

ARTICLES

BREAKING THE SPELL OF TAX BUDGET MAGIC

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Abstract

To date, tax scholars have responded to the proliferation of so-called temporary or sunset tax expenditure legislation by staking claims either for or against it, focusing on its relative merits and shortcomings. In this Article, I argue that these positions are analytically incomplete. Rather than address the underlying deficiencies in the budget process that have led to the preference for temporary tax provisions, the advocacy of the use (or non-use) of temporary provisions simply asks which type of provision will yield the least problematic results.

This Article seeks to help fill a gap in the literature by focusing on remedies meant to address the source of many issues related to both temporary and permanent tax expenditure legislation. In particular, I propose the adoption of a bundle of new budget rules that will work as precommitment devices to restrain lawmakers from exploiting weaknesses in the existing process. I argue that these proposed rules would still give lawmakers the flexibility to adopt either temporary or permanent tax legislation as appropriate. However, the proposed rules would help to decrease opportunities for budget manipulations, impose more fiscal restraint on lawmakers, achieve greater legislative transparency, help loosen the hold of special interest groups on lawmakers, and enhance legislative stability.

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I. INTRODUCTION	3
II. BEHIND THE VEIL: THE CURRENT BUDGET PROCESS FOR TAX EXPENDITURES	5
A. Tax Expenditures and Tax Extenders	5
B. Budget Rules	8
1. <i>Overview</i>	8
2. <i>PAYGO</i>	10
3. <i>Reconciliation and the Byrd Rule</i>	11
4. <i>Senate Point of Order</i>	13
III. THE BLACK AND WHITE MAGIC OF TEMPORARY TAX EXPENDITURES	13
A. Budget Manipulation	14
1. <i>Front Loading with Temporary Provisions</i>	15
2. <i>Back Loading with Permanent Provisions</i>	17
B. Rent Extraction	19
C. Political Opaqueness.....	20
D. Uncertainty and Inefficiency	22
E. Dynamic Lawmaking?	23
IV. BREAKING THE SPELL WITH NEW BUDGET RULES.....	24
A. Proposed Budget Rules	24
1. <i>Disregard Sunsets for Budget Scoring Purposes</i>	25
2. <i>Lock-Step PAYGO</i>	27
3. <i>Mandatory Baseline Review</i>	27
B. Consequences of the Proposed Budget Rules	28
1. <i>Decrease Opportunities for Budget Manipulation and Increase Fiscal Restraint</i>	28
2. <i>Maintain Legislative Flexibility and Enhance Oversight</i>	29
3. <i>Enhance Legislative Stability</i>	29
4. <i>Achieve Greater Political Transparency</i>	30
5. <i>Diminish Captivity to Special Interest</i>	30
C. Potential Criticisms	31
V. CONCLUSION	32

I. INTRODUCTION

Over fifty tax expenditure provisions in the Internal Revenue Code reside in an effective tax abyss—neither permanently enacted nor affirmatively repealed.¹ This predicament is a natural byproduct of the so-called “tax extender” legislative phenomenon, whereby tax expenditures are routinely enacted on a temporary basis (typically for one or two years). At the end of their effective period, these provisions are habitually extended, sometimes retroactively.

The proliferation of tax extender provisions is not insignificant. It is estimated that the cost of tax extenders each year is approximately \$54 billion, and the cost to have these same extenders in effect for the next ten years would cost over \$930 billion.² The growing prevalence of temporary tax legislation is primarily attributable to vagaries in the budget process that give tax expenditures an advantage over direct spending equivalents and temporary tax provisions an advantage over their permanent counterparts.³ First, the nominal cost of a tax extender is significantly reduced due to its purported shorter effective period, even if it is anticipated that it will be extended again the following year. Moreover, providing offsets necessary to make a temporary provision revenue neutral is far easier than for a permanent provision. With the ten-year budget window typically used for scoring legislation, lawmakers can use ten years of revenue to offset the cost of a single year of tax legislation rather than having to find revenue offsets for a full ten years. This type of budget manipulation is in large part responsible for the explosion of temporary tax legislation in recent years.⁴

It is not surprising that the rise of tax extenders has garnered significant attention from both legislators and academics alike. In response to this proliferation of temporary legislation, scholars have come out both for and against the use of temporary provisions as a legitimate legislative tool.⁵ In particular, recent analysis has focused on the inherent

¹ See Staff of Joint Committee on Taxation, LIST OF EXPIRING TAX PROVISIONS 2013-2024 (Jan. 10, 2014), available at <https://www.jct.gov/publications.html?func=startdown&id=4540>. On December 3, 2014 the House of Representatives passed a bill to renew the tax extenders that expired at the end of 2013 until the end of 2014, when they once again will expire. Tax Increase Prevention Act of 2014 H.R. 5771. Even if approved by the Senate, the bill only represents a one-year deal, and Congress will have to revisit these same extenders again in 2015.

² Molly F. Sherlock, Cong. Research Serv., TAX PROVISIONS EXPIRING IN 2013 (“TAX EXTENDERS”), Table 1 (2013), available at <http://www.fas.org/sgp/crs/misc/R43124.pdf> (estimating the cost of extending all of the expired provisions to 2014 at \$54.2 billion and the cost of extending these same provisions throughout the entire 2014-2023 period at \$938.3 billion).

³ Rebecca M. Kysar, *Lasting Legislation*, 159 U. PA. L. REV. 1007, 1011 (2011); William Gale and Peter Orszag, *Sunsets in the Tax Code*, TAX NOTES at 115 (June 9, 2003), available at <http://www.brookings.edu/~media/research/files/articles/2003/6/09useconomics%20gale/20030609.pdf> (noting “[s]unsets are now a *de facto* element of fiscal policy”).

⁴ *Testimony before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means*, 112th Cong. 3-4 (June 8, 2012) (statement of Donald B. Marron), available at <http://www.taxpolicycenter.org/UploadedPDF/1001620-tax-expirers.pdf>.

⁵ See, e.g., Kysar, *supra* note 3 at 1008 (arguing against a presumption for temporary legislation); Rebecca M. Kysar, *The Sun Also Rises: The Political Economy of Sunset Provisions in the Tax Code*, 40 GA. L. REV. 335, 339 (2006) (arguing that sunset provisions do not function as “good government” tools); Jacob E. Gersen, *Temporary Legislation*, 74 U. CHI. L. REV. 247, 298 (2007) (arguing “there should be a presumptive preference in favor of temporary legislation”); George K. Yin, *Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint*, 84 N.Y.U. L. REV. 174, 187-94 (2009) (proposing presumption in favor of temporary effect legislation).

virtues and vices of temporary tax provisions versus their permanent counterparts.⁶ Most notably, George Yin argues that the “enactment of temporary-effect rather than permanent legislation would promote political accountability and may result in greater fiscal restraint.”⁷ In contrast, Rebecca Kysar believes “‘pro-temporary legislation’ scholars understate the costs of such legislation because temporary legislation increases rents from interest groups, entrenches current majoritarian preferences, and produces planning conundrums for public and private actors alike.”⁸ She therefore recommends a “policy presumption against temporary legislation.”⁹

Neither of these diametrically opposed views, however, fully addresses the limitations and faults of our modern day legislative budget process. While there are certainly merits and drawbacks to either type of legislation, in this Article I argue that simply focusing the analysis on the preferable length of the tax legislation is insufficient. I believe that a more complete analysis can be achieved by alternatively focusing on determining what types of budget constraints, if any, can best achieve the goals of responsible legislation. In particular, this Article proposes budget reforms and explores how these reforms could affect the goals of fiscal restraint, transparency, adaptability, and resistance to capture by private interests, independent of the length of the legislation being used.

In order to assess the potential impact that budgetary process constraints could have on the challenges presently plaguing the tax legislative process, this Article proposes three primary budgetary framework rules. In particular, I argue that when tax expenditures are scored for budget purposes, they should be presumed to be in effect for the entire applicable budget window, even if they are set to expire prior to the end of the window. This is consistent with what is currently required with respect to mandatory spending programs.¹⁰ Moreover, if this presumption is overcome and a temporary tax provision in fact is treated as such, there should be adopted a lock-step pay-as-you-go (PAYGO) rule which only allows qualifying offsets to be made from revenues generated during the term of the temporary legislation and not from the entire budget window period. Lastly, I propose that there should be a baseline review of all permanently enacted legislation at the end of the initial ten-year budget window. If after review the originally projected cost for the succeeding five-year period were more than a specified threshold less than the new projected costs over the same period, then Congress would have to find new revenue offsets for the legislation or risk sequestration.

I believe that if implemented, these proposed rules could have significant consequences on the tax legislative process and help set the stage for more responsible tax legislation. Specifically, these rules would yield a more nuanced use of temporary

⁶ Edward Kleinbard has addressed a related, but different, issue with tax expenditure legislation—the preference of tax expenditure legislation versus direct spending measures caused by defects in the current budget framework process which make tax expenditures less salient to the public. *Tax Expenditure Framework Legislation*, USC Center in Law, Economics and Organization Research Paper No. C10-1 (April 6, 2010), available at <http://ssrn.com/abstract=1531945>.

⁷ Yin, *supra* note 5, at 253.

⁸ Kysar, *supra* note 3, at 1008.

⁹ *Id.*

¹⁰ The Congressional Budget Office (CBO) currently follows guidelines in the now-expired provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974, which ignore sunset provisions for any legislation with annual costs in excess of \$50 million. CBO, *THE BUDGET AND ECONOMIC OUTLOOK: FISCAL YEARS 2014 TO 2024*, at 14 (2014), available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/45010-Outlook2014_Feb.pdf.

legislation that would maximize its benefits while limiting situations where it is more commonly abused. These rules would impose more fiscal discipline on lawmakers while preserving the ability to tailor the term of legislation to specific situations—leaving in place lawmakers’ current ability to capitalize on benefits of both short- and long-term tax legislation where appropriate. These rules would also increase fiscal transparency as to the true cost of legislation and prohibit the manipulation of estimates achieved by phase-outs and other budget window manipulations. Lastly, they would work to diminish, at least relative to the current system, the ability of politicians to extract rents from special interest groups.

Part II of this Article discusses the current budget process for federal tax expenditures, and in particular explores how the current rules have helped spur the rise of the use of temporary tax legislation. Part III outlines the important pros and cons of both temporary and permanent tax expenditure legislation, including their effects on budget estimations and transparency, rent extraction, and legislative stability and flexibility. Part IV outlines three proposed changes to the current budgetary process. It also describes both the advantageous consequences and potential criticisms of the proposals. Part V concludes.

II. BEHIND THE VEIL: THE CURRENT BUDGET PROCESS FOR TAX EXPENDITURES

A. Tax Expenditures and Tax Extenders

The Congressional Budget and Impoundment Control Act of 1974 (Budget Act) defines tax expenditures as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”¹¹ Thus, tax expenditures include any targeted tax provision that provides benefits to a particular subset of taxpayers.¹² These expenditures are indistinguishable from direct expenditures in many respects and are often used in lieu of direct mandatory and discretionary spending programs.¹³ For example, if Congress wanted to encourage the proliferation of smartphone devices, it could enact a special tax deduction or credit for purchasers of smartphones. Likewise, it could directly subsidize the manufacturers or distributors of smartphone devices. In either instance, federal dollars are being used to try to achieve a certain policy goal. The only difference is that one proposal uses the tax system and the other does not.

The use of tax expenditures as a legislative tool has grown dramatically over the past two decades.¹⁴ Their use, however, is not always a result of a deliberate determination that the tax system is the best method to deliver government interventions. When tax laws are intended to generate immediate impacts in response to emergency

¹¹ Congressional Budget and Impoundment Control Act of 1974, 2 U.S.C §622(3) (1974). The concept of tax expenditures was popularized by Stanley Surrey, former Assistant Secretary of the Treasury, in his book *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (Harvard University Press, 1973).

¹² Staff of Joint Committee on Taxation, *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012-2017* (2013), available at <https://www.jct.gov/publications.html?func=startdown&id=4504>.

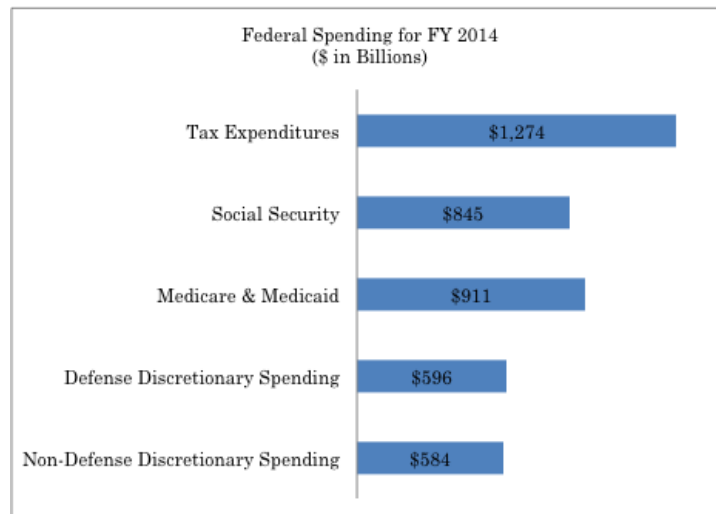
¹³ Thomas L. Hungerford, Cong. Research Serv., *TAX EXPENDITURES AND THE FEDERAL BUDGET*, at 2 (2011), available at <http://www.fas.org/sgp/crs/misc/RL34622.pdf>; Eric J. Toder, *Tax Cuts or Spending – Does it Make a Difference?*, 53 NAT’L TAX JOURNAL 1, 361 (Sept. 2000).

¹⁴ U.S. Gov’t Accountability Office, *Key Issues: Tax Expenditures*, available at http://www.gao.gov/key_issues/tax_expenditures/issue_summary#t=0.

situations, such as the housing mortgage crisis, the use of the tax system to deploy government funds can be an efficient vehicle for intervention because an infrastructure is already in place to quickly administer the program. For example, emergency tax legislation was adopted in response to Hurricane Katrina, to, among other things, provide extended carryback rules of certain losses incurred, provide additional exemptions for individuals housing displaced persons, and giving businesses tax credits for providing in-kind housing to displaced employees.¹⁵ In other instances, however, tax expenditures are used when it is not evident there is any advantage in doing so.¹⁶

As shown in Chart A below, in terms of relative magnitude, tax expenditures now account for nearly \$1.3 trillion in federal spending each year, comprising about one quarter of total federal expenditures. Tax expenditure spending now exceeds national spending on Social Security, Medicare and Medicaid, and discretionary defense spending.

Chart A¹⁷



The increased use of tax expenditures, generally, can in part be tied specifically to the increased use of tax extenders. The term “tax extenders” refers to the subset of tax expenditure provisions that are passed for short-term periods (typically one or two years), but nevertheless are routinely extended upon their expiration. In 2013, there were over ninety such provisions on the books with over fifty of them expiring on December 31, 2013.¹⁸ To date, none of these provisions has been extended, although it is anticipated

¹⁵ THE KATRINA EMERGENCY TAX RELIEF ACT OF 2005, Pub. L. No. 109-73 (2005); THE GULF OPPORTUNITY ZONE ACT OF 2005, Pub. L. No. 109-135 (2005).

¹⁶ Kleinbard, *supra* note 6, at 2 (“By excluding tax expenditures from the reach of most budget framework processes, Congress privileges tax expenditures over explicit spending... Tax expenditures in fact have become the preferred vehicle for delivering new spending programs — even appropriation-equivalent programs — in cases where the tax system offers no particular advantage as the delivery mechanism.”).

¹⁷ Staff of Joint Committee on Taxation, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018 (Aug. 5, 2014), *available at* https://www.jct.gov/publications.html?func=download&id=4663&chk=4663&no_html=1; Hungerford, *supra* note 13.

¹⁸ Staff of Joint Committee on Taxation, *supra* note 1.

that nearly all of them will be extended retroactively in some form (which is why they are also more aptly termed by some as the “tax expirers”).¹⁹ Together, these tax extenders accounted for almost \$50 billion of tax expenditures for the fiscal 2013 budget year.²⁰

The quintessential tax extender is the research and experimentation (R&D) credit.²¹ Although the R&D credit expired on December 31, 2013 and thus is currently technically in legislative limbo, to-date its renewal has been all but automatic. In fact, it has already been extended fifteen times since 1981.²² Why then has this provision not been permanently enacted? Why does Congress go through the process of passing new R&D credit legislation every year or two when there seems to be a pervasive political consensus over the past thirty years in favor of granting the credit? The simple answer is that the existing legislative budgeting construct makes it advantageous to do so.

As more fully described below, when new legislation is introduced, its revenue effects must be scored by the Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT)—generally for five- and ten-year budget window periods.²³ The cost of the proposed legislation is equal to the difference between the total expected government revenues without the legislation enacted (the “baseline”) and the total expected government revenues with the legislation enacted.²⁴ This so-called “scoring” of legislation is intended to give legislators an estimate of the expected fiscal impact the proposed legislation will have on the federal budget.

With respect to tax expenditures, when permanent legislation is proposed, the scoring (rightfully) assumes that the legislation will be in effect for the entire budget window period. Thus, the estimated annual cost of the enacted legislation is included in the scoring for each year of the applicable budget window. On the other hand, if a temporary provision is proposed, the scoring assumes that the provision will only remain in effect until its expiration date, even if it has (as in the case of the R&D credit for instance) been routinely renewed. Thus, the scoring of the provision will only include the estimated costs of the legislation for those years during the budget window for which the proposed legislation is scheduled to be in effect. So, for example, if a temporary two-year tax expenditure is proposed, the scoring will only include costs associated with the provision for that two-year period.

This budget rule for temporary tax expenditures is in direct contrast to how mandatory spending programs are scored. If any proposed mandatory spending program contains a provision that has annual costs in excess of \$50 million, it is treated as remaining in effect throughout the entire budget window period, even if the enabling

¹⁹ In fact, on April 3, 2014 the Senate Finance Committee approved a bill to extend almost all of the expired tax provisions for two years at a projected cost of \$85 billion. EXPIRING PROVISIONS IMPROVEMENT REFORM AND EFFICIENCY (EXPIRE) ACT (2014), available at <http://www.finance.senate.gov/newsroom/chairman/release/?id=43dc8d45-2748-4b19-820d-20f6c0be506d>.

²⁰ Center on Budget and Policy Priorities, *Paying for “Tax Extenders” Would Shrink Projected Increase in Debt Ratio by One-Third*, (Dec. 9, 2013), available at <http://www.cbpp.org/cms/?fa=view&id=4058>.

²¹ Also referred to by some as the “R&E” credit.

²² U.S. Senate Committee on Finance, *Business Investment and Innovation*, at 3 (April 11, 2013), available at <http://www.finance.senate.gov/imo/media/doc/04112013%20Business%20Investment%20and%20Innovation3.pdf>.

²³ See H.R. Res. 5, 111th Cong. §2(j) (2009); S. Con. Res. 21, 110th Cong. §201(a) (2007).

²⁴ *Id.*

statute expires prior to the end of the budget window.²⁵ As a result, from a scoring perspective, there is no up-front advantage to enacting a temporary mandatory spending provision, because all non-de minimis legislation is assumed to endure even if by its terms it is scheduled to sunset.²⁶

The different scoring procedures for these two approaches can produce drastically different results. For example, the typical two-year extension of the R&D tax credit is estimated to result in federal outlays of \$15 billion.²⁷ On the other hand, if the R&D credit were to either be made permanent or if it were to be scored as permanent (like a mandatory program would be), its ten-year cost would total nearly \$100 billion.²⁸ Thus, when lawmakers are trying to comply with PAYGO principles and enact revenue neutral legislation, a two-year R&D credit will only need to be offset with new spending cuts or revenue sources totaling \$15 billion rather than \$100 billion. This scoring advantage that tax expenditures are afforded in the budget legislative process, combined with other procedural advantages discussed below, have spurred the increased use of temporary tax provisions as a legislative tool.

B. Budget Rules

In order to give a more complete picture of the budgetary backdrop that governs this process, I will first briefly discuss the basic practices governing the budget process. I will then talk about specific budgetary rules that impact the enactment of tax expenditures by creating biases for temporary provisions, such as the PAYGO and Byrd rules.

1. Overview

Every year Congress funds discretionary spending programs through the annual appropriations process.²⁹ These programs include national defense, homeland security, transportation, agriculture, education, and general government operations.³⁰ Certain rules and procedures govern the consideration of appropriations measures, which are under the jurisdiction of the House and Senate Appropriations Committees.³¹ The majority of direct spending programs are funneled through this annual process, whereby Congress reviews and approves the amount of spending for these programs for the upcoming year.³² How much, if any, funding is available for a particular program during a fiscal year typically is dependent on how much funding it receives in the appropriations process.

In contrast, mandatory spending programs (also known as entitlement programs) are not subject to this annual appropriations review. Rather, funding is open-ended with the amounts paid out being a function of the number of eligible claimants and the amount each claimant is entitled to receive under the specific program.³³ Once created, these

²⁵ See Cong. Budget Office, *supra* note 10.

²⁶ As discussed more fully below in Part IV.A.1, there is an exception to statutory PAYGO for emergency legislation.

²⁷ The Committee for a Responsible Fed. Budget, *The Tax Breakdown: Tax Extenders* (Mar. 26, 2014), available at <http://crfb.org/blogs/tax-break-down-tax-extendors>.

²⁸ *Id.*

²⁹ Sandy Streeter, Cong. Research Serv., THE CONGRESSIONAL APPROPRIATIONS PROCESS: AN INTRODUCTION, 4 (2007), available at <http://www.senate.gov/reference/resources/pdf/97-684.pdf>. Occasionally appropriations will cover a multi-year period.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

programs generally are entitled to spend whatever funds are required under their statutory terms and no additional spending authorization is needed from Congress. Examples include Social Security, food stamps, federal retirement programs, Medicare, and Medicaid.³⁴ These provisions are typically enacted on a permanent basis (*i.e.* there is no definitive end date for the provision expressly provided in the statute and the program will continue unless action is taken to repeal the existing law).

Government spending is also achieved through a third mechanism, which does not fall squarely into either category: tax expenditures. These may be enacted on a permanent or temporary basis, and, although subject to approval by the Congressional tax committees, are not subject to the annual appropriations process governing discretionary spending programs.³⁵ Similar to entitlement programs, the funding for tax expenditures is generally open-ended with amounts paid out being a function of the number of eligible taxpayers entitled to receive particular tax benefits and the dollar value of the actual benefits.

Each year, the JCT is required to furnish to the House Committee on Ways and Means and the Senate Committee on Finance a Tax Expenditure Budget containing estimates of tax expenditures over the following five-year period.³⁶ These estimates are prepared in conjunction with the staff of the Office of Tax Analysis (OTA) in the Department of the Treasury.³⁷ Although technically an official part of the budget process, the Tax Expenditure Budget is solely informational and does not provide any constraints or directives with respect to Congressional spending.³⁸ Funding for any particular tax expenditure program continues automatically unless legislative action is taken to modify or repeal the underlying statutory provision. As a result, Congressional attention and focus on the budgetary impact of a given tax expenditure primarily occurs only upon the provision's initial enactment.

Although select temporary tax provisions have been regularly in use since the 1970s, it was not until the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) when acts of tax legislation were passed that sunsetted in their entirety.³⁹ Until 2001, most proposed tax expenditures were permanent and were therefore treated the same as other types of mandatory spending programs for budget scoring purposes.⁴⁰ From the outset, the scoring of these permanent tax expenditures included their costs throughout the full ten-year budget window. Since EGTRRA, however, the use of temporary tax provisions has greatly increased. This increase can be directly attributable to the advantageous budget manipulations that are possible with temporary tax expenditure items.⁴¹ By enacting temporary rather than permanent tax legislation,

³⁴ Hungerford, *supra* note 13, at 2 (“In some instances, such as for the Medicaid program, funding is provided in the annual appropriations acts, but the Appropriations Committees do not effectively control it.”).

³⁵ Yin, *supra* note 5, at 183-4.

³⁶ The Budget Act requires CBO and the Department of the Treasury to annually publish detailed lists of tax expenditures. This report is also furnished to the House and Senate Budget Committees. See Staff of Joint Committee on Taxation, *supra* note 17, at 1.

³⁷ *Id.*

³⁸ Kleinbard, *supra* note 6, at 2 (“By excluding tax expenditures from the reach of most budget framework processes, Congress privileges tax expenditures over explicit spending.”).

³⁹ All provisions in EGTRRA had an expiration date of December 31, 2010. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §901(a), 115 Stat. 38, 150 (2001).

⁴⁰ Yin, *supra* note 5, at 183-4.

⁴¹ Kysar, *supra* note 5, at 340.

lawmakers are able to manipulate budget windows and scoring calculations to capitalize on peculiarities in the procedural budget rules, such as the PAYGO and Byrd rules.

2. PAYGO

PAYGO rules generally require that the estimated budget effects of any new or augmented mandatory spending or tax expenditures be “paid for” with offsetting revenue increases or spending cuts.⁴² Thus, the PAYGO rules are intended to impose fiscal restraint on lawmakers by requiring that new spending or revenue reducing legislation be made at least revenue-neutral. Persistent concerns about the vast federal budget deficit have only heightened Congressional and public pressure to enact revenue-neutral or revenue-increasing legislation. The PAYGO rules do not apply to discretionary spending, which is controlled and limited by the amount of appropriations made available in the annual Budget Resolution.⁴³ However, PAYGO principles are applied to both mandatory spending and tax expenditure proposals.

The PAYGO rules were first imposed through the Budget Enforcement Act of 1990, and extended in 1993 and 1999 until they ultimately expired in 2002.⁴⁴ In 2010, the Statutory Pay-As-You-Go Act⁴⁵ was passed by Congress and signed into law by President Obama, making PAYGO once again mandatory. Under the current PAYGO statute, if legislation is passed that is projected to increase the deficit for either the following five- or ten-year budget window period, then automatic across-the-board cuts in selected mandatory programs (sequestration) is triggered.⁴⁶

Although on its face the PAYGO statute is supposed to apply to tax expenditures and mandatory spending rules with equal force, in practice it does not. The scoring mechanisms and statutory exceptions significantly compromised the PAYGO statute’s ability to damper tax expenditure legislation. They specifically excluded many of the tax extender provisions by incorporating into the budget baseline trillions of dollars in tax expenditures, including many of the EGTRRA and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) tax cuts, as well as the costs of extending alternative-minimum-tax (AMT) relief and permanently reenacting the estate-tax exemption at 2009 levels.⁴⁷ As a result, only new tax expenditures proposed in excess of these baseline amounts will result in deficit increasing budget scoring that requires revenue offsets to avoid sequestration.

The House of Representatives and Senate also each have their own internal set of PAYGO rules. Under both sets of internal rules, proposed legislation must be revenue-neutral over both a five- and ten-year budget window.⁴⁸ These internal rules have no force of law and can be waived (for example, the rules were waived in order to pass the 2007 and 2008 AMT relief for individuals),⁴⁹ but do provide a procedure for objecting

⁴² Office of Budget Management (OMB), THE STATUTORY PAY-AS-YOU-GO ACT OF 2010: A DESCRIPTION, available at http://www.whitehouse.gov/omb/paygo_description/.

⁴³ *Id.*

⁴⁴ Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990); Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 312 (1993); Balanced Budget Act of 1997, Pub. L. No. 105-33, 111 Stat. 251 (1997).

⁴⁵ Statutory Pay As You Go Act of 2010, P.L. 111-39, 124 Stat. 8 (2010).

⁴⁶ Specified exemptions from sequestration include Social Security, most unemployment benefits, veterans’ benefits, interest on the debt, Medicaid, food stamps, and federal retirement. OMB, *supra* note 42.

⁴⁷ Accordingly, when many of these tax cuts and the AMT patch were made permanent, no new offsets were needed because their projected costs were already included in the baseline.

⁴⁸ Kleinbard, *supra* note 6, at 16.

⁴⁹ *Id.* at 19.

Congress members to raise points of order against their colleagues when the PAYGO rules have been violated.⁵⁰ The House of Representatives and Senate each have internal procedural rules for waiving the point of order. While the Senate requires a three-fifths vote of all members (*i.e.* sixty votes), the House of Representatives only requires a simple majority of the Rules Committee.⁵¹ If the point of order is sustained, it will serve to strike the PAYGO violating proposal from the bill.⁵²

As discussed more fully below in Part III.A, the PAYGO rules are easily subject to manipulation through the use of temporary tax expenditure provisions. Unlike mandatory spending programs, temporary tax expenditure provisions are only scored as having revenue effects associated with the provision being enacted throughout its proposed duration rather than throughout the entire budget window period. Thus, if tax expenditure legislation is only enacted for a one- or two-year period, it will require far fewer offsets to satisfy PAYGO than if it were permanently enacted. For example, a two-year extension of the R&D credit may be scored as costing \$15 billion (its two-year estimated cost), rather than \$100 billion (its projected cost over the full ten-year budget window). In order to comply with PAYGO, legislators need only identify \$15 billion of revenue sources in order for the proposed two-year bill to move forward.

3. Reconciliation and the Byrd Rule

The Budget Act was enacted to establish the congressional budget process.⁵³ It established the Senate and House Budget Committees as well as the Congressional Budget Office (CBO).⁵⁴ The Budget Act provides for the annual adoption of a concurrent budget resolution, which may include reconciliation instructions directing one or more committees to propose changes to existing laws in order to conform federal spending, revenue and debt targets to the budget resolution.⁵⁵ The Budget Act created a fast-track process for these so-called reconciliation bills, which propose the changes in law pursuant to the reconciliation instructions.⁵⁶ The expedited process restricts the time limits for debate and thereby removes the threat of filibuster, an obstructive parliamentary practice whereby members opposed to the proposed bill can extend debate in order to delay or prevent a vote entirely.⁵⁷ In order for a proposed bill to receive the benefit of the reconciliation process and avoid filibuster, Congress must pass a budget resolution for each budget category setting forth limitations on spending (a “section 302 spending allocation”), and any provision that exceeds the allocation must be coupled with a revenue-raising provision.⁵⁸ House and Senate points of order enforce this procedural reconciliation rule.⁵⁹

As originally conceived, the reconciliation process was intended to provide a way to expedite spending and revenue bills in order to bring down the deficit.⁶⁰ However,

⁵⁰ *Id.*

⁵¹ U.S. Senate Committee on the Budget, BUDGET POINTS OF ORDER (2014), <http://www.budget.senate.gov/republican/public/index.cfm/points-of-order>.

⁵² *Id.*

⁵³ Budget Act, *supra* note 11.

⁵⁴ *Id.* at §§ 101-102 and 201.

⁵⁵ Bill Heniff, Jr., Cong. Research Serv., THE CONGRESSIONAL BUDGET PROCESS TIMETABLE, 2 (2008), available at <http://www.senate.gov/reference/resources/pdf/98-472.pdf>.

⁵⁶ Budget Act, *supra* note 11, at §§ 310(c).

⁵⁷ Debate time is limited to 20 hours in both the Senate and House of Representatives.

⁵⁸ Kysar, *supra* note 3, at 1020.

⁵⁹ Budget Act, *supra* note 11, at §§ 310(c).

⁶⁰ Kysar, *supra* note 3, at 1019.

because by its terms the 1974 Budget Act merely references only “changes” to spending and revenue amounts and not specifically to decreases or increases in such amounts, savvy Congressional members realized that the reconciliation process could be used to fast-track deficit-increasing legislation.⁶¹ In fact, in 2001 Congress passed EGTRAA through the reconciliation process with estimated costs of over \$1 trillion, sidestepping any chance of filibuster.⁶²

The Byrd Rule, named after Senator Robert Byrd, was introduced in 1985 as an additional internal rule in the Senate intended to prevent Senators from attaching unrelated bills to the reconciliation bill.⁶³ The Byrd Rule establishes a point of order against such extraneous provisions. Importantly, one of the categories of unrelated provisions that cannot be attached to reconciliation bills are any provisions that decrease revenues beyond the applicable window of the budget resolution.⁶⁴ If the presiding officer sustains the point of order, the offending provision is struck from the bill, but the rest of the legislation remains.⁶⁵

Tax expenditure provisions that are temporary in nature are advantageous in the reconciliation process in two ways. First, temporary tax expenditures are more likely to make it into the reconciliation process because their lower estimated costs make it easier to satisfy the section 302 budget allocation limits. Because temporary tax provisions are scored by giving effect only for their statutory enactment periods, their scored costs will be lower than an otherwise similar permanent piece of tax legislation or a temporary mandatory spending provision. Moreover, any legislation that exceeds the allocation must be coupled with a revenue-raising provision, so the lower the scored cost of a proposed expenditure, the fewer offsetting revenue-raising provisions will be needed to offset it.

Second, because the Byrd Rule will be triggered if a bill results in budget outlays beyond the budget window of the resolution, sunset provisions can be used on tax expenditures to prevent invocation of the Byrd Rule. If a tax expenditure is proposed as permanent legislation, it will have projected costs beyond the applicable budget window and can be struck from the reconciliation bill by raising a point of order. However, no matter how high the anticipated cost of a tax expenditure bill, as long as it does not generate costs beyond the budget window, it will not be subject to the Byrd Rule. For this reason, the entire EGTRAA was sunsetted before the end of the reconciliation budget

⁶¹ Robert Dove, Former U.S. Senate Parliamentarian 1981-1987, C-SPAN, *Use of Senate Filibuster* (Mar. 12, 2010), available at <http://www.c-span.org/video/?292506-1/use-senate-filibuster> (00:50-00:53).

⁶² Kysar, *supra* note 3, at 1020 (“Although the original intent of the reconciliation process was to provide an easier path to enact deficit-reducing legislation, in 2001, Republicans won a procedural battle by passing one of the largest tax cuts in history, EGTRRA, through the reconciliation process in order to avoid a filibuster.”); *see also* Gale and Orszag, *supra* note 3, at 1154 (noting that the Byrd Rule itself did not necessitate the sunset provisions, rather the lack of support from 60 senators required to waive the rule necessitated the sunset).

⁶³ Robert Keith, Cong. Research Serv., *THE BUDGET RECONCILIATION PROCESS: THE SENATE’S “BYRD RULE”* (2010), available at <http://democrats.budget.house.gov/sites/democrats.budget.house.gov/files/documents/reconciliation.pdf>; Cheryl D. Block, *Pathologies at the Intersection of the Budget and Tax Legislative Process*, 43 B.C. L. REV. 863, 874 (2002).

⁶⁴ *Id.*

⁶⁵ BUDGET POINTS OF ORDER, *supra* note 51. Provisions that are removed from reconciliation legislation as a result of a Byrd Rule objection are sometimes referred to as “Byrd droppings.” Yin, *supra* note 5, at 215.

window in order to avoid invocation of the Byrd Rule.⁶⁶ Since EGTRAA, numerous tax provisions have been passed as temporary legislation and been able to sidestep application of the Byrd Rule.⁶⁷

4. *Senate Point of Order*

The Senate more recently enacted another point of order (SPO), aimed at budget distortions that can occur when proposed legislation is expected to have revenue effects outside of the original budget window period. When permanent spending legislation is enacted, revenue neutrality only has to be achieved for the relevant five- and ten-year window periods in order to avoid invocation of the PAYGO rules. However, many provisions have enormous budgetary consequences beyond the first ten years of enactment. Under the current budget rules, there is no mechanism requiring a re-evaluation or re-neutralization of existing spending provisions whose costs greatly exceed projected offsetting revenue sources.

The SPO tries to manage deliberate attempts by lawmakers to escape the reach of PAYGO rules by back loading the revenue outlays of proposed legislation to periods beyond the budget window. Under the SPO, Senators can raise an objection and block consideration of legislation that is projected to result in net outlays in excess of \$5 billion in any one of the four successive ten-year periods beginning after the initial ten-year budget window.⁶⁸ Again, at least three-fifths (or sixty) votes are necessary to waive the point of order.⁶⁹

While the SPO may provide a deterrent for passing legislation with significant projected costs beyond the budget window, it has little to no effect on temporary tax legislation. In fact, it provides an incentive for lawmakers to make tax expenditures temporary. If temporary tax legislation is proposed, the costs will be front loaded in the budget window and will have no projected effect beyond the initial ten-year budget window period. They will thus be able to escape the reaches of the SPO.

III. THE BLACK AND WHITE MAGIC OF TEMPORARY TAX EXPENDITURES

As suggested above, temporary tax expenditures are prized gems of lawmakers for a number of reasons. First, they are easier to manipulate for budget scoring purposes. They can escape the reaches of any applicable PAYGO rules by requiring fewer offsets to achieve revenue-neutrality, as well as sidestep the Byrd Rule and SPO. Second, when tax expenditures are enacted as temporary provisions, there are more opportunities for lawmakers to extract rents from private parties that are eager to ensure the renewal of their favored tax break. Third, tax expenditures also enjoy a certain political opaqueness that can enhance opportunities for political maneuvering and make it easier to target benefits towards private interests.⁷⁰ Targeted benefits to select industries or taxpayers

⁶⁶ Kysar, *supra* note 3, at 1021; Rudolph G. Penner, Urban Institute and Brookings Institution Tax Policy, *Taxes and the Budget: What are extenders?* Briefing Book (Feb. 15, 2008), available at <http://www.taxpolicycenter.org/briefing-book/background/taxes-budget/extenders.cfm>.

⁶⁷ See, e.g., Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRAA), Pub. L. No. 108-27, §§107, 303, 117 Stat. 752, 755-56, 764 (most provisions were set to expire between 2004 and 2009).

⁶⁸ BUDGET POINTS OF ORDER, *supra* note 51, at 2.

⁶⁹ *Id.* at 1. *But see* Yin, *supra* note 5, at 224 (“It seems doubtful that estimates of the long-term budget effects of proposals increasing and decreasing the deficit can be made with sufficient precision to carry out the point of order.”).

⁷⁰ Kleinbard, *supra* note 6, at 5 (“Existing tax expenditures hide in plain sight, appearing in the operative Budget Resolution only as an undifferentiated component of baseline revenues. The low salience of

that are buried in the Internal Revenue Code are much less transparent to the general public and when passed often receive less Congressional scrutiny than targeted mandatory spending provisions.⁷¹ Moreover, some politicians may prefer the use of expiring tax provisions because they are able to essentially consent to a tax increase by taking no affirmative legislative action on an expiring tax extender.⁷² Lastly, temporary tax provisions can, in theory, provide more opportunity for legislative review and refinement. If a statute expires and is up for renewal, legislators have an opportunity (whether or not utilized) to assess the effectiveness of the rule and adjust, amend or discontinue the provision to the extent it is not fulfilling its original objectives.⁷³

While there may be certain political and legislative advantages to temporary tax legislation, there are countervailing costs. Fiscal accountability and legislative stability can be significantly compromised as a result of the budget manipulations. Enacting temporary legislation may obscure the true long-term costs to legislators of provisions that in substance are intended to remain permanent (for example the R&D credit), as well as result in deeper current tax cuts than may otherwise be made. Moreover, if a tax provision is intended to affect taxpayer behavior but its legislative fate is constantly in limbo, as is the case for the current fifty plus expired tax extenders, taxpayers may over- or under-respond to the provision. In addition, while decreased transparency may be beneficial from the perspective of politicians, it also makes it harder for the public to monitor and hold accountable political actors. As a result, the voting public may not be fully aware of the decisions being made by their elected officials.

A. Budget Manipulation

The current legislative budget rules, described in Part II.B above, are subject to two primary forms of manipulation by lawmakers. First, by using temporary tax legislation, lawmakers are able to limit the estimated costs of a proposed bill for scoring purposes. This makes it much easier to find necessary offsets to achieve revenue-neutral legislation in accordance with the PAYGO rules. It also makes it much easier for a proposed tax expenditure to take advantage of the reconciliation process and avoid invocation of the Byrd Rule. Second, because PAYGO constraints are only confined to a finite time horizon (typically a five- or ten- year budget window), permanent legislation that has substantial back loaded costs is able to seemingly satisfy revenue-neutrality upon enactment, even if over time it results in significant deficit increases. The Byrd Rule is only applicable to legislation proposed as part of a reconciliation bill.⁷⁴ The SPO tries to

tax expenditures, when compared with the spending programs for which they substitute, affects not only public perceptions but also Congressional consideration.”)

⁷¹ See generally, *id.* at 6-7.

⁷² Rather, they will just let the beneficial tax provision die, in substance causing an increase in tax revenues. Howard Gleckman, *Can Expiring Tax Provisions Save The Budget Talks?* FORBES (Nov. 8, 2013), available at <http://www.forbes.com/sites/beltway/2013/11/08/can-expiring-tax-provisions-save-the-budget-talks/>.

⁷³ In fact, some commentators argue that sunsets should be used as a way to prevent obsolete laws from remaining on the books. Thomas Merrill, *The Federalist Society 2011 National Lawyers Convention*, 16 TEX. REV. L. & POL. 339, 343 (Spring 2012) (citing generally Guido Calabresi, A COMMON LAW FOR THE AGE OF STATUTES (1982); Guido Calabresi, *The Nonprimacy of Statutes Act: A Comment*, 4 VT. L. REV. 247 (1979); Jack Davies, *A Response to Statutory Obsolescence: The Nonprimacy of Statutes Act*, 4 VT. L. REV. 203 (1979)).

⁷⁴ See Keith, *supra* note 63 and accompanying text.

address this by requiring revenue neutrality for each of the successive four decades after the initial budget window,⁷⁵ but as illustrated below, this rule can also be manipulated.

The problem with these budget manipulations is that they enable lawmakers to skew the impact that proposed provisions will have on the overall fiscal health of the nation.⁷⁶ As illustrated below, if temporary provisions are enacted that are in fact intended to be permanent in nature, as is the case with most of the tax extenders, then lawmakers are able to both reduce the amount of offsets necessary for revenue neutrality and to push out those lesser offsetting revenues to the latter years of the budget window. Not only does this practice systematically understate the full fiscal impact of the underlying tax expenditure, but it also allows legislators to make larger current tax cuts or increase spending in other programs because more current revenue streams are available to offset spending. In a time when fiscal restraint and attention to deficit reduction are touted as top national priorities, lawmaking budget practices that serve to undermine these goals are problematic.

1. *Front Loading with Temporary Provisions*

The single largest driver behind the proliferation of temporary tax provisions, or tax extenders, is the ability to reduce the upfront estimated costs of the provisions.⁷⁷ Unlike the scoring estimates for mandatory spending provisions, which ignore sunset provisions for spending programs with current-year costs of greater than \$50 million,⁷⁸ the scoring estimates for tax expenditures treat a provision as becoming inactive on the sunset date.⁷⁹ This is true whether or not a renewal of the tax expenditure is expected at that time.

Because a tax expenditure is more likely to be passed if it is packaged as revenue neutral, a lower estimated cost over the budget window through the use of an early expiration date provides two advantages, as illustrated in Chart B below. It lowers the amount of revenue sources or spending cuts that are needed in order to offset the expected cost. It also provides more offsetting years in the budget window to find those revenue sources and spending cuts.

Examples of tax extenders in this category include the R&D credit, the subpart F exception for active finance income, and numerous energy incentives.⁸⁰ Even when lawmakers would like to make these provisions permanent, they find it too expensive to do so. Offsetting revenue sources are just not available to make their permanent enactment fiscally or politically viable. In fact, renewing the existing tax extenders for one year will impose an estimated cost of \$54 billion.⁸¹ In contrast, if these same extenders are made permanent, they will cost a projected \$938 billion over the full ten-year budget window.⁸²

⁷⁵ BUDGET POINTS OF ORDER, *supra* note 51, at 2.

⁷⁶ Gale and Orszag, *supra* note 3, at 1554 (“As sunsets have come to dominate the tax code, the official budget projections have become increasingly divorced from reality”).

⁷⁷ Marron, *supra* note 4, at 6.

⁷⁸ See Cong. Budget Office, *supra* note 10.

⁷⁹ Marron, *supra* note 4, at 6.

⁸⁰ *Id.* at 3-4.

⁸¹ Sherlock, *supra* note 2, at 6 (Tbl.1).

⁸² *Id.*

Chart B: Budget Manipulation Using Temporary Provisions⁸³

Projected Cost of Legislation (\$ in Billions)											
Option	FYs 1-2	FYs 3-4	FYs 5-6	FYs 7-8	FYs 9-10	FYs 11-12	FYs 13-14	FYs 15-16	FYs 17-18	FYs 19-20	Total
(A)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(95)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>(\$35)</u>					<u>(\$60)</u>					
(B)	(5)	0	0	0	0	0	0	0	0	0	(5)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>(\$5)</u>					<u>\$0</u>					
(C)	0	(6)	0	0	0	0	0	0	0	0	(6)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>(\$6)</u>					<u>\$0</u>					
Projected Revenue from Legislation (\$ in Billions)											
Option	FYs 1-2	FYs 3-4	FYs 5-6	FYs 7-8	FYs 9-10	FYs 11-12	FYs 13-14	FYs 15-16	FYs 17-18	FYs 19-20	Total
(D)	5	6	7	8	9	10	11	12	13	14	95
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>\$35</u>					<u>\$60</u>					
(E)	0	0	0	0	5	0	0	0	0	0	5
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>\$5</u>					<u>\$0</u>					
(F)	0	0	0	0	0	6	0	0	0	0	6
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
	<u>\$0</u>					<u>\$6</u>					

As illustrated in Chart B, legislative Option A represents a proposed tax expenditure's estimated cost over a twenty-year fiscal period. Under the current legislative rules, Option A would be scored as having an official cost of \$35 billion over the initial ten-year budget window and would require lawmakers to find \$35 billion of additional revenue or spending cut sources in order to make the proposal revenue neutral. If bundled with legislative Option D, Option A would satisfy the PAYGO requirements.

Legislative Option B represents the estimated cost of enacting the same tax expenditure, except that the provision expires after two years. Under the current budget scoring rules, Option B would only have an official cost of \$5 billion that would need to be offset, even if it was expected that the same provision would be extended throughout fiscal years three through ten. Not only does Option B have a lower "official" cost than Option A, but lawmakers are able to use ten fiscal years (years 1-10) to generate offsets for only two fiscal years of outlays (years 1-2). If a revenue generating provision was also proposed and was estimated to generate \$5 billion during fiscal years 9 and 10, such as Option E, it would be unable to fully offset Option A because the total official

⁸³ Chart B assumes the applicable budget window period covers ten fiscal years.

revenues generated for the budget window would only be \$5 billion in comparison to the official cost of Option A of \$35 billion. On the other hand, the same revenue provision could be used to offset Option B and PAYGO would be satisfied. Moreover, the Byrd Rule and SPO would be satisfied because there would be no scored revenue effects for Option B beyond the initial ten-year budget window period.

The disparity between opportunities for budget manipulation with Option A and B endure even if, as illustrated with Option C, the same tax expenditure is continuously extended through a series of temporary provisions. Even though each time the tax expenditure is extended it will have to be fully offset with a revenue raising provision, the renewed tax expenditure will gain additional budget window years during which to find offsetting revenues. As a result, revenue neutrality can be significantly more distorted than it can be with an equivalent permanent piece of legislation.

For example, if upon the expiration of Option B, Congress enacts identical legislation with Option C, it will be able to use fiscal years 3 through 12 (the then applicable ten-year budget window) to find offsetting revenues. As such, it could use Option F to couple with Option C in order to make it revenue neutral and satisfy PAYGO. Note none of the revenues for Option F accrue during the original ten-year budget window. If the same provision is similarly extended through the end of fiscal year 10 and is in each instance paid for with revenues generated during the last two-years of the then applicable budget window, then by the end of fiscal year 10, a significant gap in revenues will occur. The actual cost of the tax expenditure (assuming the projections are accurate and remain constant) will be identical to those in Option A where the legislation is made permanent from the outset. Fiscal years one through ten will incur a total cost of \$35 billion. However, the only revenue raised during this period would be \$5 billion (through Option D). This tax expenditure would create a \$30 billion budget deficit over the initial ten-year period. By contrast, if instead Option A were enacted, it would require at the outset \$35 billion of revenue to offset its cost during the initial ten fiscal years and no deficit would be created.

It is also worthwhile to note that if legislators pass the \$35 billion revenue raiser Option D along with Option B, which will soak up only \$5 billion of revenue offsets, Congress will be able to enact an addition \$30 billion of spending provisions and still satisfy the current PAYGO and revenue neutrality principles. This is true even if, as discussed above, the full cost of the tax expenditure contained in Option B will be \$35 billion if it is continuously reenacted for the full ten-year fiscal period. If Option A were instead enacted making the tax expenditure permanent, or if Option B were scored the same as Option A (which it would be if it were a mandatory spending program), then Option D would be fully offset by the tax provision and no additional revenues would be available to offset other spending programs.

2. *Back Loading with Permanent Provisions*

Another problem with limiting the inclusion of a proposed provision's budget impact to a finite window is that revenue effects that take place outside the relevant budget window period are ignored. Because the baseline assumes permanent legislation will continue forever, once enacted, the cost of permanent legislation beyond the end of the initial budget window essentially disappears from the legislative process.⁸⁴ Thus, a proposed provision can be scored at the outset as revenue neutral for PAYGO purposes,

⁸⁴ Yin, *supra* note 5, at 204.

even if the purported offsetting provision is not expected to generate any revenues outside of the initial ten-year budget window and the expenditure is projected to continue to generate substantial outlays. Likewise, if a permanent tax expenditure becomes much more costly than originally projected (or conversely if projected revenue offsets end up falling short), there is no automatic process to recalibrate that provision's neutrality and ballooning deficits can result.

The SPO can help mitigate the issues related to the former problem, but not the latter. If a permanent tax expenditure is paired with a revenue generating provision that is only expected to raise revenues prior to the end of the initial ten-year budget window, the SPO may be triggered. The SPO can be invoked if other offsetting provisions are not available for the outer years and projected deficits exceed \$5 billion in any of the subsequent four ten-year budget windows.⁸⁵ If, on the other hand, deficits are incurred because expected projected outlays were too high or inflows were too low, the SPO will not be implicated. Although the SPO's focus is on the time period outside of the initial budget window, the determination of whether or not the SPO is triggered is made at the time the enacting bill is deliberated and no automatic subsequent redeterminations are made. Accordingly, if subsequent budget shortfalls do occur as a result of the legislation, Congress will on its own have to initiate a completely new bill to either amend or enact legislation that either reduces the outlays generated by the existing tax expenditure provision or raises new offsetting revenues.

Proponents of tax expenditure legislation can also exploit the use of finite budget windows by either delaying the effective date of the legislation and/or back loading major outlays of the provision until late in the budget window.⁸⁶ As illustrated in Chart C below, these strategies will decrease the amount of offsets necessary for neutrality.

Chart C: Budget Manipulations Using Permanent Provisions⁸⁷

Option	Projected Cost of Legislation (\$ in Billions)										Total
	FYs 1-2	FYs 3-4	FYs 5-6	FYs 7-8	FYs 9-10	FYs 11-12	FYs 13-14	FYs 15-16	FYs 17-18	FYs 19-20	
(X)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(50)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
					<u>(\$25)</u>					<u>(\$25)</u>	
(Y)	0	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(5)	(45)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
					<u>(\$20)</u>					<u>(\$25)</u>	
(Z)	0	(5)	(5)	(5)	(5)	(5)	0	0	0	0	(25)
	Fiscal Years 1-10 Total					Fiscal Years 11-20 Total					
					<u>(\$20)</u>					<u>(\$5)</u>	

As depicted in Chart C, Option X represents a baseline case of the scoring of a permanently enacted tax expenditure projected to generate \$25 billion of costs during

⁸⁵ BUDGET POINTS OF ORDER, *supra* note 51, at 2.

⁸⁶ Similar manipulation is possible with all permanent spending provisions.

⁸⁷ Chart C assumes the applicable budget window period covers ten fiscal years.

each ten-year fiscal period. In order to make Option X satisfy PAYGO, lawmakers will have to come up with \$25 billion of offsets to cover the official ten-year cost of the provision upon enactment. On the other hand, if the same tax expenditure is enacted, but lawmakers push back the effective date for two years, as in Option Y, they will only have to find \$20 billion of offsets to comply with PAYGO. This option may be attractive to lawmakers who will be able to take credit for enacting a particular tax cut, while at the same time reducing the amount of revenue offsets they will be required to produce in order to get the bill through Congress.

Note, Options X and Y will require an equal amount of offsets in fiscal years eleven through twenty in order to avoid invocation of the SPO. Specifically, they will have to come up with at least \$20 billion in revenue sources or spending cuts for fiscal years eleven through twenty in order to avoid triggering the \$5 billion SPO shortfall threshold.⁸⁸ Option Z, however, avoids this problem. By combining the tactics of legislative back loading (or phase-ins) with a sunset provision, Option C both reduces the present offset cost of the proposed tax expenditure and avoids application of the SPO. Option Z's official cost is \$20 billion for the initial ten-year budget period (the same as Option Y). However, unlike Option Y, even if no other offsetting revenues are available for fiscal years eleven through twenty, the SPO cannot be invoked because the projected deficits in years eleven through twenty do not exceed \$5 billion. Moreover, the above-illustrated scoring of Option Z is only available with respect to a tax provision, because any other type of mandatory spending provision will be scored the same as Option Y because only the phase-in (and not sunset) will be respected for scoring purposes.⁸⁹

B. Rent Extraction

Another common complaint with the way tax expenditures, in particular, are treated under the current budget rules is that they create an environment that encourages the extraction of rents by lawmakers. The fact that offsets are required for all tax expenditures creates a fierce competition among special interest groups, each hoping that it is not harmed by any trade offs that must be made for the sake of revenue neutrality.⁹⁰ Lobbyists for particular industries or interest groups therefore seek to pay rent to lawmakers (in the form of campaign contributions and votes) in order to encourage them to extend or propose special tax breaks or to prevent them from closing beneficial loopholes. Because the proposals will need to be revenue neutral, the offsetting spending reductions or revenue increases can come at the expense of a politically inactive minority or a diffuse majority. A diffuse majority may not have an incentive to fight the proposed change because the individual cost to each member is relatively minor. While this type of rent extraction is a problem frequently encountered in politics in general, it is particularly troublesome in the tax expenditure context for several reasons.

Because of the ever-increasing use of temporary rather than permanent tax legislation, politicians are often able to demand payment at predictably frequent intervals.⁹¹ Many favored tax benefits are continually in legislative jeopardy, and even if there is only a small chance that a provision will not be renewed, lobbyists will still pay

⁸⁸ See BUDGET POINTS OF ORDER, *supra* note 51, at 2.

⁸⁹ See Cong. Budget Office, *supra* note 10.

⁹⁰ Kysar, *supra* note 5, at 365 (“[B]y either requiring offsets to tax expenditures or demanding sequesters, the budget rules create competition between interests in tax benefits and thus guarantee the possibility, although at times remote, of lapse, especially if interest group activity on behalf of the threatened provision ceases.”).

⁹¹ *Id.*

rents for fear that if they are inactive, their benefits may be crowded out by other more motivated interest groups.⁹² For example, if businesses rely on the R&D credit and it is only extended in one- or two-year increments, then even though businesses may be relatively certain that the credit will continue to be re-enacted (as it has been fifteen times), they will not be willing to take a chance that non-action will cause the provision to lapse. As such they continue to pay rent. This fear is particularly warranted in the current legislative environment where politicians are increasingly willing to break out of their predictable budget norms.⁹³

Although businesses should be equally concerned about the threat of repeal in the case of permanently enacted legislation, the likelihood of legislative action is much smaller because enough momentum would have to be generated in order to get actionable repeal legislation on the floor to change the status quo.⁹⁴ When provisions are automatically set to expire, on the other hand, the legislative fate of a provision is already on the table. Affected taxpayers are repeatedly put in economic limbo as they await the determination of their legislative fate. As long as the present value of the threatened benefits from the expiring legislation exceeds the current lobbying costs, rational interest groups will continue to lobby legislators for targeted tax expenditures.⁹⁵ The shorter the enactment period for a particular piece of tax legislation, the more frequently the give-and-take rent extraction game can be played between legislators and their affected constituents.

C. Political Opaqueness

Another issue with tax expenditures of any duration is that they tend to have a less than transparent role in the budget process.⁹⁶ They therefore often assist in obscuring legislators' behavior from the voting public.⁹⁷ For example, if a minority-targeted tax provision is pushed through the reconciliation process in a revenue-neutral way, it can be fast-tracked through the legislative process with little to no debate or oversight by the substantive Congressional committees.⁹⁸ As discussed above, temporary tax provisions are able to capitalize on the reconciliation process more easily because they are scored in

⁹² *But see* Yin, *supra* note 5, at 244 (arguing that even if “a credible threat could be made relatively costlessly through, for example, the mere sponsorship of a bill or issuance of a press release, it is not clear why legislators would prefer to threaten temporary, as opposed to permanent, action. The latter would presumably present a more harmful outcome to the interested groups and therefore should generate greater returns to forestall the threatened action.”).

⁹³ For instance, the threat of sequestration, or automatic across-the-board federal spending cuts, at one time seemed so onerous that many predicted Congress would never actually let it happen. However, in fiscal 2013 lack of Congressional action led to sequestration.

⁹⁴ Manoj Viswanathan, *Sunset Provisions in the Tax Code: A Critical Evaluation and Prescriptions for the Future*, 2009 FED. B.A. SEC. TAX'N REP. 14, 21 (“Any law enacted by Congress has some probability of getting overturned; however, this baseline probability of statute repeal is fairly low.”), citing Guido Calabresi, *A COMMON LAW FOR THE AGE OF STATUTES* 6 (1982); Kysar, *supra* note 5, at 365 (stating “repeal, unlike a lapse after sunset, requires affirmative action by Congress and, thus, endangerment to the status quo is greater in the sunset context”).

⁹⁵ *Id.* at 367 (“These scenarios are problematic in that they bolster the competitive advantages of an organized minority, thereby increasing the likelihood of a reduction in social welfare due to the greater costs imposed on the poorly organized majority.”).

⁹⁶ Kleinbard, *supra* note 6, at 5.

⁹⁷ Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. ON REG. 253 (2011).

⁹⁸ Kleinbard, *supra* note 6, at 6-7.

such a way that makes achieving revenue neutrality and avoiding the Byrd Rule and SPO much easier than it is for their mandatory spending program counterparts.⁹⁹

Moreover, specialized tax provisions are considered to be less salient (or obvious) to the public than equivalent direct spending measures.¹⁰⁰ It is well established that the Internal Revenue Code is a complex labyrinth of rules that leaves even the most seasoned tax professionals at times scratching their heads. Not surprisingly, legislators have found that it is much easier to hide targeted legislation benefiting their favorite interest groups among the morass of existing tax rules than it is to propose a stand-alone traditional spending provision.

Indeed, it is sometimes impossible to determine from the face of a tax statute what subset of taxpayers are actually affected by its terms and what any impact would be.¹⁰¹ For instance, the average voter may not understand the economic impact that adjusting the phase-in or phase-out levels of a particular deduction will have or to what extent the double-declining balance depreciation method will favorably impact taxpayers versus the straight-line method.¹⁰² On the other hand, if a law is proposed to give a particular industry group cash subsidies through a mandatory spending program, the economic transfer of money from the fisc to the interested group may be much more transparent to the voting public at large.

Similarly, the temporary nature of tax provisions can provide a further dimension to obscure politically motivated behavior. For example, fiscal conservatives have been known to favor temporary tax expenditures because when necessary, they are able to consent to tax increases without taking affirmative legislative action for which their constituents may negatively judge them.¹⁰³ Rather, if a tax expenditure expires, the politician may simply fail to act to renew the provision. This inaction will result in an overall increase in tax revenues, but optically the public perception of the politician would presumably be much more favorable than it would if he or she voted favorably for a bill increasing taxes.

The diminished political transparency of tax expenditures can lead to several problems. First, diminished transparency can result in a diminished ability to successfully motivate political opposition at the time of enactment. This can cause even more funds to be funneled to targeted interest groups that are able to effectively capture legislative actors by paying rents. The diffuse majority will be less able to detect, and thus respond, to the passage of special targeted tax provisions. As a result, the organized minority will be able to reap economic gains at the expense of the more disorganized majority.

If a targeted tax provision results in an increased economic burden to the average taxpayer that is so small they would not rationally organize to oppose the provision even if they were aware of it, the reduced salience of targeted tax provisions still diminishes the ability of constituents to exercise checks and balances on their elected officials. If legislators are aware that their behavior is not evident to the voting public, they may be

⁹⁹ See discussion in Section III.A *supra*.

¹⁰⁰ Kleinbard, *supra* note 6, at 6-7; Schenk, *supra* note 97.

¹⁰¹ Schenk, *supra* note 97, at 257.

¹⁰² The double-declining balance depreciation method significantly accelerates depreciation deductions as compared to the straight-line depreciation method.

¹⁰³ Gleckman, *supra* note 72 (“There is no chance that GOP lawmakers will accept tax increases, but maybe they would accept revenue by passively conceding the quiet death of scores of temporary tax cuts that are due to expire at the end of this year.”).

even more likely to act in ways that are contrary to the interests of the majority of their constituents.

D. Uncertainty and Inefficiency

The uncertainty in a tax extender's legal status caused by the persistent use of temporary legislation not only encourages increased political rent seeking, but also creates significant planning and implementation problems for lawmakers and affected taxpayers alike. When the legal status of an extender is unclear, it makes it extremely difficult for affected businesses and individual taxpayers to plan ahead.

Over fifty tax extenders are sitting in legislative limbo, including the R&D credit, the subpart F exception for active financing, and the deduction for state and local taxes.¹⁰⁴ While it is anticipated that they all will be extended in some form, given the current hostile budget environment, nothing is guaranteed.¹⁰⁵ Even if all of the extenders are renewed, Congressional staffers have indicated that Congress will not act on legislation until the end of the year.¹⁰⁶

When extenders are intended to encourage particular taxpayer behaviors, such as innovation with the R&D credit, their purpose is in large part undermined when the affected constituents are not sure whether or not they will be entitled to the benefits of the provision.¹⁰⁷ For example, one of the tax extenders that expired at the end of 2013 was a provision allowing educators to deduct up to \$250 of unreimbursed expenses for books, supplies, and computers used in the classroom.¹⁰⁸ It is not guaranteed that this provision will be retroactively extended to apply to educator expenses incurred in 2014 as well.¹⁰⁹ Because the legislation was not renewed prior to the start of the 2014-2015 school year for elementary and secondary education schools, teachers had to prepare for the classes as if the deduction was not available.¹¹⁰ While there are teachers who may spend the same amount of money on their classroom supplies with or without the deduction, there are certainly those for whom the amount, and/or quality of expenditures they make would change if they knew those expenses were deductible. Thus, even if the tax extenders are renewed retroactively, the incentives created by these provisions have been undermined.¹¹¹

Moreover, retroactivity can lead to significant costs and added compliance complexities with interim financial reporting.¹¹² When a significant tax credit, such as the

¹⁰⁴ See *supra* note 1.

¹⁰⁵ See *supra* note 19.

¹⁰⁶ National Council of State Housing Agencies, *Camp Continuing Tax Reform Discussions as Senate Prepares to Extend Expiring Tax Provisions* (2014), available at <http://www.ncsha.org/blog/camp-continuing-tax-reform-discussions-senate-prepares-extend-expiring-tax-provisions>.

¹⁰⁷ See Marron, *supra* note 4, at 2.

¹⁰⁸ I.R.C. § 62(a)(2)(D) (effective for taxable years 2002 through 2013).

¹⁰⁹ Internal Revenue Service, *Topic 458 – Educator Expense Deduction* (Aug. 18, 2014), available at <http://www.irs.gov/taxtopics/tc458.html> (“The educator expense deduction expired December 31, 2013. You may claim it on your tax year 2013 tax return. Under current law, the deduction is not available for tax years after 2013.”).

¹¹⁰ Elisabeth Hulette, *Teachers lose deduction for school supplies*, THE VIRGINIAN-PILOT (Jan. 20, 2014), available at <http://hamptonroads.com/2014/01/teachers-lose-deduction-school-supplies>. (“According to a survey by the National School Supply and Equipment Association, teachers spent \$485 of their own money, on average, on supplies during the 2012-13 school year.”).

¹¹¹ *Id.*

¹¹² Joe Harpaz, *The Real Cost Of The R&D Tax Credit Expiration*, FORBES (Feb. 13, 2014), available at <http://www.forbes.com/sites/joeharpaz/2014/02/13/the-real-cost-of-the-rd-tax-credit-expiration/>; See also Marron, *supra* note 4, at 2.

R&D credit, is expected to, but has not yet been, renewed retroactively, tough decisions have to be made. Companies have to determine whether to book the credit in their accruals or wait until the legislation is actually renewed, thereby skewing their interim financial results.¹¹³ A study of public companies that rely on the R&D credit revealed that they have less accurate earnings estimates on average by about four cents per share due to the expired credit.¹¹⁴ There are real financial costs being incurred as a result of the legislative uncertainty being created by the persistent use of temporary tax provisions.

E. Dynamic Lawmaking?

Although the lack of certainty of an expiring provision may result in certain inefficiencies, one purported advantage of temporary tax provisions is that they can more readily achieve dynamic lawmaking that is both reflective of the current majority preferences and responsive enough to adjust to intervening social and economic changes.¹¹⁵ Their natural termination is supposed to invite re-deliberation of whether or not the provisions, as enacted, are meeting their purported objectives or whether their objectives have been completed. In this way, laws that no longer serve their stated purpose or have any relevance are cleansed from the statutory books.

While this account of the advantages of temporary legislation is potentially favorable, unfortunately, tax extenders rarely have been able to achieve any of the benefits that can accrue from their temporary status. First, most of the tax extenders are not passed because of lawmakers' desires to have temporary versus permanent legislation as such.¹¹⁶ Rather, their temporary status is a byproduct of preferences in the Congressional budget rules.¹¹⁷ When tax extenders expire en masse (such as the fifty plus tax extenders that expired at the end of 2013), none are given due consideration upon renewal.¹¹⁸ Lawmakers are not examining each extender, piece-by-piece, to assess their individual merits. Instead, the expired or expiring provisions are typically cobbled together in a single extender bill and not given any significant individual consideration or assessment.¹¹⁹

¹¹³ *Id.*

¹¹⁴ Emily Chasan, *Firms May Take Hit From Expired R&D Tax Credit*, WALL ST. J., Jan. 3, 2014 (citing study conducted by Jeffrey Hoopes, an assistant professor at Ohio State University's Fisher College of Business).

¹¹⁵ In fact, advocacy for temporary legislation dates back to the Founding Era.

¹¹⁶ Gale and Orszag, *supra* note 3, at 1153 ("In principle, sunsets might be justifiable under certain circumstances. Sunsets are appropriate for policies that are designed to be—and should be—temporary. They may also provide flexibility in policymaking, and be useful in focusing policymakers' attention on fiscal issues. In practice, however, none of these potential justifications appears to be the motivation for the recent dramatic expansion in sunsets.").

¹¹⁷ *Id.* ("Recent sunsets have been motivated by the desire to manipulate budget rules and hide the likely costs of new tax cuts."); *see generally* discussion *supra* Part II.A.

¹¹⁸ Testimony before the U.S. Senate Finance Committee, *Hearing on Extenders and Tax Reform: Seeking Long-Term Solutions*, 112th Cong. at 2 (Jan. 31, 2012) (statement of Rosanne Altshuler) ("[P]olicymakers may impose expiration dates on provisions so that they can periodically evaluate their effectiveness. In this case an expiration date can be seen as a mechanism to force policymakers to consider the cost and benefits of the special tax treatment and possible changes to increase the effectiveness of the policy. This reasoning is compelling in theory, but has been an absolute failure in practice as no real systematic review ever occurs. Instead of subjecting each provision to careful analysis of whether its benefits outweigh its costs, the extenders are traditionally considered and passed in their entirety as a package of unrelated temporary tax benefits.").

¹¹⁹ *Id.*

Moreover, as discussed above in connection with rent seeking, many of the temporary provisions are not reflective of the majority's present preferences, but rather they are byproducts of deals struck with motivated minority groups.¹²⁰ As such, rather than providing a fluid process by which laws are able to responsively change to shifting dynamics affecting the target of the legislation, temporary provisions are more frequently used as avenues for legislators to gain additional rents from a concentrated and motivated minority and to mitigate the effects of the budget rules.

IV. BREAKING THE SPELL WITH NEW BUDGET RULES

As outlined above, the current budget rules create incentives that are driving Congressional behavior. By scoring tax expenditures differently than other direct spending programs, they create a preference for using tax law as the vehicle for government intervention, even when it would not otherwise be advantageous to do so. For example, other government agencies may have better knowledge, staff, and resources to fund, influence, and monitor the legislated issue more directly than the IRS. Moreover, the present tax expenditure budget rules do not adequately enforce fiscal restraint because the rules are easily manipulated to avoid PAYGO through the use of phase-ins and sunsets.¹²¹ These manipulations can create an artificial preference for using temporary tax legislation to enact government expenditures. As discussed above, the use of temporary legislation itself can lead to other problems such as increasing the opportunities for political rent seeking and introducing undue uncertainty and administrative burdens.¹²²

I propose that a fundamental problem with tax expenditure lawmaking is not the use of temporary or permanent legislation per se. Rather, it is the current framework of budgetary rules that govern the creation of the tax laws. Congress has repeatedly demonstrated that it is unable to exercise reasonable discretion and engage in optimal lawmaking practices without the constraints of some type of precommitment device governing their actions.¹²³ That is, without ex ante rules in place restricting or directing their behavior, they are often unable to resist pressures to act in their own self-interest rather than the interests of their constituents.

As such, rather than add to the existing analysis examining which type of rules, temporary or permanent, will cause the least amount of damage under the current budgetary framework, in this Article, I explore whether more ideal tax expenditure rulemaking can be achieved by modifying the underlying rules themselves. I propose three budget rules and explore the envisioned consequences that these rules would have on the current budget process. I conclude that if implemented, this bundle of proposed budget process modifications could yield more ideal tax legislation by instilling more fiscal restraint, reducing opportunities for rent seeking, achieving greater political transparency, and enhancing legislative stability while retaining legislative flexibility.

A. Proposed Budget Rules

I propose three different modifications to the current budget rules: (i) a presumption for budgetary scoring purposes that tax expenditure legislation will endure throughout the applicable budget window, whether or not the provision is set to expire prior to the end of the window; (ii) if this presumption is overcome and the sunset of a tax

¹²⁰ See discussion *supra* Part III.B.

¹²¹ See discussion *supra* Part III.A.

¹²² See discussions *supra* Part III.B and D.

¹²³ Kysar, *supra* note 5.

expenditure is given effect, it will have to comply with a more rigorous lock-step PAYGO requirement unless it is designated as emergency legislation; and (iii) a mandatory review of all permanent tax expenditures will be required after their initial ten-year period of enactment. In examining the consequences that these proposals could have on Congressional lawmaking, I conclude that together these rules could enable lawmakers to make more disciplined deliberations and trade offs when enacting tax expenditure legislation.

1. Disregard Sunsets for Budget Scoring Purposes

In order to weaken the preference for tax expenditure legislation over direct spending in the budget process and to strengthen adherence to PAYGO principles, I propose that sunset provisions should be disregarded presumptively for purposes of scoring tax expenditures.¹²⁴ Accordingly, whether or not a proposed piece of tax legislation is set to expire prior to the end of the applicable budget window, it would be scored by assuming the legislation is in effect throughout the entire budget period.

Currently, the CBO scores both mandatory and tax expenditures in accordance with procedures set up by the now-expired Balanced Budget and Emergency Deficit Control Act of 1985.¹²⁵ Pursuant to this act, early expiration dates of proposed legislation are ignored for all spending programs with annual costs in excess of \$50 million.¹²⁶ All other proposals, including tax expenditures, are scored under the presumption that any early expiration provision takes effect, even if the provision has already been repeatedly extended.¹²⁷ As illustrated above in Chart B, this scoring practice can create a preference for using the tax expenditure model over other forms of direct government intervention.¹²⁸ Through the use of sunset provisions, lawmakers can significantly decrease the estimated costs of proposed temporary tax legislation, push offsetting revenues to later fiscal years, and free up existing or proposed revenue streams to offset additional spending initiatives or tax cuts.

I propose that tax expenditure legislation should be scored under principles similar to their direct spending counterparts. Specifically, if any tax expenditure is projected to have costs in any year in excess of \$50 million (*i.e.* more than a relatively de minimis amount), then any sunset provision presumptively will be disregarded and the proposed legislation will be scored as if the legislation is in effect for the entire applicable budget window.

For example, in Chart B above, this proposed scoring rule would require that legislative Option B score as having projected costs for the ten-year budget window of \$35 billion, which is identical to Option A, the permanent but otherwise equivalent legislation. The projected cost of Option B is well above the \$50 million threshold, and accordingly the proposed statutory sunset after year two would be disregarded. Unlike the current budget system, for PAYGO purposes there would be no advantage for proposing Option B over Option A.

¹²⁴ Donald Marron has also suggested this revision to current practice. *See Marron supra* note 4, at 2. *See also* Gale and Orszag, *supra* note 3, at 1554 (“CBO treats mandatory spending provisions that expire as though they will be granted a continuance and should do the same for tax provisions.”).

¹²⁵ Cong. Budget Office, *supra* note 10.

¹²⁶ Congressional Budget and Impoundment Control Act of 1974, 2 U.S.C §622(3) (1974).

¹²⁷ *Id.*

¹²⁸ As noted by Edward Kleinbard, the preference for tax expenditures over mandatory spending programs is also attributable to the lack of attention and oversight tax provisions receive in the budget process as compared to their direct spending program counterparts. Kleinbard *supra* note 6, at 5.

In some instances, disregarding the sunset date for a proposed tax expenditure may not be warranted because the legislation may be proposed in response to an emergency or may otherwise be in fact inherently temporary in nature. Requiring offsets for years during which the proposed legislation is not intended to be in effect would be unduly onerous and likely not reflective of the anticipated costs of the provision. As such, I believe that it should be a rebuttable presumption that sunset provisions are ignored for scoring purposes. However, the presumption should only be overcome if proposed legislation is deemed “emergency legislation” under the existing congressional budget rules¹²⁹ or if Congress otherwise concludes that the proposed legislation’s purpose and effect is to specifically address a “temporary challenge.”¹³⁰

An emergency legislation exemption from the budget rules already exists in Congress for purposes of the PAYGO statute.¹³¹ It provides that if a provision is designated as an emergency under the statutory PAYGO Act, then neither the CBO nor OMB can include the projected budgetary effects of the provision in its estimates.¹³² As such, no offsetting revenues are required for emergency legislation. For example, emergency provisions directly targeted towards helping victims of natural disasters or acts of terrorism will be exempted from the presumptive rules and excluded from the scoring estimates, assuming Congress designated them as such.¹³³

Even if there is not an emergency, Congress should be able to obtain an exemption from the mandatory full budget window scoring if they are able to sustain a “temporary challenge” designation supported by CBO estimates. A temporary challenge designation will only be able to be made if the outlays and effects of a targeted piece of legislation are not expected or projected to exceed a certain number of years (*e.g.* four years). For example, current temporary provisions, such as the provision to allow homeowners to exclude from income the forgiveness of underwater mortgage debt, would have to fall within the temporary challenge designation in order to escape the presumption. In making this determination, the CBO would have to analyze whether the projected outlays and effects of the legislation are of an inherently finite nature to warrant temporary challenge classification. Procedural backstops should be put in place to safeguard against any potential abuse or over-use of the temporary challenge designation by Congress. For instance, there should be a limit on the number of times and active legislative years a particular provision can be deemed a “temporary challenge.”¹³⁴ However, because, as discussed below, temporary challenge legislation is subject to a more rigorous lock-step PAYGO rule, the ability for lawmakers to engage in budget manipulations will be limited in any event.

¹²⁹ Congress may exempt the budgetary effects of a provision in legislation from certain enforcement procedures by designating the provision as an “emergency” provision. If so designated, the provision’s projected spending and revenue effects are not counted for purposes of enforcing the budget rules. Cong. Research Serv., EMERGENCY DESIGNATION: CURRENT BUDGET RULES AND PROCEDURES (Jan. 6, 2011), available at <http://www.fas.org/sgp/crs/misc/R41564.pdf>.

¹³⁰ Marron, *supra* note 4, at 7.

¹³¹ Statutory PAYGO Act of 2010, 2 U.S.C. § 933(g) (2010) (providing that any legislation affecting direct spending or revenues designated as an emergency requirement shall not be counted for purposes of projecting the budgetary effects of the legislation).

¹³² *Id.* at § 933(g)(4).

¹³³ *Id.* at § 933(g). For example, emergency tax expenditure legislation was enacted to help victims of Hurricane Katrina and 9/11. See *supra* note 15.

¹³⁴ For example, a provision should only be eligible to get temporary challenge status up to two times or for up to a total of four consecutive active legislative years. Any further proposals would not be able to take advantage of the exclusion and all further sunset dates would be disregarded for scoring purposes.

On the other hand, current provisions such as the R&D credit and the deduction for state and local taxes would not be excluded from the reaches of the mandatory scoring rule because they would not be proposed in response to an emergency and they would not qualify for temporary challenge status. Accordingly, if they were once again proposed through a temporary extension, under the proposed budget rule they would be scored as having revenue impacts for the entire applicable budget window.

2. *Lock-Step PAYGO*

If the presumption for full budget window scoring is overcome through the designation of a “temporary challenge,” the temporary tax provision should be scored as such and projected costs should take into account the sunset provision. This will allow temporary challenge legislation to require fewer offsets to achieve revenue neutrality. However, temporary challenge provisions should have to adhere to what I call a “lock-step PAYGO” requirement.¹³⁵

Lock-step PAYGO will only allow qualifying offsets to be made from revenues generated during the term of the temporary legislation and not from the entire budget window period.¹³⁶ For example, if a temporary challenge tax expenditure is only proposed to be in effect for two years, lawmakers would have to come up with revenue offsets or spending decreases from that same two year period. If Option B in Chart B was proposed and was able to secure temporary challenge status, unlike the current budget rules, it could not use Option E to offset the expenditures and satisfy lock-step PAYGO. Rather, \$5 billion of revenue sources would have to be found from fiscal years one and two. This rule would thereby mitigate the ability of legislators to finance current expenditures with future revenue streams and thus help instill more fiscal restraint.

3. *Mandatory Baseline Review*

Lastly, I propose that there should be a baseline review of all permanently enacted legislation at the end of the initial ten-year budget window. If the difference between the original projected costs for the succeeding five-year period is more than some threshold amount (*e.g.*, \$2 billion)¹³⁷ less than the new projected costs over the same five years, Congress will need to find new offsets for the difference or risk sequestration.

As mentioned above, the JCT provides an annual Tax Expenditure Report to both chambers of Congress.¹³⁸ This report is currently used for informational purposes only and serves no active role in the budget process. This report contains estimates for tax expenditures projected to exceed \$50 million over the immediately ensuing five-year period. Importantly, when putting together these projections, the JCT takes into account statistics from recent returns. Thus, over time these estimates reflect the historical impact that the provision has actually had since its enactment. I believe that this Tax Expenditure Report could serve as the basis for the mandatory review process.

¹³⁵ I do not believe that emergency legislation should be subject to this requirement. Emergency legislation would be exempt from the PAYGO requirements.

¹³⁶ See also Marron, *supra* note 4, at 7.

¹³⁷ The threshold amount would be highly dependent on the level of fiscal restraint Congress would want to precommit itself to. The lower the threshold, the more likely it would be that they would have to re-balance the costs of an existing tax expenditure, and vice-a-versa. This number is relatively consistent with the \$5 billion SPO requirement, which covers a ten-year budget window.

¹³⁸ See *supra*, note 36 and accompanying text.

A weakness of the current budget process is that it only includes, and thus requires offsets for, costs projected to be incurred over a ten-year budget window. Additional budget costs incurred after this period are not taken into account because they become folded into the budget baseline. Therefore, the true budgetary impact of any proposed permanent legislation is understated to the extent that actual costs exceed projected costs.¹³⁹

The SPO attempts to get Senators to consider projected escalating costs that may occur outside the initial ten-year budget window by requiring projected deficits not to exceed \$5 billion over each of the following four ten-year periods.¹⁴⁰ However, to the extent that projected costs are significantly understated relative to actual costs, there currently is no specific mechanism in place to force Congress to recalibrate the budget. Instituting a mandatory review would prevent existing legislation that has significant underestimated or unforeseen costs from being permanently rolled into the budget baseline. Moreover, it would force Congress to affirmatively acknowledge the accumulation of escalating deficits. Lawmakers would have to act by finding new offsets for the existing provision or be forced to scale back the current level of provided benefits. Even if instead Congress chose to overturn or waive this budgetary rule,¹⁴¹ lawmakers would still have to acknowledge the budgetary problem and could not simply continue on with its proverbial head in the budgetary sand.

B. Consequences of the Proposed Budget Rules

If implemented, these budget rules would yield a more nuanced use of temporary legislation that would maximize their benefits while limiting situations where they are more commonly abused. The rules would impose more fiscal discipline on lawmakers while preserving the ability to tailor the term of legislation to specific situations—leaving in place the ability to capitalize on benefits of both short- and long-term tax legislation, where appropriate. These rules would increase fiscal transparency as to the true cost of legislation and prohibit the manipulation of estimates achieved by phase-outs and budget window and baseline manipulations. Lastly, they would potentially diminish, at least relative to the current system, the ability of special interest groups to extract rents from politicians.

1. *Decrease Opportunities for Budget Manipulation and Increase Fiscal Restraint*

The proposed bundle of budgetary rules should limit the ability of lawmakers to manipulate budget scoring. As discussed above, if sunsets are disregarded for budget scoring purposes, lawmakers would have to fully account and find revenue offsets for the total cost of the proposed tax expenditure over the full ten-year budget window. In Chart B, above, assuming that no emergency or temporary effect exception applied, Option B, which sunsets after two years, would be scored the same as Option A. Not only would legislators have to acknowledge the full \$35 billion cost of the tax expenditure over the initial ten-year budget window, but they would also have to find \$35 billion of revenue offsets in order to satisfy PAYGO. This is drastically different from the \$5 billion of

¹³⁹ Yin, *supra* note 5, at 193.

¹⁴⁰ See *supra* discussion in Part II.B.4.

¹⁴¹ See *infra* discussion in Part IV.C.

offsets they would have to find during the initial ten-year budget period if they merely extended Option B every two years.¹⁴²

Even if a tax expenditure were deemed to satisfy the temporary challenge exception, the lock-step PAYGO requirement would still limit lawmakers' ability to create significant gaps between the tax expenditures and offsetting revenue sources. For example, even if Option B met the temporary challenge standard, revenue offsets would have to be found during years one and two. Likewise, if it were renewed after the first two years for another two-year period, as in Option C, unlike with the current budget rules, Option F would not be able to offset it. Lock-step PAYGO would require the revenue offsets to come from years three and four. As a result, under the proposed rules, if the tax expenditure in Option B was repeatedly renewed, it would have to generate the same amount of offsets during the first ten fiscal years as would Option A. The only difference is that rather than having to come up with the full \$35 billion of offsets upfront, renewing the legislation piecemeal would enable lawmakers to stage the funding of the expenditure throughout the ten-year budget window.

2. *Maintain Legislative Flexibility and Enhance Oversight*

Although the proposed budget rules mandate more stringent scoring practices for temporary tax provisions, they do not preclude the ability to tailor the term of any legislation to specific situations where appropriate. Although the mandatory scoring of legislation for the full ten-year budget window would seemingly create a de-facto preference for permanent legislation, in situations where temporary legislation is more justified, there would be no such preference. Specifically, in situations where legislators face temporary challenges and need to enact tax expenditures that are specifically designed to apply for a finite period of time, the more onerous mandatory scoring rule would be waived. In these situations, temporary provisions would actually have an advantage because they would have more favorable budget scoring than their permanent counterparts and would require fewer available revenue offsets.

To the extent that current budget preferences in favor of temporary provisions are reduced or neutralized, perhaps only tax expenditures which are purposely and appropriately temporary in nature will remain so. No longer being crowded out in the renewal process by scores of other expiring provisions, more deliberative action and reflection could be taken with respect to their implementation. With over fifty currently expired tax extenders waiting in legislative limbo, it is hard to imagine that due consideration will be given to each one. Moreover, even with respect to permanent tax provisions, more opportunities for reevaluation and oversight would exist because of the proposed mandatory baseline review. If a provision is becoming significantly more costly than originally anticipated, lawmakers will be forced to examine the source of the increased cost and find ways to either generate more revenues or scale back the benefits provided under the existing legislation.

3. *Enhance Legislative Stability*

To the extent fewer tax expenditures are enacted in temporary form and are instead enacted as permanent provisions, this would lead to greater legislative stability.

¹⁴² As discussed above, if the tax expenditure in legislative Option B was merely extended every two years, lawmakers could always find offsets for the renewed legislation (as illustrated in Option C) by finding revenue raisers in the latter years of the then-applicable budget window (e.g. Option F). If they did this, then only \$5 billion of revenue offsets would have to be generated during the first ten fiscal years, even if the tax expenditure was in effect throughout the entire period.

As discussed above, taxpayers have a really difficult time planning their behavior and transactions around legislation that is constantly either in legislative jeopardy or limbo.¹⁴³ This undermines the efficacy of the enacted tax provision, and creates an inefficient and unstable legislative environment. At the beginning of the 2014-2015 school year, teachers had to purchase school supplies for their classrooms without knowing whether there would be a retroactive extension of the educator expense deduction.¹⁴⁴ Even if the deduction is ultimately extended retroactively, teachers may have already spent less than they otherwise would have on supplies for their students if they knew there would be a deduction available to offset their costs.¹⁴⁵

Further complications exist for business where interim reporting and forecasting requires firms to make determinations about their current and projected financial positions.¹⁴⁶ As discussed above with respect to the R&D credit, money, and opportunities can be lost and company valuations can be skewed when important tax provisions are subjected to the legislative merry-go-round caused by the continuous cycle of expiring and renewing tax provisions. These types of real world consequences can be mitigated to the extent that more permanent legislation is put in place. By removing the preference for temporary tax expenditures in the budget process, more tax legislation may be enacted without sunsets, providing more legislative stability.

4. *Achieve Greater Political Transparency*

The proposed rules would also enhance political transparency. The budget rules would make it more difficult for lawmakers to obscure the full costs of their proposed legislation by artificially sunsetting provisions. Scoring tax legislation for a ten-year period does not fully reflect the true cost of a proposed expenditure because it does not take into account the costs projected outside of the budget window. However, it provides a much clearer reflection of the overall fiscal burden than is portrayed by breaking up the projected outlays into smaller one- or two-year pieces that are more easily digested by the general public. Moreover, by requiring the temporary challenge designation in order to overcome the presumptive full budget window scoring requirement, lawmakers would have to reveal to the public the underlying expected duration of the proposed tax provision at the outset.

In addition, by conforming the scoring for tax expenditures to the scoring requirements for mandatory spending programs, one of the built-in preferences for using the tax code to achieve government spending would be removed. This could lead to more federal spending being proposed and administered through mandatory spending programs. As discussed above, federal spending through the IRC is often less salient to the general public.¹⁴⁷ Taking spending programs out of the tax system that do not naturally belong there (but may be there only because of the budgetary advantages afforded tax expenditures), could enhance political transparency with respect to federal spending.

5. *Diminish Captivity to Special Interest*

¹⁴³ See *supra* discussion in Part III.D.

¹⁴⁴ To the extent the provision is intended to encourage teachers to fill in supply gaps that are not covered by their respective schools, the deduction may underachieve its purpose.

¹⁴⁵ See *supra* notes 106 and 107 and accompanying text.

¹⁴⁶ Harpaz, *supra* note 112.

¹⁴⁷ See *supra* notes 98 through 100 and accompanying text.

Lastly, these proposed rules would help diminish the ability of lawmakers to extract rents from special interest groups. Under the present system, politicians are able to predictably extract rents from interest groups benefiting from targeted tax provisions that are perpetually under the threat of expiration.¹⁴⁸ It is true that these same groups surely would have an interest in securing the passage of favorable permanent legislation and would presumably be willing to pay more for that privilege (including payments to ensure that the favorable provisions would not subsequently be repealed). However, it is arguably reasonable to assume that over time the ability to extract rents with perpetual temporary legislation is greater than that with respect to equivalent permanent legislation.¹⁴⁹ More opportunities to bargain with an industry's legislative future can lead to greater opportunities to extract rents.

C. Potential Criticisms

Notwithstanding the potential benefits of the proposed budget framework rules, there are some potential concerns with and criticisms of the proposal. First, because of the endogenous nature of the budget rules, there is always the legitimate concern that Congress will choose not to follow them. Statutory budget rules have the peculiar status of not being binding on Congress, even though they are duly passed and signed into law.¹⁵⁰ They are instead given the same status as internally adopted Congressional budget rules.¹⁵¹ As such, either the House of Representatives or the Senate may at any time modify or waive the application of internal procedural rules.¹⁵² Nevertheless, the budget rules are still believed to have some effect as precommitment devices and in fact affect legislative outcomes.¹⁵³ Therefore, it is reasonable to assume that the proposed modifications to the existing budget rules will affect the legislative budget process as well.

Another potential criticism of the proposed budgetary framework is that it is a second-best solution to universal tax reform. Tax reform would be the ideal way to deal with many of the underlying issues with the budget process and would help stabilize, at least temporarily, the tax laws. However, the likelihood of a complete overhaul of the tax code happening in the near future is unclear at best.¹⁵⁴ Even if the tax laws were completely updated, that solution by itself is also incomplete. Inevitably, new tax

¹⁴⁸ See *supra* discussion in Part III.B.

¹⁴⁹ Kysar, *supra* note 3, at 1020. *But see* Yin, *supra* note 5, at 244 (arguing that even if “a credible threat could be made relatively costlessly through, for example, the mere sponsorship of a bill or issuance of a press release, it is not clear why legislators would prefer to threaten temporary, as opposed to permanent, action. The latter would presumably present a more harmful outcome to the interested groups and therefore should generate greater returns to forestall the threatened action.”).

¹⁵⁰ The Supreme Court has given special deference to these Congressional framework rules due to concerns about separation of powers and the Rulemaking Clause of the Constitution. Kysar, *supra* note 3, at 1022.

¹⁵¹ *Id.*

¹⁵² In fact, when Senator Byrd proposed his amendment (the Byrd Rule) to the Budget Act in order to impose restraint on the Senate's growing practice of adding extraneous items to reconciliation bills, it was approved by a vote of 96-0. Michael W. Evans, *The Budget Process and the “Sunset” Provision of the 2001 Tax Law*, 99 TAX NOTES 405, 409 (Apr. 21, 2003), citing 131 CONG. REC. 28974 (Oct. 24, 1985). Not only did Senators overwhelmingly decide to subject themselves to a precommitment device, but also since that time they have followed the letter of the rule (even though they have repeatedly used sunset legislation to undermine the purported spirit of the rule). See also Kleinbard, *supra* note 6, at 6-7.

¹⁵³ *Id.* at 6.

¹⁵⁴ Although there is always a seemingly growing push for tax reform, the Internal Revenue Code has not been overhauled since 1986.

expenditure provisions would be introduced and a firm procedural framework would still need to be in place in order to prevent the newly reformed tax laws from devolving back to their present state. New rules would be subject to the same budgetary pressures that exist under the present law, and the proposed rules would help maintain any ground gained with a new tax regime.

V. CONCLUSION

The increased use of temporary tax expenditures by lawmakers has exposed defects in the underlying legislative budget rules. Lawmakers are able to use combinations of sunsets, phase-ins, sliding budget windows, and baseline manipulations in order to diminish and obscure the true projected cost of their proposals. Although Congress is ultimately left in the position of having to police itself in order to regain more fiscal restraint, by using strategically tailored precommitment devices, it may be able to achieve more sound legislative outcomes. Indeed, implementation of more nuanced budget rules is necessary in order to better combat the countervailing pressures that lawmakers face from well organized special interest forces and to ensure that Congress is able to improve the country's long-term fiscal health.