Cut the deficit? Go after tax breaks. Yeah, tax breaks.

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Abstract

In a contribution to the Christian Science Monitor, Donald Marron discusses the hundreds of billions of dollars in spending plans that masquerade as tax breaks, and why these provisions need greater scrutiny.

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Cut the deficit? Go after tax breaks. Yeah, tax breaks.

Here's a shocker: America can cut government spending by eliminating tax breaks.

I know that sounds crazy. Everyone usually talks as if spending and tax breaks are distinct. Spending is what the government gives out or uses for purchases; tax breaks reduce how much revenue it collects.

Reality, however, is a lot blurrier. Hundreds of billions of dollars of spending are disguised as tax cuts.

It's not hard to see why. Voters like tax cuts more than spending increases. Politicians understand that, so they convert spending into tax breaks.

The ethanol tax credit is a perfect example. Fuel producers qualify for a 45-cent tax credit for each gallon of ethanol they blend into gasoline. Blenders calculate their income taxes like other businesses, then deduct the value of the credit before they send their check to the Internal Revenue Service (IRS).

The ethanol subsidy thus looks like a tax cut, but it's really government spending in disguise. The Department of Energy could accomplish the same thing by sending out subsidy checks. The same is true for dozens of other tax provisions, such as the business credit for research and development and personal tax breaks for mortgage interest, health insurance, and charitable giving.

Politicians act as if those provisions are tax cuts. That seems plausible. Businesses and families send less money to the IRS because of them.

But think about it. These tax breaks don't let you keep your money. They pay you for doing what government wants, whether that's taking out a mortgage, giving to charity, or investing in R&D. What you pay the IRS equals the taxes you owe minus the payments for which you've qualified. Those payments are no different from spending; they just happen to be netted against your tax bill.

That doesn't mean all tax preferences are bad policy. Some support important goals, and the tax system is sometimes the best way to administer a program. The income tax, for example, provides a natural structure for benefits like the earned income tax credit that should vary with income.

It does mean, however, that these provisions should get the same scrutiny as traditional spending programs. Social Security, health care, defense, and domestic spending must all go under the budget knife if we want to avoid unsustainable debts. The middle-class entitlements, business incentives, and social programs embedded in the tax code shouldn't escape that surgery just because they're designed as tax breaks.

That's why many budget hawks believe that cutting these preferences is essential to deficit reduction. The president's fiscal commission, for example, proposed dramatic cuts to "spendinglike" tax preferences as a way to reduce future deficits while lowering – not raising – income tax rates.

That approach has great merit, but has not yet been universally embraced. When Sen. Tom Coburn, a conservative Republican and budget hawk from Oklahoma, recently introduced legislation to eliminate the ethanol tax credit, he drew fierce opposition from some advocacy groups that favor lower taxes. Both Senator Coburn and the advocates favor smaller government. Where they differ is that Coburn recognizes that spending can hide in the tax code.

Trimming tax preferences won't be painless – many businesses and families would send more to the IRS. But the result would be a fairer, more honest tax code and a broader, more solid base of revenue to pay for government services.

Other Publications by the Authors

- Donald Marron