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Search for Budget Savings Leads to Scrutiny of Tax Expenditures

By Michael J. Novogradac, CPA

Given the current economic environment, it should come as little surprise to tax credit professionals that tax expenditures and their role in the federal budget have become the focus of increasing scrutiny in recent months.

In general, tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers. This includes the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), historic tax credit (HTC), renewable energy tax credit (RETC) and similar programs. Champions of these programs should be vigilant in light of the increased attention to the broader issue of tax expenditures.

About Tax Expenditures

Each year the Joint Committee on Taxation (JCT) staff publishes a report on tax expenditures prepared for the House Committee on Ways and Means and the Senate Committee on Finance. The JCT also submits the report to the House and Senate Committees on the Budget.

Importantly, a tax expenditure estimate is not the same as a revenue estimate. Unlike revenue estimates, tax expenditure estimates do not incorporate any taxpayer behavioral responses or changes in the timing of tax payments. Policymakers and the public use the study of tax expenditures to understand and gauge the actual size of government, how the government uses its resources, and—most significantly for the tax credit community—the tax and economic policy consequences that follow from implicit or explicit choices made in fashioning legislation.

How the LIHTC, NMTC, HTC and RETC Stack Up

According to the most recent JCT report on tax expenditures released on January 13, 2010, the home mortgage interest deduction will cost \$572.9 billion during the five year period between 2009 and 2013. In contrast, the low-income housing tax credit program is expected to cost only \$30 billion dollars during the same period. This represents a federal homeownership subsidy worth 19 times more than the LIHTC subsidy—and the \$30 billion estimate for LIHTC expenditures includes \$3.4 billion for the estimated cost of the LIHTC cash grant election created by the American Recovery and Reinvestment Act.



The committee's report also includes estimates for other tax credits. The federal expenditure for RETC programs under Section 45 and Section 48 is estimated at \$7.9 billion. The estimated federal expenditure for the HTC program between 2009 and 2013 is \$3.6 billion. The expenditure for the NMTC program under Section 45D is estimated at \$3.5 billion.

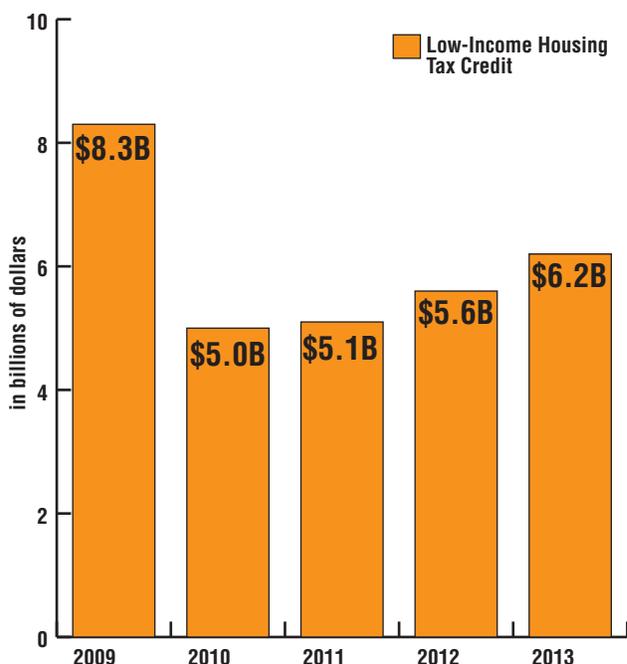
Some Proposals Being Considered

In the public sector, President Barack Obama's Fiscal Reform Commission is combing tax expenditures for possible savings. The President created the commission to identify policies to balance the budget, exclusive of interest payments on debt, by 2015 and meaningfully improve the long-term fiscal outlook. Bloomberg reported last

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Tax Expenditure Estimates



Source: Joint Committee on Taxation, Novogradac & Company LLP

month that cuts to expenditures could account for two-thirds to three-quarters of the panel's package of proposals for reducing the federal budget deficit. The commission is supposed to vote on a final report containing a set of recommendations no later than December 1, 2010. The completed report would have to be approved by 14 of its 18 members to be forwarded to Congress for consideration.

In the meantime, Rep. Scott Murphy, D-N.Y., introduced the Tax Information for New Fiscal Oversight (Tax INFO) Act in the House on May 12, a bill that would require the JCT, beginning with its 2011 annual tax expenditure report, to provide an annual analysis of each provision in the tax code for its equity, efficiency and ease of administration, and report on the aggregate revenue lost through the tax code due to those tax expenditures. Murphy and members of the Blue Dog Coalition say the bill would provide Congress with a consistent process to analyze and measure tax expenditures to determine whether they are achieving their objectives.

In the private sector, Harvard University economist Martin Feldstein said in a July 20 *Wall Street Journal* column that reducing tax expenditures would be the single best way to cut the deficit. Feldstein acknowledges that some tax expenditures provide good incentives and others increase the fairness of the tax system; nonetheless, he suggests that even these valuable tax expenditures could be reduced by one-third or more through a partial and gradual phase-down.

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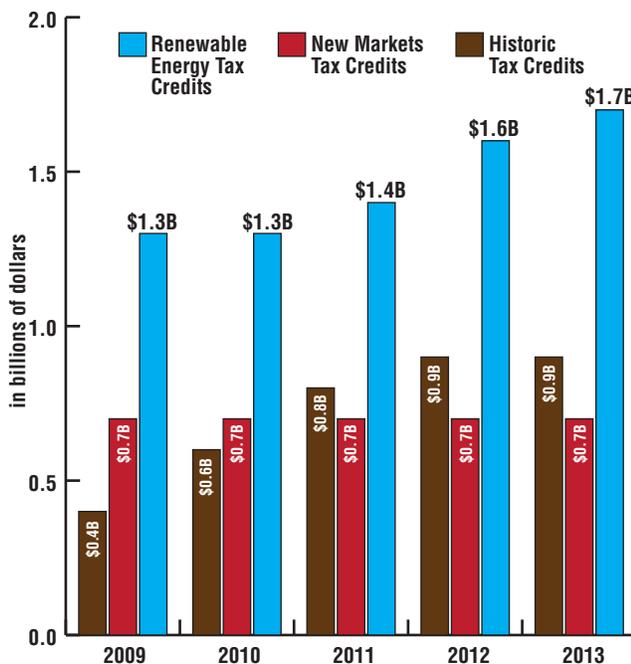
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Tax Expenditure Estimates



Source: Joint Committee on Taxation, Novogradac & Company LLP

In April, the Center for American Progress, a progressive think tank, issued a report that suggests that the JCT's annual reports—as well as similar biannual estimates prepared by the Congressional Research Service and periodic studies conducted by the Government Accountability Office and Congressional Budget Office—are insufficient. Instead, the report suggests that tax expenditures should be the subject of analysis similar to that provided by the Congressional Budget Office for direct spending. In "Audit the Tax Code: Doing What Works for Tax Expenditures," author Sima Ghandi suggests that in addition to being evaluated for effectiveness, tax expenditures should be subject to the annual budget process and PAYGO rules.

In contrast, in a report issued last month, the Tax Foundation, a Washington, D.C.-based nonpartisan tax research group, suggested that any debate about the future of tax expenditures should be done within the broader context of reforming the entire tax code rather than scrutinizing certain provisions in a piecemeal approach.

What Does this Mean for the Tax Credit Community?

It's unclear at this time which of these proposals could gain traction, if any. As illustrated by these examples, the conversation about tax expenditures is wide-ranging and could expose all tax expenditures to scrutiny. Conversely, as the dialogue continues it's also possible that specific programs could be placed under the microscope in the coming months.

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In the short term, lawmakers' emphasis on the deficit and this examination of tax expenditures could make it more difficult to secure extensions for specific tax expenditures, such as the NMTC. Though not in immediate danger, the tax credits for renewable energy investment and production also will face an uphill battle for extension. In the long term it could be argued that even permanency shouldn't grant too much comfort to the

LIHTC or HTC communities, as some proposals could apply even to those permanent tax expenditures.

In the coming months, it will be vital for the tax credit community to demonstrate the benefit of these programs to the country and to lawmakers so that their value is unmistakable and undeniable. ♦

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