Cost-Benefit Analysis of Tax Regulations

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Cost-benefit analysis of tax regulations

• The traditional tools of tax analysis are the appropriate tools for cost-benefit analysis of tax regulations

  • Fundamental tradeoff: taxes impose burden/compliance costs to raise revenue
  
  • Analytic frameworks already exist for estimating these quantities
    
    • Distribution analysis provides estimates of burden changes
    
    • Revenue analysis provides estimates of revenue changes
    
    • Estimates of compliance costs are produced, though not as prominent

• Cost-benefit analysis should report revenue, distribution, and compliance cost estimates

• Not a paint-by-numbers exercise: estimates rely on potentially complex economic analyses that reflect the full range of effects of a regulation

  • Baseline assumptions may need to be modified to reflect the specifics of a proposed regulation
Contrast with traditional cost-benefit analysis

- Social benefits and costs are not quantified, and should not be quantified
  - Translating revenue and burden impacts into benefits and costs requires assumptions about the value of revenues and the appropriate distribution of the tax burden
  - Treasury/IRS should not claim to have definitive answers to these questions in the regulatory impact analysis
- Policymakers and the public should use the analysis conducted in the regulatory impact analysis to draw conclusions about the merits of the regulation
Why distribution analysis is the answer

• Burden is the welfare impact of a change in tax policy (ignoring revenues)

• (Most) distribution analyses aim to estimate burden
  • Under standard economic assumptions, changes in behavior in response to a (small) change in policy don’t matter for the well-being of the affected actor
  • Incidence assumptions for each tax allocate the burden of the tax to the groups thought to bear the tax

• Challenge: need incidence assumptions for regulations
  • May be able to apply existing corporate or individual incidence assumptions
  • Important source of uncertainty given limited research typically available for Treasury/IRS when regulating
Adapting distribution analysis to more complex settings

• Adjustments required when benchmark assumptions fail
  • Externalities and market failures
  • Policy changes that lead to large changes in marginal incentives

• Compliance costs can be understood as another form of modification to the distribution table
  • Benchmark is the estimate for maintaining current behavior
  • Adjustments required when policy changes lead to large changes in incentives
The baseline for analysis of tax regulations

• Tax regulations should be judged against a no-action baseline
  • Post-statutory in the case of new legislation
  • Current practice in the case of other regulations

• A no-action baseline focuses the analysis where it is most useful to policymakers and provides valuable transparency into the regulatory process

• JCT will have estimated the change in revenues and burden (exclusive of compliance costs) during the legislative process
Criteria for an economically significant tax regulation

• A tax regulation should be deemed economically significant if it
  • Increases or decreases revenues by more than $100 million in any year
  • Increases or decreases the sum of
    • the total tax change shown in a distribution analysis
    • total compliance costs
    by more than $100 million in any year

• Without normative assumptions cannot convert revenues and burden into benefits and costs, but can still use these impacts as indicators of the scale of the regulation

• Could increase the $100 million threshold given the scale of the tax system
Summary Recommendation

• The traditional tools of tax analysis are the appropriate tools for cost-benefit analysis of tax regulations

• Cost-benefit analysis of tax regulations should report revenue, distribution, and compliance cost estimates

• Social benefits and costs are not quantified in this approach, and should not be quantified