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Hypersalience and Why Understanding Behavioral Tax Law and Economics Means Understanding Tax

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Lilian V. Faulhaber, The Hidden Limits of the Charitable Deduction: An Introduction to Hypersalience (Boston Univ. School of Law, Public Law Research Paper No. 12-02, 2012).

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As Lilian Faulhaber describes in her article, *The Hidden Limits of the Charitable Deduction: An Introduction to Hypersalience*, salience recently has become a hot topic in tax scholarship. This increasing focus on salience arises out of the behavioral economics school. No longer are taxpayers assumed to be rationally maximizing their utility in the manner that economic models might predict. Rather, behavioral economics suggests that they often rely on mental shortcuts, or heuristics, to make decisions. As a result, scholars have suggested and, to some extent, documented how the salience, or prominence, of a tax provision may determine taxpayer responsiveness to the provision. Scholars have identified two types of salience: market salience (the impact of salience on market, or economic, activity) and political salience (the impact of salience on political outcomes). Faulhaber's article addresses the scholarship regarding market salience. As Faulhaber describes, the primary focus of such scholarship has been on whether and how low salience taxes (sometimes referred to as "hidden taxes") may cause taxpayers to underestimate the true cost of taxation and thereby potentially reduce behavioral distortions from taxation, which many view as the Holy Grail of tax policy.

However, Faulhaber astutely notes that this perspective regarding salience is only one side of the "hidden tax coin." Faulhaber explains that low salience tax provisions only cause taxpayers to underestimate the true cost of taxation when the tax provisions are *revenue-raising* provisions. Since scholars have not focused on *revenue-reducing* tax provisions, they have not focused to any great extent on the phenomenon that Faulhaber introduces in this article: hypersalience. Hypersalience, as Faulhaber defines it, is "the phenomenon by which the prominence of a tax provision leads taxpayers to overestimate its incidence." Hypersalience exists when there is a highly salient tax-reduction provision, combined with low salience restrictions or limitations on the tax-reduction provision. Faulhaber's introduction of hypersalience into the tax literature is important for a number of reasons. First, Faulhaber's discussion adds an important new dimension to the increasingly prominent salience scholarship. Second, Faulhaber's focus on hypersalience allows her to delve into a number of resulting, pressing policy issues, which have not previously been examined. Finally, Faulhaber's general discovery of hypersalience illustrates a basic but fundamentally important lesson: Behavioral economics phenomena do not operate in a vacuum. Rather, how they affect taxpayers depends on how they actually interact with particular tax provisions and with the administration of such provisions.

Faulhaber focuses on one particular set of tax provisions, the charitable deduction and its limitations, in order to examine hypersalience. Faulhaber describes the popular belief (often promoted by charitable organizations themselves) that charitable contributions are fully tax-deductible. However, numerous tax provisions in fact limit the deductibility of charitable contributions. In particular, charitable deductions are only available to taxpayers who itemize their deductions, meaning that the vast majority of taxpayers cannot actually deduct charitable contributions. Faulhaber calculates that approximately a quarter of all charitable contributions made in 2008 were not actually deducted by taxpayers, and suggests that hypersalience played a role in at least some of these contributions. She does so by examining in detail multiple factors including: the complexity that taxpayers face when trying to determine whether or not they will be itemizing deductions, and the tax filing incentives that likely decrease non-itemizing taxpayers' knowledge about the limitations on deductibility.

Faulhaber's examination of the charitable deduction allows her to delve into a number of broader policy issues raised by hypersalience. First, as Faulhaber demonstrates, charitable organizations themselves greatly contribute to the hypersalience of the charitable deduction, which potentially raises practical and normative issues regarding the role of third parties in (mis)educating taxpayers. Second, policymakers' failure to incorporate the concept of hypersalience into studies regarding price elasticity and treasury efficiency means that policymakers may not be calculating these measures correctly. For example, with the charitable deduction, if taxpayers charitably give in response to the deduction, even when they are not actually going to be able to take the deduction, then the deduction may result in much greater giving per revenue cost than government forecasts currently suggest. As Faulhaber indicates, this phenomenon could be an important, yet currently nonexistent, argument in favor of tax expenditures enacted through the Internal Revenue Code, rather than equivalent amounts of direct spending. Third, taxpayers influenced by hypersalience may overconsume goods under the mistaken belief that their consumption of those goods costs them less than it really does. Perhaps most notably and problematically, taxpayers may overinvest in home ownership as a result of the hypersalience of the home mortgage interest deduction. Having identified these issues with hypersalience, Faulhaber concludes that we should try to reduce hypersalience and suggests restricting third-party marketing as a means of doing so. While both her conclusion and solution will not be the last word on the matter, they are a good beginning in an ongoing conversation made possible by her unearthing of hypersalience.

At bottom, Faulhaber's article provides important contributions to both the specific salience scholarship and to tax scholarship employing behavioral economics generally. Her article underscores a lesson any tax lawyer would love: Understanding behavioral economics in tax means more than just understanding behavioral economics; it also means deeply understanding tax law and its administration.

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