

PRESIDENTIAL ADDRESS  
104<sup>TH</sup> ANNUAL CONFERENCE ON TAXATION, NEW ORLEANS  
COMPLEXITY AND SYSTEMIC TAX REFORM

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**W**E NEED BETTER DATA. BOTH OUR RESEARCH and practice suffer because the available data are grossly inadequate to our needs and we often do not even use the best data available. We use public-use tax data that are a grudging byproduct of the tax administration process or surveys where tax information is an afterthought—if it is there at all.

**WHY CURRENT PRACTICE IS SECOND BEST  
(IF THAT)**

Before I plumb the depths of our ignorance, I want to acknowledge that we know much more than we did when I started my career, due in no small measure to work done by NTA members. Indeed, the rich tapestry of research presented at our annual research conference is testament to the energy, intelligence, and creativity of our colleagues.

Dan Feenberg and the NBER deserve a lot of credit for developing TAXSIM, a federal and state income tax calculator that has stimulated a host of research papers. Researchers at Treasury, the Joint Committee on Taxation (JCT), Statistics of Income (SOI), and the Congressional Budget Office (CBO) have done some great work using administrative tax data. The SOI has made heroic efforts to expand access to those data (which I shall return to).

But there are still enormous challenges. One is that the data sets that most of us use are deeply deficient. Tax returns have very useful information about taxes, but little of the information we need to control for different preferences. There is an adage that to a man with a hammer, every problem looks like a nail. We often pretend that our information requirements look like tax returns, but more often than not, they really do not.

There are nice survey data sets that have great information about all the household characteristics we are interested in, *except tax*. It is impossible

to accurately measure marginal tax rates using data from the Survey of Income and Program Participation (SIPP), Current Population Survey (CPS), or Health and Retirement Study (HRS), especially for people with capital gains. We know from theory that people have an incentive to bunch at kink points, and the tax code is riddled with kinks, but they are impossible to identify using survey data. And most surveys under-sample high-income people, meaning that most of the tax dollars, and a lot of the interesting variation, are unrepresented.

Finally, even if we had better data, it is very hard to identify key parameters like the elasticity of taxable income. Congress never changes one thing at a time. Tax rates invariably change at the same time that tax bases change. Since tax bases are correlated with income, macroeconomic factors that apply to people at different income levels will also appear to be correlated with tax rates. Researchers have used statistical techniques to try to control for these flaws, but the inherent data limitations mean that standard errors will be large, even if we can conjure up consistent estimates.

With few exceptions, the events we describe as “natural experiments” do not meet the standard for experimental evidence. Controls often are affected by the treatment and sometimes it is not even possible to accurately distinguish treatment from control groups.

We need real experiments. One of the high points in my experience at the Treasury Department was when I almost convinced Larry Summers that we should do a national savings experiment. The idea was that taxpayers would qualify for different subsidy schemes or a lump sum transfer depending on the last digit of their social security number. For example, ones and twos would get Roth IRA treatment; threes and fours would get traditional IRAs; fives and sixes would get a flat tax credit; sevens and eights would get a flat dollar subsidy if they contributed more than  $x$ ; and nines and tens would get 100 bucks. Larry was intrigued. I knew he was with me — a rare event in my tenure at Treasury.

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\*This is a slightly adapted version of my presidential address. Views expressed are my own and should not be attributed to any of the organizations with which I am affiliated.

We were ready to go until some of the lawyers at the table pointed out that the scheme was probably unconstitutional.

But there is a way we could get better quasi-experimental evidence. States are the laboratory of democracy — or could be. Forty four states have income taxes with different rates and different bases. We could encourage states to try different policies — for example, to encourage saving — and then collect data adequate to measure the effects.

Even if we could not get them to experiment, we could exploit existing variation in bases and rates. In previous research on capital gains (Burman and Randolph, 1994), state taxes turned out to be surprisingly powerful instruments for measuring the effects of permanent differences in taxation. State income tax rates vary a lot, although they are not perfect instruments. People might choose their state based on its taxation regime, as well as other factors, but the other factors are very important. Furthermore, there is a lot of inertia. If a change in policy did drive people out of the state, it would take a long time to reach the new equilibrium. And in the meantime we could measure how taxpayers were responding to the change in tax rules.

#### A SHORT- AND LONG-TERM AGENDA TO GET BETTER DATA

1. Use the best available data. For the past several years the SOI has issued RFPs for academic researchers to gain access to the restricted tax data sets — cross-section as well as panel — to answer important tax policy/tax administration questions. The unrestricted data sets have a wealth of information that is not available on the public use file, and they are the only source of recent panel data. Only available inside government, panel data allow researchers to control for unchanging individual characteristics.
2. Build a better dataset from available information. Real resources should be devoted to creating better data from administrative records that would be available to researchers inside and outside of government. My ideal data set would be a panel of tax returns that are representative at the state level with administrative information linked in: Social Security earnings histories, husband and wife earnings, ages, contributions to retirement plans, contributions to health insurance (starting in 2012), stock options, and linked information from employers' tax returns about firm size and industry.
3. Collect more information. Some information would be straightforward to add to information returns and link to the panel. For example, brokers and mutual funds could easily report asset values for all portfolio assets — not just those that are sold. Home values that are currently linked to sellers could also be linked to purchasers' tax returns. Local governments could be asked to report assessed values for homes as well as property taxes.
4. Make the data available to researchers outside of IRS. Raj Chetty (2010) of Harvard wrote a great letter making just this case.
5. Encourage states to experiment. States should be encouraged to vary rates and tax bases in a systematic way. We know very little about how the tax base affects the elasticity of taxable income. There is some evidence (Kopczuk, 2002) that the elasticity is higher with a narrow base than with a broad base, and most of us take it as a matter of faith that base-broadening is efficient, but there is still more that we do not know than we do. The goal would be to have sufficient information to measure accurately the economic gains from tax reform. It would be wonderful if policy makers had an accurate menu of policy choices and their economic effects.

#### Impediments To This Plan

Beyond step one (taking SOI up on its offer for access), there are some formidable impediments to this proposal. First, some people worry that research use of tax return information interferes with the core function of the tax system, which is to raise revenue to finance the government. A second related point is that expanded access to tax data raise serious privacy issues. Third, it would cost money that we do not have.

I do not find the sanctity of tax administration to be very convincing. Maybe if we had a pure comprehensive income or consumption tax minus the 200 or so tax expenditures that muddle the tax collecting function the argument would be more persuasive, but we use the tax system to achieve all sorts of ends unrelated to tax administration. Better information about how those efforts are working out could ultimately improve the integrity of the income tax.

The privacy issues are much more serious. The role of the tax system is to collect taxes, not data, and, unlike other surveys, participation is mandatory. There is really no such thing as informed consent. Disclosure, intentional or not, would be an unconscionable breach of privacy and could undermine voluntary compliance. Even if researchers could be trusted to use the data only for valid purposes, powerful commercial interests could use the data for nefarious purposes if they got their hands on the files. Section 6103(j) recognizes these concerns by sharply limiting access to these sensitive data.

This view makes sense if you think that privacy is an absolute right with infinite value, or that research using tax data has very little value. Both propositions are demonstrably false. Almost everyone who flies knows that privacy is often trumped by other concerns, such as “homeland security.” Allowing more access to tax data with protections that make disclosure nearly impossible is both feasible and desirable.

For example, we could follow the model used for access to the restricted version of the HRS. Access is only granted to researchers with projects at approved institutions where the principal investigator is the recipient of federal grants. The data may only be used in a computer in a secure room that is not connected to a network and data security is monitored by random unannounced audits. Any data breach carries the threat of termination of federal grants for everyone associated with the project and a ban on future funding. This makes research institutions, which are dependent on federal support, partners with an enormous incentive to monitor compliance with security standards.

There should also be jail terms for *anyone* who discloses confidential tax data — not just IRS employees.

Then there is money. I think this project would have enormous public value and, thus, be worth paying for, but I do not underestimate the difficulty in making that case to the political establishment. The ideal way to pay for this would be to repeal the state and local tax deduction and use the revenue saved to finance state experiments. Ideally, there would be a review board that would consider the proposals including data collection and assessment for which states could receive grants.

Short of that, we might be able to privately finance SOI efforts to expand access and improve data sets. One option would be to create a consortium of universities and research institutions with an annual subscription fee, following the model of Michigan’s Interuniversity Consortium for Political and Social Research.

I am an academic now, so here is an assignment. Explain to policy makers that we have a bipartisan interest in better data and suggest that more resources for SOI and expanded access with safeguards could help accomplish that. It might even lead to better policy. In a world where 9-9-9 and the Buffett Rule pass for policy, think how refreshing that would be.

## References

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