, tax expenditures expire after a finite period. This option would result in Congress periodically considering whether to allow tax expenditures to expire or to extend them, similar to the subset of tax expenditures that currently expire unless extended. Most other tax expenditures are enacted permanently and continue without change unless amended. Under Pay-As-You-Go (PAYGO) rules, this option would result in the tax-writing committees needing to find revenues to offset the cost of extending expiring tax expenditures.<sup>81</sup> However, Congress could incorporate the cost of extending expiring tax expenditures in its baseline revenue estimates, thus negating the need to find offsetting revenues, or it could waive the PAYGO rules on a case-by-case basis.<sup>82</sup> This option could result in greater oversight of tax expenditures, as policymakers would be required to explicitly decide whether or not to extend more or all tax expenditures.

## Design Considerations

- **Which tax expenditures should expire, when, and in what way?**  
Congress could develop a general rule establishing which tax

<sup>81</sup>The Statutory Pay-As-You-Go (PAYGO) Act of 2010 (Pub. L. No. 111–139) requires that new direct spending and tax legislation be deficit neutral so that in the aggregate such legislation does not increase the deficit. Thus, if policymakers wanted to reenact an expiring tax provision, under current law this reenactment would need to be paid for through increases in revenues or reductions in spending in other PAYGO legislation affecting the same fiscal year.

<sup>82</sup>Section 257 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, defines the baseline with which PAYGO rules are enforced. However, Congress can include language in direct spending or revenue legislation effectively waiving the PAYGO requirements. For example, section 601 of the Protecting Americans from Tax Hikes Act of 2015 excluded the budgetary effects, including the impact of making various tax expenditures permanent, from PAYGO scorecards. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. Q, 129 Stat. 2242, 3040-3127 (Dec. 18, 2015).

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expenditures should expire and how often. It could also consider the added legislative workload imposed on the tax-writing committees by such a policy when deciding when tax expenditures might expire, and which ones would expire. We have previously reported that frequent changes in the tax code, such as from extended or expired tax provisions, can create uncertainty and contribute to compliance burden by making tax planning more difficult.<sup>83</sup> Policymakers could consider if policies should be developed to mitigate this effect. For example, grandfathering could be provided for assets purchased under tax-preferred regimes.<sup>84</sup> Policymakers could also examine how other countries that require tax expenditures to periodically expire have designed these policies to minimize this burden.<sup>85</sup>

- **Could or should the option be designed to be revenue neutral?** All else equal, if a tax expenditure expires, the result would be additional revenue that the federal government would collect. Policymakers could consider whether to design this option in a way that would automatically lower tax revenues to achieve revenue neutrality.<sup>86</sup>

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## Conclusions

In recent years, revenue losses from tax expenditures have reached levels similar to discretionary spending; approximately \$1.23 trillion in revenue was forgone for fiscal year 2015. Even as discretionary spending has decreased, in real terms, since 2010, the amount of revenue forgone via tax expenditures has increased. Yet tax expenditures do not receive the same level of scrutiny within federal budget processes as discretionary spending. Moreover, the executive branch has made little

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<sup>83</sup>GAO, *Understanding the Tax Reform Debate: Background, Criteria, and Questions*, [GAO-05-1009SP](#) (Washington, D.C.: September 2005).

<sup>84</sup>If Congress provided a transition period for changes to take effect, taxpayers who based their decisions on tax laws in force at that time may not be significantly harmed by later changes. Grandfathering can be controversial, however, due to issues such as generational equity and the fact that it would limit the revenues that could be collected in early years.

<sup>85</sup>For example, according to one publication, Japan and Korea require that most or all tax expenditures periodically expire. See Organization for Economic Cooperation and Development, *Tax Expenditures in OECD Countries* (Paris: 2010).

<sup>86</sup>For example, one way to offset the potential revenue generated by expiring tax expenditures is to lower individual or corporate tax rates.

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progress toward increasing transparency of the budgetary effects of tax expenditures—compared to related spending—or toward implementing a framework to gauge their performance, as we have recommended previously. We continue to believe in the merit of those recommendations.

GPRAMA provides an existing framework for the executive branch to exercise greater oversight over tax expenditures and could help facilitate further incorporating tax expenditures into performance and budget discussions. In implementing GPRAMA, OMB has directed agencies to take tax expenditures into account when identifying programs and activities that contribute to their goals. However, despite this guidance, agencies have identified few tax expenditures that contribute to such goals. We have found that a lack of clarity about the roles of different agencies in conducting reviews of tax expenditures impedes their ability to identify tax expenditures that contribute to agency goals. OMB—given its government-wide purview—and Treasury—given its familiarity with administering the tax code—are well positioned to assist agencies in identifying tax expenditures that relate to their goals. Without additional OMB and Treasury assistance, agencies may continue to have difficulty identifying whether or which tax expenditures are relevant to their goals, and may be limited in their understanding of how the range of federal investments and policy tools contribute to agency goals.

More broadly, we identified various other options to further integrate tax expenditures into both the executive and congressional budgeting processes based on our review of literature and our past work, and our interviews and roundtable discussion with experts. If implemented, these options could increase transparency on how the federal government allocates resources, provide additional means for policymakers to review tax expenditures' effectiveness, and create additional controls over spending through the tax code. However, the options come with a range of challenges and tradeoffs that policymakers would need to consider.

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## Recommendation for Executive Action

To help ensure that the contributions of tax expenditures toward the achievement of agency goals are identified and measured, the Director of OMB, in collaboration with the Secretary of the Treasury, should work with agencies to identify which tax expenditures contribute to their agency goals, as appropriate—that is, they should identify which specific tax expenditures contribute to specific strategic objectives and agency priority goals.

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## Agency Comments

We provided a draft of this report for review and comment to the Secretaries of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, the Interior, Labor, State, Transportation, the Treasury, and Veterans Affairs; the Attorney General of the United States; the Directors of the Office of Management and Budget, and the National Science Foundation; the Administrators of the Environmental Protection Agency, General Services Administration, National Aeronautics and Space Administration, Small Business Administration and the U.S. Agency for International Development; the Acting Director of the Office of Personnel Management; the Acting Commissioner of the Social Security Administration; and the Chairman of the Nuclear Regulatory Commission.

OMB staff spoke with us about their comments on our report and generally agreed with the recommendation and further noted that implementing it could be beneficial. However, they also said it is not an effort they are currently pursuing due to competing priorities, as well as capacity and resource constraints. They also provided technical comments, which we incorporated as appropriate.

The following agencies provided technical comments that were incorporated into the draft as appropriate: The Departments of Energy, Health and Human Services, Housing and Urban Development, the Interior, and Labor.

The following agencies had no comments on the draft report: The Departments of Agriculture, Commerce, Defense, Education, Homeland Security, Justice, State, Transportation, the Treasury, and Veterans Affairs; the Environmental Protection Agency; the General Services Administration; the National Aeronautics and Space Administration; the National Science Foundation; the Nuclear Regulatory Commission; the Office of Personnel Management; the Small Business Administration; the Social Security Administration; and the U.S. Agency for International Development.

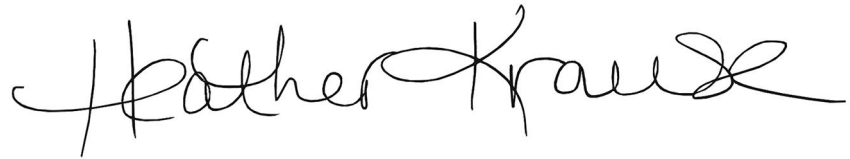
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We are sending copies of this report to the Director of OMB, Secretary of the Treasury, and the heads of the other agencies we reviewed, as well as appropriate congressional committees. In addition, this report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions about this report, please contact me at (202) 512-6806 or [krauseh@gao.gov](mailto:krauseh@gao.gov). Contact points for

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our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in the appendix.

A handwritten signature in black ink that reads "Heather Krause". The signature is written in a cursive style with a large, stylized 'H' and 'K'.

Heather Krause  
Acting Director, Strategic Issues

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# Appendix I: GAO Contact and Staff Acknowledgments

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## GAO Contact

Heather Krause, (202-512-6806) or [krauseh@gao.gov](mailto:krauseh@gao.gov).

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## Staff Acknowledgments

In addition to the contact named above, Jeff Arkin (Assistant Director), Amy Radovich (Analyst-in-Charge), Amy Bowser, Hannah Dodd, Robert Gebhart, Carol Henn, Susan Irving, Benjamin Licht, Donna Miller, Ed Nannenhorn, Cynthia Saunders, MaryLynn Sergent, Timothy Shaw, and Emily Upstill made significant contributions to this report.

# Appendix II: Accessible Data

## Data Tables/Accessible Text

**Data Table for Highlights Figure: Tax Expenditures Identified by Agencies As Contributing to Agency Goals or Missions, As of January 2016**

Tax expenditures identified by agencies as contributors to their missions	\$2.4 billion
Tax expenditures identified by agencies as contributors to specific goals	\$29.5 billion
Tax expenditures not identified by agencies as contributors to their missions or specific goals	\$1.20 trillion

Source: GAO review of Chief Financial Officer Act agency performance documents. | GAO-16-622

### Accessible Text for Figure 1: Examples of Six Types of Tax Expenditures

- 1. Credit:** Reduces tax liability dollar-for-dollar. Additionally, some credits are refundable, meaning that a credit in excess of tax liability results in a cash refund.  
**Example:** Taxpayers with children under age 17 potentially can qualify for up to a \$1,000 partially refundable, per child credit, provided their income does not exceed a certain level.
- 2. Deduction:** Reduces gross income due to expenses taxpayers incur.  
**Example:** Taxpayers may be able to deduct mortgage interest for owner-occupied homes.
- 3. Deferral:** Delays recognition of income or accelerates some deductions otherwise attributable to future years.  
**Example:** Taxpayers may defer paying tax on interest earned on certain U.S. savings bonds until the bonds are redeemed.
- 4. Exclusion:** Excludes income that would otherwise constitute part of a taxpayers gross income.  
**Example:** Employees generally pay no income taxes on contributions that employers make on their behalf for medical insurance premiums.
- 5. Exemption:** Reduces gross income for taxpayers because of their status or circumstances.  
**Example:** Credit unions are exempt from federal corporate income taxes.
- 6. Preferential tax rate:** Reduces tax rates on some forms of income.  
**Example:** Capital gains on certain income are subject to lower tax rates under the individual income tax.



**Data Table for Figure 2: Estimated Revenue Losses from Tax Expenditures Compared to Mandatory and Discretionary Spending**

<b>Fiscal Year</b>	<b>Discretionary spending (in billions of 2015 dollars)</b>	<b>Mandatory spending minus net interest (in billions of 2015 dollars)</b>	<b>Sum of tax expenditure revenue loss estimates (in billions of 2015 dollars)</b>
1985	802	773.6	682.4
1986	826.9	784.1	742.8
1987	819.4	776.9	695.3
1988	829.7	800.8	539.4
1989	839.9	834.9	570.7
1990	830.2	942.1	578
1991	854.1	955.3	569.4
1992	834.5	1,013.60	589.2
1993	824.3	1,024.50	596.7
1994	808.9	1,072.20	627.1
1995	797.3	1,081.10	649.4
1996	765.3	1,130.20	653.2
1997	772.2	1,143.60	682
1998	769.8	1,198.30	771.5
1999	787.8	1,239.30	830.4
2000	829.1	1,283.40	867.9
2001	855	1,327.40	940.8
2002	951.6	1,433.90	977.3
2003	1,048.60	1,504.30	938.1
2004	1,111.20	1,536.20	903.9
2005	1,165.70	1,588.00	933.6
2006	1,185.00	1,645.70	987
2007	1,182.10	1,645.50	958.1
2008	1,261.80	1,773.20	976
2009	1,360.00	2,300.40	1077.9
2010	1,467.70	2,084.80	1116.3
2011	1,438.30	2,163.20	1145.1
2012	1,348.60	2,129.20	1132.6
2013	1,239.30	2,094.30	1180.7
2014	1,194.70	2,126.90	1184.5
2015	1,168.60	2,296.60	1351.4

Source: GAO analysis of Treasury estimates and OMB historical data.

Note: Summing tax expenditure estimates is a useful gauge of size but does not take into account possible interactions among individual tax expenditures.

**Data Table for Figure 6: Tax Expenditures Identified by Agencies as Contributing to Agency Goals or Missions, as of January 2016**

Tax expenditures identified by agencies as contributors to their missions	\$2.4 billion
Tax expenditures identified by agencies as contributors to specific goals	\$29.5 billion
Tax expenditures not identified by agencies as contributors to their missions or specific goals	\$1.20 trillion

Source: GAO review of Chief Financial Officer Act agency performance documents. | GAO-16-622

**Accessible Text for Figure 7: Examples of Broad Benefits to Further Incorporating Tax Expenditures into Budgeting Processes**

**Increasing information transparency of resource allocation:**

Additional information on tax expenditures in the federal budget process could increase transparency to policymakers and the public on the levels of resources associated with national priorities (budget functions) each year.<sup>a</sup> Options to increase transparency generally only require incremental changes in existing processes.

**Creating further opportunity to review effectiveness and outcomes:**

Additional reviews could help ensure that tax expenditures are achieving their intended goals, and help assess their effectiveness in absolute, or as compared to other policy tools, while taking into account the level of resources allocated to each.

**Exercising greater control over resources:**

Further incorporating tax expenditures into congressional budgeting controls could help policymakers better adapt the government to shifting environments, evolving demands, changing risks, and new priorities. Moreover, certain changes in budgetary controls may allow Congress more flexibility in allocating federal resources to the most efficient programs.

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