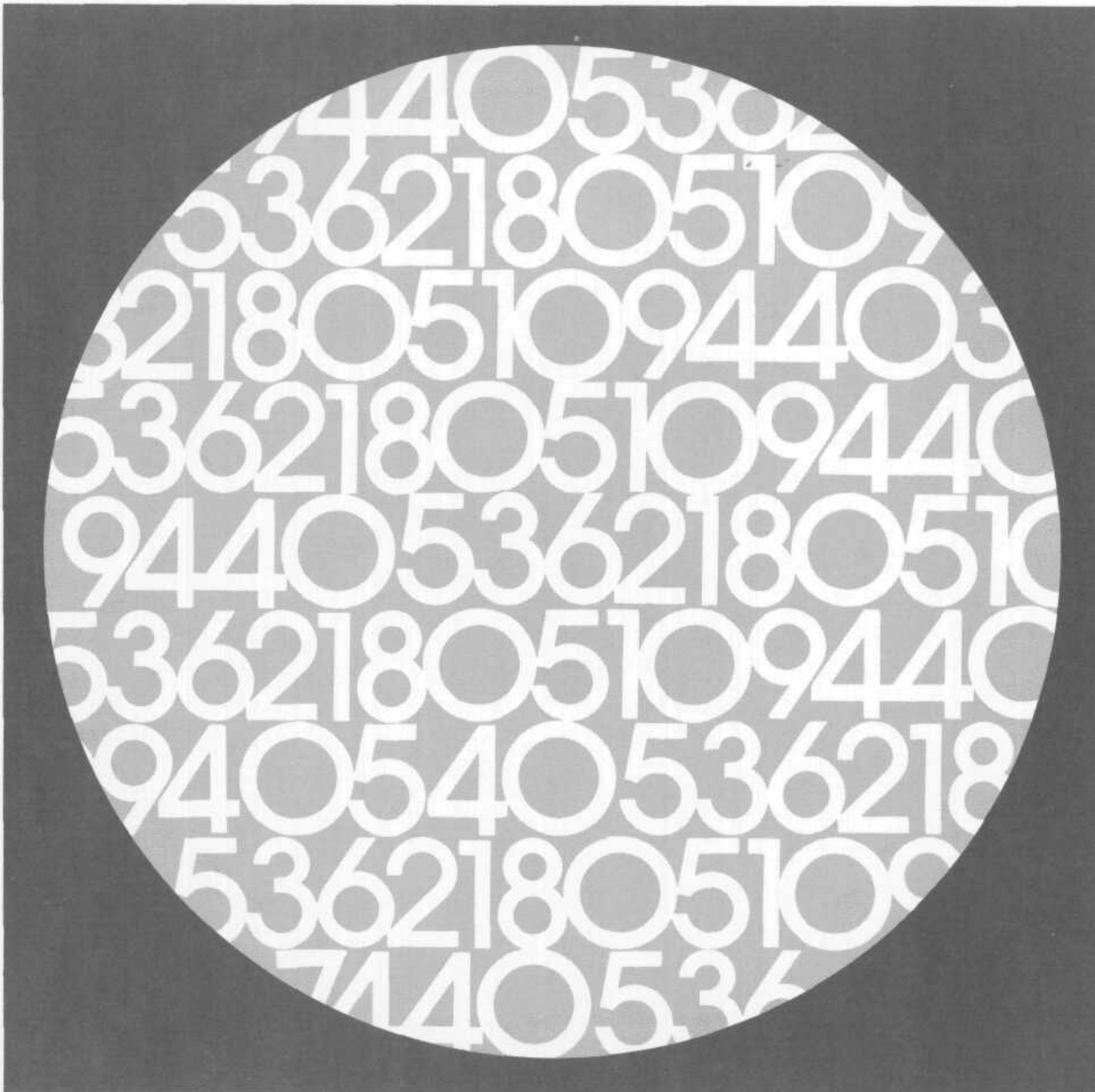


FIVE-YEAR  
BUDGET  
PROJECTIONS:  
FISCAL  
YEARS  
1978-1982

April 1977  
As required by  
Public Law 93-344

*SUPPLEMENT ON TAX EXPENDITURES*



**FIVE-YEAR BUDGET PROJECTIONS:  
FISCAL YEARS 1978-1982  
SUPPLEMENTAL REPORT ON  
TAX EXPENDITURES**

**April 1977**

**The Congress of the United States  
Congressional Budget Office  
Washington, D.C.**

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PREFACE

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As required by Section 308(c) of the Congressional Budget Act of 1974 (Public Law 93-344), this report by the Congressional Budget Office projects tax expenditures for each fiscal year between 1978 and 1982. It is a supplement to the Congressional Budget Office's recently issued Five-Year Budget Projections: Fiscal Years 1978-1982.

Alice M. Rivlin  
Director

April 1977



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## TAX EXPENDITURES

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### INTRODUCTION

Tax expenditures are revenue losses from provisions of the tax law that provide special or selective tax relief. These revenue losses are called tax expenditures because they are very much like payments by the federal government — except that they are made through a reduction of taxes rather than by a direct grant. For example, if a taxpayer buys a machine costing \$1,000, the 10 percent investment tax credit allows him to reduce his income tax by \$100. Instead of allowing this credit, the government could collect this \$100 as it does from other taxpayers, and then provide financial assistance by a government payment of \$100.

A tax expenditure provision may offer its tax relief in any of the following forms:

- o special exclusions, exemptions, and deductions, which reduce taxable income, and thus result in a lesser amount of tax (for example, tax-exempt municipal bond interest or the deduction of interest paid on consumer loans).
- o preferential rates, which reduce taxes by applying lower rates to part or all of a taxpayer's income (for example, the special 50 percent maximum tax rate on personal service income).
- o special credits, which are subtracted from the actual taxes due rather than from the income on which the tax is figured (for example, the investment tax credit).
- o deferrals of tax, which generally result from allowing in the current year deductions that are properly attributable to a future year (for example, accelerated depreciation).

The tax relief offered by tax expenditure provisions is generally available to any taxpayer who meets the requirements of the tax law. Thus, a tax expenditure is analogous to an entitlement program on the spending side of the budget; the amount expended is not subject to any legislated limit but is dependent solely upon taxpayer response to the particular provision. In this respect, tax expenditures closely resemble spending programs that have no ceiling.

MEASUREMENT OF TAX EXPENDITURES

In calculating the revenue loss from each tax expenditures, it is assumed that only the provision in question is deleted and that all other aspects of the tax system remain the same. In the case of a tax credit, for example, the amount of the credit is the amount of the tax expenditure. If the tax expenditure takes the form of a special deduction, the amount deducted is added back into taxable income, and a new tax liability is computed by applying the appropriate tax rates to the increased amount of taxable income. The revenue loss is then computed as the difference between the new tax liability and that under existing law. Also for each itemized nonbusiness deduction for individuals, the estimated revenue loss is based on the amount by which the standard deduction is exceeded. In the case of a deferral, the revenue loss is calculated as the difference between tax under current law and the amount that would be paid if the deferral were not allowed. The revenue loss due to a preferential rate is calculated by multiplying the base to which the special rate applies by the difference between the normal tax rate and the special tax rate.

Two assumptions are critical to this technique. First, economic aggregates are assumed to remain unchanged despite the hypothetical repeal of the provision in question. Second, any change in taxpayer behavior in response to the change is not taken into account. In short, "second order" effects of the revenue gain are not estimated. This general revenue estimating technique is consistent with the estimating of decreases in outlays which would result from the cessation of spending programs. In neither case are the changes in economic conditions or individual behavior estimated.

Interaction between tax expenditures should be kept in mind when the estimates of them are considered. For example, the amount of revenue not collected because a particular tax expenditure provision exists may not be the same as the net revenue gain which would be realized if the tax expenditure provision were eliminated.

This seeming paradox may be illustrated by an example. If the provision which allows rapid amortization of pollution control facilities were repealed, some affected taxpayers would switch to using accelerated depreciation and the Asset Depreciation Range (ADR)(see page 31). A tax expenditure attributable to ADR would result. Total federal receipts would increase only by the difference between (1) the revenue raised by the repeal of rapid amortization and (2) the revenue lost through the use of ADR. This amount would be smaller than the tax relief shown in Table 1 as attributable to rapid amortization.

The same kind of interaction occurs on the spending side of the



budget. For example, a repeal of the program for Aid to Families with Dependent Children (AFDC) probably would result in increased outlays for other programs such as food stamps. Thus, if the AFDC program were repealed, the net reduction in federal expenditures probably would be less than the present AFDC outlays. In other words, the cost of the AFDC program likely is different from the increased cost of food stamps which would result from elimination of the AFDC program. Also, if two tax expenditure provisions were repealed, the revenue loss would differ from the total of amounts shown for the two in Table 1. For example, if interest income from state and local government securities were made taxable and capital gains were taxed at ordinary rates, many more individuals would be pushed into higher tax brackets than if just one of these sources of income became fully taxable; the combined effect on revenue would be greater than the sum of the two separate estimates. In other cases, the revenue gain from the deletion of two items would be smaller than the sum of the individual estimates. For example, if the deductibility of mortgage interest payments and homeowner property taxes were both repealed, and the standard deduction unchanged, many individuals who now itemize their deductions would opt for the standard deduction, thus limiting the revenue gain. In general, elimination of multiple items that are personal deductions would increase revenue by less than the simple sum of the revenue gains from eliminating each item measured separately since many taxpayers would switch to using the standard deduction. Conversely, elimination of multiple items that are exclusions from adjusted gross income would increase revenue by more than the sum of the individual gains as taxpayers would be pushed into higher tax brackets.

Although the estimates shown in Table 1 (page 7) are subject to these estimating limitations, they are totaled both by functional category of the budget and for the entire tax expenditures budget.

#### TAX EXPENDITURE ESTIMATES

The tax expenditure estimates for the next five years are shown in Table 1. These estimates were supplied to the CBO by the staffs of the Joint Committee on Taxation and the Department of the Treasury. Where these estimates depend on outlays by the federal government, the estimates are consistent with the projections for outlay programs. 1/ As with the revenue projections, the tax expenditure estimates are based on the law in effect after passage of the Tax Reform Act of 1976. However, in contrast to the revenue projections, 2/ the underlying assumption is that any provision which has a termination date will expire on that date.

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1/ Five-Year Budget Projections: Fiscal Years 1978-1982, Congressional Budget Office, December, 1976.

2/ Ibid, p. 39.

For easier comparison with direct expenditures, the estimates are grouped under each functional category of the federal budget, and totals for each category are shown.

For the period of fiscal years 1978-1982, the total amount of tax expenditures in both the individual and corporation income taxes is projected to grow at a 7.8 percent average annual rate, amounting to a total increase of 35.3 percent for the period. About 94 percent of the total increase is in individual income tax expenditures, which are expected to grow at an average annual rate of 9.4 percent — a 43.2 percent total increase. Corporation income tax expenditures are projected to rise at a 2.1 percent rate — for a total increase of 8.9 percent during the next five years. These calculations are based on the assumption that all of the statutory provisions due to expire during the projection period will be allowed to do so. If the "tax cut" provisions of the 1976 act do not expire but continue, quite different growth rates result. These different results are discussed on page 6 in the last paragraph of text before Table 1.

#### TAX EXPENDITURES AND TAX REFORM

The Congress focused attention on tax expenditures while considering the Tax Reform Act of 1976. The act contained numerous tax reform provisions and also extended the tax cuts that were enacted in 1975. Both the reform provisions and the tax cut extensions affected tax expenditures. Forty-one of the act's amendments to tax expenditure provisions were estimated to affect revenues by \$5 million or more in any one year. Eighteen of these provisions reduced or eliminated tax expenditures while another twenty-two enacted new tax expenditures or liberalized old ones. One provision (relating to amortization of, and investment credits for, pollution control facilities) will result in a decrease in tax expenditures through fiscal year 1979 but will thereafter result in an increase in them.

For individuals, the major tax expenditure changes will result from changes in the treatment of child care expenses and the retirement income credit, the virtual elimination of the sick-pay exclusion, the increase in the percentage standard deduction, and the continuation of the earned income credit. All of these, except the sick-pay provision, increase tax expenditures (i.e., they result in revenue losses).

For corporations, the major decrease in tax expenditures (i.e., revenue gain) is attributable to the tightening of the DISC rules. 3/ The principal tax expenditure increases are due to the extension of the larger corporate surtax exemption and lower rate through calendar year 1977, and the extension of the higher investment credit rate through calendar year 1980. For those provisions affecting revenue by \$5 million or more in any one year, the total of the changes for corporations and individuals during the next five years are shown in Table 2 (page 17). This table does not project any tax expenditure beyond its scheduled expiration date.

Two other reform provisions of the 1976 act do not affect tax expenditures directly and cannot be properly described as tax expenditure provisions. Yet, they will have a significant impact on some tax expenditures. These are the so-called "at risk" rules and the changes in the minimum tax.

Under the "at risk" rules, deductions attributable to an investment will be limited to the amount of the investment plus the debts for which the taxpayer is personally liable. Deductions in excess of this total will not be allowed. Some of the deductions that will be disallowed by these rules would be tax expenditures, but some would not be. There is no good way of allocating the resulting revenue gain between items that are not tax expenditures and items that are tax expenditures. Thus, the revenue gains resulting from the "at risk" rules cannot be assigned to particular tax expenditures, and the quantitative effect of the new rules on tax expenditures is not clear. For these reasons, the revenue raised by the "at risk" rules has not been offset against particular tax expenditures in showing the estimates in Table 1. Instead, it is shown in Table 2 as increasing the revenue gain from the reform provisions of the act.

The minimum tax does not reduce tax expenditures directly. Rather, it imposes a tax on tax preferences. Where the tax preferences result in tax expenditures, the estimates in Table 1 have been reduced by their associated minimum tax liabilities, and only the net amount is shown. In Table 2, however, to show the effect of the 1976 act amendments to the minimum tax, this offset has not been made, and the minimum tax is shown separately as a reform provision that decreases tax expenditures.

The additional revenue raised by the "at risk" and minimum tax provisions under the 1976 act is shown in Table 2 as other tax reform provisions that will decrease tax expenditures. As shown in this table, the net impact of the tax reform provisions of the 1976 act is to decrease tax expenditures by about \$1.4 billion or 1.2 percent in fiscal year 1977 and \$2.9

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3/ See Appendix (page 25, last paragraph) for an explanation of DISC.

billion or 1.7 percent by 1982.

In addition to tax reform provisions, the 1976 act extended tax cuts that were first enacted in the Tax Reduction Act of 1975. These extensions generally have not been referred to as tax reform provisions, and in Table 2, they are described as "Extensions of the 1975 Cuts." These provisions are the earned income credit, the larger standard deduction, the lower corporate rate and larger surtax exemption, and the larger investment credit rate and limit on used property qualifying for the investment credit. The earned income credit terminates at the end of calendar year 1977 as do the lower corporate rate and larger surtax exemption. The investment credit changes will expire at the end of calendar year 1980. Even though these expirations occur during the projection period, the extensions increase tax expenditures each year. Indeed, for the first four years of the projection period, they increase tax expenditures by more than the tax reform provisions discussed above decrease tax expenditures. In fiscal year 1982, however, the tax reform provisions decrease tax expenditures by slightly more than the extensions increase them. The effect of the 1976 act then is to increase tax expenditures during the first four of the projection years but to decrease them in the last. This effect is shown in the Summary of Table 2 on page 17.

The reversal from net increases in tax expenditures to a net decrease in them comes about only because the tax cut extensions noted above terminate during the projection period. If the Congress does not allow these expirations to occur, tax expenditures will increase during each year of the projection period. Table 3 shows the increase in tax expenditures that would result from continuing the extensions throughout the projection period. Table 4 then adds the amounts shown in Table 3 to the amounts shown in Table 2 to demonstrate the effect of the 1976 act on tax expenditures if the tax cut extensions were not allowed to expire. In that case, the 1976 act would increase tax expenditures throughout the projection period -- by \$3.8 billion in fiscal year 1977, \$6.7 billion in 1981, but by only \$6.4 billion in 1982. For the fiscal years 1978-1982 period, these added tax expenditures would increase the average annual rate of growth to 9.8 percent for individual income tax expenditures -- for a total increase of 45.2 percent. Corporation income tax expenditures would rise at a 6.1 percent annual rate -- for a total increase of 26.8 percent during the next five years.

TABLE 1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION <sup>a/</sup>  
(Fiscal Years, in Millions of Dollars)

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
<u>National Defense</u>												
Military personnel:												
Exclusion of benefits and allowances to armed forces personnel							1095	1260	1360	1470	1585	1715
Exclusion of military disability pensions							<u>105</u>	<u>115</u>	<u>120</u>	<u>130</u>	<u>135</u>	<u>145</u>
TOTAL							<u>1200</u>	<u>1375</u>	<u>1480</u>	<u>1600</u>	<u>1720</u>	<u>1860</u>
<u>International Affairs</u>												
International financial programs:												
Exclusion of income earned abroad by U.S. citizens							120	135	150	160	170	185
Deferral of income of domestic international sales corporations (DISC)	1030	1190	1360	1455	1475	1545						
Deferral of income of controlled foreign corporations	410	410	410	410	410	410						
Special rate for Western Hemisphere trade corporations	<u>35</u>	<u>25</u>	<u>15</u>	<u>5</u>	<u>--</u>	<u>--</u>						
TOTAL	<u>1475</u>	<u>1625</u>	<u>1785</u>	<u>1870</u>	<u>1885</u>	<u>1955</u>	<u>120</u>	<u>135</u>	<u>150</u>	<u>160</u>	<u>170</u>	<u>185</u>
<u>Natural Resources, Environment, and Energy</u>												
Conservation and land management:												
Capital gains treatment of certain timber income	300	325	340	355	375	395	95	100	105	110	115	125

<sup>a/</sup> All estimates are based on the tax code as of January 1, 1977.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Pollution control and abatement:												
Exclusion of interest on state and local government pollution control bonds	170	220	265	300	330	355	75	100	125	145	160	175
Five-year amortization on pollution control facilities	b/	b/	b/	40	130	180						
Energy:												
Expensing of exploration and development costs	610	600	610	635	675	735	105	150	155	185	200	230
Excess of percentage over cost depletion	1035	1060	1135	1220	1295	1360	275	300	330	360	400	410
Other natural resources:												
Capital gains treatment of royalties on coal and iron ore	20	20	25	25	30	30	45	50	60	70	80	90
TOTAL	<u>2135</u>	<u>2225</u>	<u>2375</u>	<u>2575</u>	<u>2835</u>	<u>3055</u>	<u>595</u>	<u>700</u>	<u>775</u>	<u>870</u>	<u>955</u>	<u>1030</u>
<u>Agriculture</u>												
Farm income stabilization:												
Capital gains treatment of certain ordinary income	10	15	15	15	15	15	330	350	365	385	405	425
Expensing of certain capital outlays	80	70	75	80	80	85	370	440	460	475	490	510

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b/ This provision initially applied to new facilities added to plants in existence on January 1, 1969. It expired on December 31, 1975. No investment credit was allowed on property subject to this provision. The 1976 Act renewed the provision for property in existence on January 1, 1976. An investment credit of one-half now applies to facilities installed after December 31, 1976. Amortization on these facilities is a tax preference falling under the minimum tax. The interaction of these provisions result in revenue gains of \$80 million, \$130 million, and \$45 million in fiscal year 1977, 1978, and 1979, respectively. They are not shown in the table.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
<u>Agriculture continued:</u>												
Deductibility of noncash patronage dividends and certain other items of farm cooperatives	455	490	535	570	610	655	c/	c/	c/	c/	c/	c/
TOTAL	<u>545</u>	<u>575</u>	<u>625</u>	<u>665</u>	<u>705</u>	<u>755</u>	<u>700</u>	<u>790</u>	<u>825</u>	<u>860</u>	<u>895</u>	<u>935</u>
<u>Commerce and Transportation</u>												
Mortgage credit and thrift insurance:												
Exemption of credit union income	165	185	200	225	250	275						
Excess bad debt reserves of financial institutions	560	645	860	875	945	925						
Deductibility of mortgage interest on owner-occupied homes							5435	6030	6695	7430	8250	9160
Deductibility of property tax on owner-occupied homes							4500	4995	5545	6155	6830	7580
Deductibility of interest on consumer credit							2310	2565	2845	3160	3505	3895
Credit for purchase of new homes							100	--	--	--	--	--
Deferral of capital gains on home sales							890	935	980	1030	1080	1135

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c/ Some individuals will have their taxable income increased by the dividends paid by the cooperative. It is estimated that these dividends will increase revenues by \$165 million, \$170 million, \$180 million, \$190 million, \$200 million, and \$210 million in fiscal year 1977, 1978, 1979, 1980, 1981, and 1982, respectively.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Other advancement and regulation of commerce:												
Dividend exclusion							410	425	450	470	495	520
Corporate surtax exemption	4650	4250	3655	3915	4205	4485						
Capital gains (other than farming, timber, iron ore and coal)	555	550	550	585	615	650	7030	7360	7710	8265	8855	9495
Capital gains at death							7280	8120	8975	9910	10945	12090
Depreciation on rental housing in excess of straight line	100	100	105	105	105	105	405	425	450	470	490	515
Depreciation on buildings (other than rental housing) in excess of straight line	210	200	190	185	180	175	185	175	170	165	160	155
Expensing of research and development expenditures	1395	1450	1520	1610	1695	1715	30	30	30	30	35	35
Exclusion of interest on state and local industrial developments bonds	195	235	270	315	355	400	90	110	130	150	170	190
Excess first-year depreciation	45	45	50	50	55	55	135	145	155	160	170	180
Expensing of construction period interest and taxes	475	500	525	555	585	615	150	140	90	140	160	205
Investment credit	8640	9670	10375	10910	9380	7380	1970	2205	2430	2595	2595	1725
Asset depreciation range	1630	1825	2000	2095	2115	2115	175	195	220	230	235	235
Ground transportation:												
Five-year amortization on railroad rolling stock <u>d/</u>												

d/ Before 1976, railroad rolling stock, at the taxpayer's election, could be amortized over 5 years rather than depreciated. Some property which was amortized is still in service producing income. Because such property has no basis for depreciation, taxable income from it is higher than it would have been if the property had not been amortized. The revenue on this income is greater than the revenue losses on property subject to amortization. The amounts accruing to corporations are \$35 million in fiscal year 1977 and \$40 million in each of the other years.



Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Ground transportation continued:												
Deductibility of nonbusiness state gasoline taxes							795	880	980	1085	1205	1340
Water transportation:												
Deferral of tax on shipping companies	<u>90</u>	<u>70</u>	<u>60</u>	<u>50</u>	<u>40</u>	<u>35</u>						
TOTAL	<u>18710</u>	<u>19725</u>	<u>20360</u>	<u>21475</u>	<u>20525</u>	<u>18930</u>	<u>31890</u>	<u>34735</u>	<u>37855</u>	<u>41445</u>	<u>45180</u>	<u>48455</u>
<u>Community and Regional Development</u>												
Community development:												
Five-year amortization for housing rehabilitation	10	5	5	*	*	e/	20	10	5	*	*	e/
Tax incentives for preservation of historic structures	*	*	5	5	5	5	*	*	5	5	10	10
Contributions in aid of construction for certain utilities	<u>15</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>						
TOTAL	<u>25</u>	<u>15</u>	<u>20</u>	<u>15</u>	<u>15</u>	<u>15</u>	<u>20</u>	<u>10</u>	<u>5</u>	<u>5</u>	<u>10</u>	<u>10</u>
<u>Education, Training, Employment and Social Services</u>												
Higher education:												
Exclusion of scholarship and fellowship income							250	285	375	400	420	445
Parental personal exemption for students age 19 or over							750	770	790	815	840	865

\*/ Less than \$2.5 million.

e/ Since this provision will expire on December 31, 1977, revenue gains of \$5 million each for corporations and individuals will be produced in 1982.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Higher education continued:												
Deductibility of charitable contributions (education)	215	240	265	300	335	365	540	565	595	625	655	690
Training and employment:												
Credit for child- and dependent-care expenses							840	870	960	1050	1155	1270
Deduction for eliminating barriers for the handicapped	5	10	10	5	*	*						
Credit for employment of AFDC recipients and public assistance recipients under work incentive programs	15	15	20	20	20	20						
Other labor services:												
Exclusion of employee meals and lodging (other than military)							330	350	370	395	420	445
Maximum tax on personal service income							730	855	1025	1235	1480	1775
Exclusion of contributions to prepaid legal services plans							5	10	15	20	35	50
Investment credit for ESOPs	245	255	305	330	190	--						
Social Services:												
Deductibility of charitable contributions to other than education and health	270	295	330	370	415	450	3985	4510	5100	5755	6490	7310
TOTAL	<u>750</u>	<u>815</u>	<u>930</u>	<u>1025</u>	<u>960</u>	<u>835</u>	<u>7430</u>	<u>8215</u>	<u>9230</u>	<u>10295</u>	<u>11495</u>	<u>12850</u>

\*/ Less than \$2.5 million.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
<u>Health</u>												
Health-care services:												
Exclusion of employer contributions for medical insurance premiums and medical care							5195	5840	6560	7375	8290	9320
Deductibility of medical expenses							2585	2870	3185	3535	3920	4355
Health research and education:												
Deductibility of charitable contributions (health)	<u>135</u>	<u>150</u>	<u>165</u>	<u>185</u>	<u>205</u>	<u>225</u>	<u>915</u>	<u>965</u>	<u>1010</u>	<u>1060</u>	<u>1115</u>	<u>1170</u>
TOTAL	<u>135</u>	<u>150</u>	<u>165</u>	<u>185</u>	<u>205</u>	<u>225</u>	<u>8692</u>	<u>9675</u>	<u>10755</u>	<u>11970</u>	<u>13325</u>	<u>14845</u>
<u>Income Security</u>												
General retirement and disability insurance:												
Exclusion of social security benefits --												
Disability insurance benefits							380	430	485	540	600	665
OASI benefits for retired workers							3125	3460	3795	4155	4500	4870
Benefits for dependents and survivors							730	795	875	955	1035	1120
Exclusion of railroad retirement system benefits							200	205	215	220	230	235
Exclusion of workmen's compensation benefits							705	810	935	1070	1235	1420
Exclusion of special benefits for disabled coal miners							50	50	50	55	55	55
Net exclusion of pension contributions and earnings --												
Employer plans							8715	9940	11335	12925	14740	16815

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Net exclusion of pension contributions and earnings continued -- Plans for self-employed and others							1305	1535	1760	2025	2325	2670
Exclusion of other employee benefits -- Premiums on group term life insurance							800	835	870	900	940	975
Premiums on accident and accidental death insurance							70	75	80	85	85	95
Exclusion of capital gains on home sales for persons age 65 and over							40	70	70	70	70	75
Additional exemption for elderly							1220	1280	1345	1410	1480	1555
Tax credit for the elderly							495	440	435	430	425	420
Exclusion of interest on life insurance savings							1815	1995	2185	2400	2630	2885
Exclusion of sick pay							50	55	60	60	65	70
Unemployment insurance: Exclusion of unemployment insurance benefits							2745	2445	2240	2125	2070	2035
Exclusion of income of trusts of finance supplementary unemployment benefits							10	10	10	10	10	10
Public assistance and other: Exclusion of public assistance benefits							100	105	110	115	125	130
Excess of percentage standard deduction over minimum standard deduction							1285	1410	1555	1710	1880	2070
Additional exemption for the blind							20	20	20	20	20	20
Earned income credit -- nonrefundable portion							225	205	--	--	--	--
refundable portion							1145	1145	--	--	--	--

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Public assistance and other continued:												
Deductibility of casualty losses							345	380	425	470	520	580
TOTAL							<u>25615</u>	<u>27695</u>	<u>28855</u>	<u>31750</u>	<u>35040</u>	<u>38770</u>
<u>Veterans Benefits and Services</u>												
Income security for veterans:												
Exclusion of veterans disability compensation							655	690	690	685	685	685
Exclusion of veterans pensions							30	35	35	35	35	35
Veterans education, training, and rehabilitation:												
Exclusion of GI bill benefits							255	240	220	190	160	135
TOTAL							<u>910</u>	<u>965</u>	<u>945</u>	<u>910</u>	<u>880</u>	<u>855</u>
<u>General Government</u>												
Other general government:												
Credits and deductions for political contributions							40	35	40	40	45	45
TOTAL							<u>40</u>	<u>35</u>	<u>40</u>	<u>40</u>	<u>45</u>	<u>45</u>
<u>Revenue Sharing and General Purpose Fiscal Assistance</u>												
Other general purpose fiscal assistance:												
Exclusion of interest on general purpose state and local debt	3105	3470	3865	4305	4780	5310	1680	1880	2095	2335	2595	2880
Tax credit for corporations doing business in U.S. possessions <u>f/</u>	285	310	330	350	370	390						

f/ Includes the effect of Sec. 931 exclusion for individuals doing business in certain U.S. possessions.

Function and Subfunction	Corporations						Individuals					
	1977	1978	1979	1980	1981	1982	1977	1978	1979	1980	1981	1982
Other general purpose fiscal assistance continued:												
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)							8095	8990	9975	11075	12290	13645
TOTAL	<u>3370</u>	<u>3780</u>	<u>4195</u>	<u>4655</u>	<u>5150</u>	<u>5700</u>	<u>9775</u>	<u>10870</u>	<u>12070</u>	<u>13410</u>	<u>14885</u>	<u>16525</u>
<u>Interest</u>												
Interest on the public debt:												
Deferral of interest on savings bonds							565	625	685	755	820	890
TOTAL							<u>565</u>	<u>625</u>	<u>685</u>	<u>755</u>	<u>820</u>	<u>890</u>

Sum of the Tax Expenditure Items by Type of Taxpayer  
(Fiscal Years, in Millions of Dollars)

Fiscal Year	Corporations and Individuals		Corporations		Individuals	
	Corporations	Individuals	Corporations	Individuals	Corporations	Individuals
1977	114,155	27,165	86,990			
1978	124,735	28,910	95,825			
1979	134,130	30,455	103,675			
1980	146,535	32,465	114,070			
1981	157,700	32,280	125,420			
1982	168,725	31,470	137,255			

Staffs of the Treasury Department and the Joint Committee on Taxation.

TABLE 2. EFFECTS OF TAX REFORM ACT OF 1976 ON TAX EXPENDITURES:  
SUMMARY, IN MILLIONS OF DOLLARS, BY FISCAL YEARS

Item	1977	1978	1979	1980	1981	1982
<u>Tax Reform Provisions</u>						
Tax expenditure provisions that will decrease tax expenditures	-1348	-1646	-1888	-1910	-2007	-2204
Tax expenditure provisions that will increase tax expenditures	1112	1262	1348	1421	1321	1163
Other tax reform provisions that will decrease tax expenditures <sup>a/</sup>	<u>-1148</u>	<u>-1301</u>	<u>-1471</u>	<u>-1604</u>	<u>-1753</u>	<u>-1914</u>
	<u>-1384</u>	<u>-1685</u>	<u>-2011</u>	<u>-2093</u>	<u>-2439</u>	<u>-2955</u>
<u>Extensions of 1975 Cuts</u>						
Provisions that will increase tax expenditures	<u>5231</u>	<u>7468</u>	<u>5180</u>	<u>5422</u>	<u>4139</u>	<u>2370</u>
TOTAL - Increase in Tax Expenditures	<u>3847</u>	<u>5783</u>	<u>3169</u>	<u>3329</u>	<u>1700</u>	<u>-585</u>

Source: For fiscal years 1977-1981, the Joint Committee on Taxation; for fiscal year 1982, the Tax Analysis Division, Congressional Budget Office.

<sup>a/</sup> These are the so-called "at risk" rules and the changes in the minimum tax. They do not directly reduce tax expenditures but have indirect effects on tax expenditures.

Table 2 continued

EFFECTS OF TAX REFORM ACT OF 1976 ON TAX EXPENDITURES:  
 DETAILS, IN MILLIONS OF DOLLARS, BY FISCAL YEARS

Item	1977	1978	1979	1980	1981	1982
<u>Tax Reform Provisions</u>						
<u>Tax expenditure provisions that</u> <u>will decrease tax expenditures</u> <u>(increase revenues)</u>						
Amortization of real property construction period taxes and interest	102	126	190	152	149	146
Recapture of depreciation on real property	9	18	28	38	56	66
Limitation on deductions for farm syndicates	86	32	32	33	34	34
Accrual accounting for farm corporations	8	18	18	18	18	18
Recapture of intangible drilling costs	7	14	42	51	65	81
Recapture of depreciation on player contracts	7	6	7	7	7	7
Limitation on additional first-year depreciation for partnerships	12	10	10	10	10	10
Changes in sick pay and certain military, etc., disability pensions	380	357	387	417	450	486
Changes in treatment of qualified stock options	7	20	33	33	5	3
Income earned abroad by U.S. citizens	44	38	38	38	38	38
Repeal of exclusion for earnings of less developed country corporations for the purpose of Section 1248	14	10	10	10	10	10
Dividends from less developed country corporations	80	55	55	55	55	55
Exclusion of income earned in possessions	6	10	10	10	10	10
Repeal of Western Hemisphere Trade Corporations	19	25	34	45	50	55



Tax Reform Provisions continued

Amendments affecting DISC	468	553	559	625	750	900
Increase in holding period required for capital gain	33	218	377	392	407	413
Treatment of pollution control facilities	59	102	18	-70	-160	-200 <sup>a/</sup>
Tax treatment of the grantor of options of stock, securities, and commodities	3	10	10	10	10	10
Maximum tax	<u>4</u>	<u>24</u>	<u>30</u>	<u>36</u>	<u>43</u>	<u>52</u>
<b>TOTAL</b>	<u><b>1348</b></u>	<u><b>1646</b></u>	<u><b>1888</b></u>	<u><b>1910</b></u>	<u><b>2007</b></u>	<u><b>2204</b></u>

Tax expenditure provisions which  
will increase tax expenditures  
(decrease revenue)

5-year amortization of low-income housing	1	4	8	8	8	7
Revisions of retirement income credit	391	340	340	340	340	340
Credit for child care expenses	384	368	404	444	488	536
Exclusion from Subpart F of certain earnings of insurance companies	14	10	10	10	10	10
Sale of residence by elderly	4	25	25	25	25	25
Retirement savings for certain married individuals	2	14	15	17	17	17
Participation by members of reserves etc., in individual retirement accounts	6	5	5	5	5	5

<sup>a/</sup> This provision will initially result in revenue gains but will later produce revenue losses. The negative numbers are the revenue losses.

Tax Reform Provisions Continued

Certain provisions relating to railroads	29	66	65	53	41	29
Lump sum distributions from qualified pension, etc., plans	10	9	9	9	8	8
Work incentive program expenses	3	7	11	14	9	0 <u>b/</u>
Amendments to rules relating to limitation on percentage depletion in case of oil and gas wells	24	10	10	10	10	10
Allowance of deduction for eliminating architectural and transportation carriers for handicapped	4	10	10	6 <u>c/</u>	0	0
Tax incentives to encourage preservation of historic structures	1	3	8	12	16	12
Contributions in aid of construction of certain utilities	16	11	11	11	11	11
Application of Section 117 to certain education programs for members of the uniformed services	10	8	8	2 <u>d/</u>	0	0
Prepaid legal expenses	5	8	16	21	33	12 <u>e/</u>
Special rule for certain charitable contributions of inventory and other property	19	22	22	24	24	24

b/ This provision expires on December 31, 1979.

c/ This provision expires on December 31, 1979.

d/ This provision expires on December 31, 1979.

e/ This provision expires on December 31, 1981.

Tax Reform Provisions continued

Investment credit						
First in, first out rule	0	0	5	20	40	50
ESOP	107	257	303	332	189	20
Movie and television films	37	18	13	13	3	3
Certain ships	13	12	15	18	23	28
Limitations for airlines and railroads	<u>32</u>	<u>55</u>	<u>35</u>	<u>27</u>	<u>21</u>	<u>16</u>
TOTAL	<u>1112</u>	<u>1261</u>	<u>1348</u>	<u>1421</u>	<u>1321</u>	<u>1163</u>
<u>Other tax reform provisions which</u>						
<u>will decrease tax expenditures</u>						
<u>(Increase revenue)</u>						
At risk provisions <u>f/</u>						
Oil and gas	50	18	6	3	6	6
Movies	3	10	14	17	18	18
Equipment leasing	4	14	17	17	14	14
Minimum tax						
Individuals	1032	1135	1249	1373	1511	1662
Corporations	<u>59</u>	<u>124</u>	<u>185</u>	<u>194</u>	<u>204</u>	<u>214</u>
TOTAL	<u>1148</u>	<u>1301</u>	<u>1471</u>	<u>1604</u>	<u>1753</u>	<u>1914</u>

f/ These rules also apply to farm investments but the estimated revenue gain is less than \$5,000,000 annually and thus is not shown.

Extension of 1975 Tax Cuts

Provisions which will increase  
tax expenditures (decrease revenue)

Earned income credit	695	1350	g/			
Excess of percentage standard deduction over low-income allowance	1560	1635	1720	1805	1895	1990 h/
Extension of certain corporate income tax rate reductions	1676	1177	g/			
Investment credit						
Used property	38	142	149	156 i/	118	20
10% rate	<u>1262</u>	<u>3164</u>	<u>3331</u>	<u>3461</u> i/	<u>2126</u>	<u>360</u>
TOTAL	<u>5231</u>	<u>7468</u>	<u>5200</u>	<u>5422</u>	<u>4139</u>	<u>2370</u>

g/ These provisions are scheduled to expire on December 31, 1977, but H.R. 3477, the Tax Reduction and Simplification Act of 1977, would extend them an additional year through December 31, 1978.

h/ If H.R. 3477 becomes law, as now seems likely, the low-income allowance and the percentage standard would disappear, and there would be a level standard deduction for all taxpayers. This tax expenditure thus would disappear.

i/ These provisions expire on December 31, 1980.

TABLE 3. EFFECT OF TAX EXPENDITURES OF EXTENDING  
1975 TAX CUTS THAT EXPIRE DURING PROJECTION  
PERIOD, a/ IN MILLIONS OF DOLLARS, BY FISCAL YEARS

Item	1979	1980	1981	1982
Earned income credit	1290	1235	1180	1125
Certain corporate income tax rate reductions	2100	2200	2250	2300
Investment credit:				
Used property	-0-	-0-	46	158
10%	<u>      </u>	<u>      </u>	<u>1491</u>	<u>3420</u>
	<u>3390</u>	<u>3435</u>	<u>4947</u>	<u>7003</u>

a/ Table 2 shows the revenue attributable to these items assuming that they expire as scheduled under existing law. This table shows additional amounts if the scheduled expirations do not occur.

TABLE 4. EFFECTS OF 1976 TAX REFORM ON TAX EXPENDITURES IF TAX CUTS ARE EXTENDED THROUGHOUT PROJECTION PERIOD, IN MILLIONS OF DOLLARS, BY FISCAL YEARS

Item	1977	1978	1979	1980	1981	1982
Increase in tax expenditures under 1976 Act with expiration of tax cuts, from Table 2	3847	5783	3169	3329	1700	-585
Increase in tax expenditures if tax cuts are extended, from Table 3	<u>-0-</u>	<u>-0-</u>	<u>3390</u>	<u>3435</u>	<u>4967</u>	<u>7003</u>
TOTAL	<u>3847</u>	<u>5783</u>	<u>6559</u>	<u>6764</u>	<u>6667</u>	<u>6418</u>

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APPENDIX: DESCRIPTION OF TAX EXPENDITURES

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050 National Defense

051: Military personnel

- Exclusion of benefits and allowances to armed forces personnel

Military personnel are not taxed on a variety of in-kind benefits such as quarters and meals, nor on cash payments given in lieu of such benefits. IRC Sections 112 and 113, Regulations 1.61-2.

- Exclusion of military disability pensions

Pensions paid to service personnel based on percentage of disability are fully excluded from gross income. The portion of a pension based on years of service that would have been paid on the basis of disability may also be excluded. IRC Sec. 104(a)(4) and Regulations 1.104-1(e).

150 International Affairs

151: International financial programs

- Exclusion of income earned abroad by U.S. citizens

U.S. citizens not employed by the U.S. Government are exempt from U.S. tax on up to \$15,000 (\$20,000 before 1976 and for employees of U.S. charitable organizations thereafter) of income earned abroad if they have been residents of the foreign country for an uninterrupted period that includes a taxable year or if they have been present in a foreign country for 510 days out of 18 consecutive months. Also, certain allowances paid to civilian officers of the government while serving in foreign countries are excluded from income. IRC Sections 911-912.

- Deferral of income of domestic international sales corporations (DISC)

A Domestic International Sales Corporation (DISC) engaged in exporting is not taxed on its export income that is invested in export

assets. Beginning in 1976, only a portion of export income will be exempt from tax. The stockholders of a DISC are required to include 50 percent of the DISC's exempt income in their income. Tax on the balance is not paid until the income is distributed to them. IRC Sections 991-997.

- Deferral of income of controlled foreign corporations

As a general rule, income earned by a foreign subsidiary of a domestic corporation is not subject to tax by the United States until the income is remitted to the parent corporation as dividends. There are some exceptions. In those cases, the subsidiary's income is taxed to the parent corporation as earned by the subsidiary. IRC Sections 11(f), 882, and 951-964.

- Special rate for Western Hemisphere trade corporations

Western Hemisphere trade corporations (WHTCs) are granted a special deduction that has the effect of reducing the tax rate by as much as 14 percent points. This provision has been phased out by the Tax Reform Act of 1976. IRC Sections 921 and 922.

### 300 Natural Resources, Environment, and Energy

#### 302: Conservation and land management

- Capital gains treatment of certain timber income

Gain on timber may be treated as long-term capital gain rather than as ordinary income. IRC Sections 631(a) and (b), 1221, and 1231.

#### 304: Pollution control and abatement

- Exclusion of interest on state and local government pollution control bonds

State and local governments issue bonds to finance pollution control equipment for private firms. The interest income on these bonds is exempt from federal tax. IRC Sec. 103.

- Pollution control: 5-year amortization

Taxpayers may elect to amortize a certified pollution control facility over a five-year period rather than its longer expected useful life. Before 1977, facilities subject to an election were



ineligible for the investment credit, but they now qualify for a credit equal to one-half. IRC Sec. 169.

- Contributions in aid of construction for certain sewage and water utilities

Contributions in aid of construction of facilities for certain sewage and water utilities are excluded from income. Such facilities may not be included in the rate base, and depreciation and the investment credit are not allowed with respect to them. IRC Sec. 118(b).

### 305: Energy

- Expensing of exploration and development costs

Certain capital costs necessary to bring a mineral deposit into production may be deducted as current expenses rather than spread over the useful life of the property. IRC Sections 263(c) and 616-617.

- Excess of percentage over cost depletion

Taxpayers in extractive industries may deduct a percentage of gross mining income as a depletion allowance. The deduction may not exceed 50 percent (in some cases, 65 percent) of net income from the deposit. There are additional limitations on use of the deduction by oil and gas producers. IRC Sections 611, 613.

### 306: Other natural resources

- Capital gains treatment of royalties on coal and iron ore

Royalties from coal or iron ore deposits are treated as capital gains, rather than ordinary income. IRC Sections 631(c), 1221, 1231.

## 350 Agriculture

### 351: Farm income stabilization

- Expensing of certain capital outlays

Farmers may deduct certain costs as current expenses even though these expenditures were for inventories on hand at the end of the year or for capital improvement. IRC Sections 162, 175, 180, and

Regulations 1.61-4, 1.162-12, and 1.471-6. The Tax Reform Act of 1976 will eliminate these special rules for some corporations and syndicates.

- Capital gains treatment of certain income

Gains from real estate, depreciable property, and livestock used in farming and held for specified periods are treated as long-term capital gains. IRC Sections 1221-1223, 1231, 1245, and 1251-1252.

- Deductibility of noncash patronage dividends and certain other items of cooperatives

Cooperatives may deduct noncash patronage dividends and per unit retains. To be deductible, qualified written allocations must be made with 8½ months of the end of the taxable period in which the earnings occurred; dividends and retains not qualifying as a deduction but issued within the 8½ month period are deductible when redeemed in cash or property. Farmers' cooperatives meeting certain requirements may deduct dividends on capital stock and payments to patrons from nonpatronage income (for example, income on investments). The patrons must include such dividends in their income, and at least 20 percent must be in cash or its equivalent. IRC Sections 521, 1381-1388.

#### 400 Commerce and Transportation

##### 401: Mortgage credit and thrift insurance

- Exemption of credit unions

Credit unions, operated for mutual purposes and without profits, are exempt from federal income tax. IRC Sec. 501(c)(14).

- Financial institutions: excess bad debt reserves

Commercial banks, mutual savings banks, and savings and loan associations are permitted to deduct and set aside additions to bad debt reserves in excess of actual loss experience and reasonable expectations as to future losses. IRC Sections 585, 593, and 596; Revenue Rulings 65-92, C.B. 1965-1, 112; 68-630, C.B. 1968-2, 84.

- Deductibility of mortgage interest on owner-occupied homes

A taxpayer may claim an itemized deduction for mortgage interest paid on his owner-occupied home. IRC Sec. 163.

- Deductibility of interest on consumer credit

A taxpayer may claim an itemized deduction for interest paid or accrued on nonbusiness indebtedness (for example, personal and auto loans and credit account purchases). IRC Sec. 163.

- Credit for purchase of new homes

For purchases during a part of 1975, 5 percent of the purchase price of a "qualifying" new home up to a maximum of \$2,000 could be taken as a tax credit. IRC Section 44.

- Deferral of capital gains on home sales

Capital gains on the sale of a home are recognized only to the extent the adjusted gross sales price exceeds the cost of a new home timely acquired. IRC Sec. 1034.

- Deductibility of property tax on owner-occupied homes

A taxpayer may claim an itemized deduction for property tax paid on his owner-occupied home. IRC Sec. 164.

#### 403: Other advancement and regulation of commerce

- Dividend exclusion

An individual may exclude from income up to \$100 (\$200 on a joint return) of dividends received from domestic corporations. IRC Sec. 116.

- Corporate surtax exemption

Corporations pay both a "normal tax" and a "surtax." The normal tax rate is 20 percent on the first \$25,000 of income and 22 percent on the excess. The rate on the first \$25,000 of income is scheduled to rise to 22 percent after 1977. The surtax rate is 26 percent on all income in excess of \$50,000. After 1977, the surtax is scheduled to apply to all income over \$25,000. IRC Sec. 11.

- Capital gains: Individual and corporate (other than farming and timber)

An individual is allowed to deduct 50 percent of his long-term capital gains from his income. If a smaller tax will result, the first

\$50,000 of long-term capital gains is not taxed at more than 25 percent. Corporations may elect a 30 percent alternative tax rate on capital gains. The tax expenditure for corporations is estimated on the assumption that these gains would otherwise be taxed at 48 percent. IRC Sections 1201, 1221, 1231, 1245, 1250, and others.

- Capital gains at death

Gain on assets is not taxed when the asset is transferred to heirs at the death of the owner. If the owner dies after 1976, his heirs will pay a tax on gain accruing after 1976 if they sell the asset. IRC Sections 1001, 1002, 1014, and 1023.

- Depreciation on rental housing in excess of straight line

Newly constructed rental housing may be depreciated under methods which allow faster depreciation than is allowed under the straight line method. Methods allowing accelerated depreciation are available for used buildings but at a restricted rate. IRC Sec. 167(k) and (j).

- Depreciation on buildings (other than rental housing) in excess of straight line

New construction may be depreciated under methods which produce faster depreciation than straight line. IRC Sec. 167(k) and (j).

- Expensing of research and development expenditure

Taxpayers may elect to deduct costs for research and development as incurred even though such costs may be associated with income that is earned over several years. IRC Sec. 174.

- Exclusion of interest on state and local industrial development bonds

The interest on industrial development bonds issued by state and local governments is excluded from taxable income. The proceeds of these bonds are used to finance private investment in manufacturing plants and other facilities. IRC Sec. 103.

- Excess first-year depreciation

An extra first-year depreciation deduction of 20 percent may be claimed for \$10,000 of tangible personal property (\$20,000 on a joint return) having a useful life of at least six years. IRC Sec. 179.

- Expensing of construction period taxes and interest

Before 1976, property taxes and interest paid during the construction period of a building could be deducted immediately rather than being capitalized and written off over the life of the building. In 1976 and later years, these expenses must be capitalized and written off over a period of time, ultimately ten years. IRC Sec. 189.

- Investment credit

The taxpayer may subtract an investment credit from his tax liability. The credit is equal to 10 percent of "qualified investment," made in the year, but except for airlines and railroads, in any one year the credit may not offset more than \$25,000 of tax plus 50 percent of the tax liability over \$25,000. IRC Sections 38, 46-50.

- Asset depreciation range

The Internal Revenue Service has established useful lives for broad classes of depreciable assets. Under the asset depreciation range (ADR), a taxpayer may choose any useful life within a range of 20 percent more or less than the class life. Depreciation under ADR in excess of depreciation under the class life falls into this item. IRC Sec. 167(m); Regulations 1.167(a)-11, Rev. Proc. 72-10.

#### 404: Ground transportation

- Railroad rolling stock: five-year amortization

The cost of railroad rolling stock placed in service before 1976 is eligible for amortization over a five-year period whether owned by railroad companies or by lessors. If five-year amortization is elected, the investment credit cannot be claimed. IRC Sec. 184.

- Deductibility of nonbusiness state gasoline taxes

Individuals who itemize their deductions may deduct state and local gasoline excise taxes paid. IRC Sec. 164(a)(5).

#### 406: Water transportation

- Deferral of tax on shipping companies

Certain companies which operate U.S. flag vessels on foreign trade routes receive an indefinite deferral of income taxes on that portion

of their net income which is used for purposes of construction, modernization and major repairs of ships. 46 USC Sec. 1177 (607 of the Merchant Marine Act of 1936, as amended).

#### 450 Community and Regional Development

##### 451: Community development

- Housing rehabilitation: five-year amortization

A taxpayer may, under certain conditions, elect to compute depreciation on rehabilitation expenditures for low- and moderate-income rental housing over a five-year period. Qualified rehabilitation expenditures may not exceed \$20,000 per dwelling unit and must exceed \$3,000. This provision will expire on December 31, 1977. IRC Sec. 167(k).

- Tax incentives for the preservation of historic structures

The capital expenditures incurred in a certified historic structure may be amortized over a 60-month period. This provision will expire on June 15, 1981. IRC Sec. 191.

#### 500 Education, Training, Employment, and Social Services

##### 502: Higher education

- Exclusion of scholarships and fellowships

Generally, individuals may exclude scholarships or fellowships. This exclusion does not apply to amounts received for teaching or research and is limited in the case of nondegree students. IRC Sec. 117.

- Parental personal exemption of student age 19 or over

Taxpayers may claim personal exemptions for dependent children over 19 even though they earn \$750 or more per year if the children are full-time students. The student may also claim an exemption on his or her own tax return. IRC Sec. 151(e).

- Deductibility of charitable contributions (education)

Subject to certain limitation, charitable contributions to educational organizations may be deducted by individuals, corporations, and estates and trusts. IRC Sections 170 and 642(c).

#### 504: Training and employment

- Credit for child and dependent care expenses

Twenty percent of child and dependent care expenses incurred to permit the taxpayer and his/her spouse to work or to attend school full time may be subtracted from the tax liability up to a maximum credit of \$400 for one dependent or \$800 for two or more dependents. IRC Sec. 44A.

- Deduction for eliminating barriers for the handicapped

A deduction is allowed for the cost of capital improvements made to remove architectural or transportation barriers to handicapped persons. The deduction may not exceed \$25,000 in any one year. This provision will expire on December 31, 1979. IRC Sec. 190.

- Credit for employing of AFDC recipients and public assistance recipients under work incentive programs

A credit is allowed against income tax liability equal to 20 percent of first-year wages and salaries of employees placed in employment under the work incentive program. The credit in any one year may not exceed \$25,000 plus 50 percent of the tax liability over \$25,000. A similar credit, on a temporary basis, was provided for employment of AFDC recipients by the Tax Reduction Act of 1975. IRC Sections 40, 50A, and 50B.

#### 505: Other labor services

- Exclusion of employee meals and lodging

Employees exclude from income the value of meals and lodging furnished by the employer on his business premises and for his convenience; the lodging must be required as a condition of the employment. IRC Sec. 119.

- Maximum tax on personal service income

Taxpayers are subject to a maximum marginal tax rate of 50 percent on personal service income (compared to a maximum marginal rate of 70 percent on other income). IRC Sec. 1348.

- Exclusion of contributions to prepaid legal services plans

Employees may exclude from their income amounts paid by their employers to qualified prepaid legal services plans. IRC Sec. 120.

- Investment credit: Employee stock ownership plans

An additional percent of investment credit is available if an equal amount of employer's stock is contributed to an employee stock ownership plan (ESOP). An additional one-half percent is available for contributions to ESOPs if the employees match this contribution. IRC Sec. 46(a)(2)(B).

#### 506: Social services

- Deductibility of charitable contributions (social services)

Subject to certain limitations, a taxpayer may deduct contributions to social service organizations. IRC Sections 170 and 642(c).

### 550 Health

#### 551: Health care services

- Exclusion of employer contributions to medical insurance premiums and medical care

Payments by employers for health insurance premiums and other medical expenses are deducted as business expenses by employers and excluded from income by employees. IRC Sec. 106.

- Deductibility of medical expenses

Medical expenses in excess of 3 percent of adjusted gross income, including expenditures for drugs and medicines in excess of 1 percent of adjusted gross income, may be deducted by individuals as itemized nonbusiness deductions. Individuals may also deduct half of the premiums they pay for medical care insurance up to a maximum deduction of \$150 per year, without regard to the 3 percent limitation. IRC Sec. 213.



552: Health research and education

- Deductibility of charitable contributions (health)

Subject to certain limitations, a taxpayer may deduct charitable contributions to medical research and health care organizations. IRC Sections 170 and 642(c).

600 Income Security

601: General retirement and disability insurance

- Exclusion of social security benefits

- Disability insurance benefits
- OASI benefits for the aged
- Benefits for dependents and survivors

Social security benefits paid to persons who are aged, disabled, or a dependent or widow or widower of a person who participated in the system are not included in gross income and thus are tax exempt. I.T. 3194, 1938-1 C.B. 114 and I.T. 3229, 1938-2 C.B. 136, as superseded by Rev. Rul. 69-43, 1969-1 C.B. 310; I.T. 3447, 1941-1 C.B. 191, as superseded by Rev. Rul. 70-217, 1970-1 C.B. 12.

- Exclusion of railroad retirement system benefits

Benefits under the Railroad Retirement Act are tax exempt. 45 U.S.C. 228, Railroad Retirement Act of 1935, as amended.

- Exclusion of workmen's compensation benefits

Workmen's compensation benefits are not taxable. IRC Sec. 104(a)(1).

- Exclusion of special benefits for disabled coal miners

Payments made to coal miners or their survivors for disability or death resulting from pneumoconiosis (black lung) are exempt from income tax. 30 U.S.C. 801; Rev. Rul. 72-400, 1972-2 C.B. 75, under Sec. 104(a)(1).

- Net exclusion of pension contributions and earnings

- Employer plans

Employer's contributions to qualified pension and profit-sharing plans on behalf of an employee are excluded from the employee's income. Investment income of such plans is exempt. The employee is taxed only on the amounts he receives (adjusted for his contributions). IRC Sections 401-407, 410-415.

- Plans for self-employed and others

Self-employed individuals may deduct from gross income the lesser of 15 percent of earned income or \$7,500 a year for contributions to a qualified retirement plan. An employee not covered by a qualified plan may set up a tax-exempt individual retirement account (IRA) with limited tax deductible contributions. Payments from either kind of plan are taxable. IRC Sections 401-405, 408-415.

- Exclusion of other employee benefits

- Premiums on group term life insurance

Employer payments of employee group life insurance premiums for coverage up to \$50,000 are not included in income by the employee. Proceeds of the policy are not subject to income tax. IRC Sections 79 and 101, L.O. 1014, 2 C.B. 8 (1920).

- Premiums on accident and accidental death insurance

Premiums paid by employers for employee accident and accidental death insurance plans are not included in gross income of the employee. IRC Sec. 106.

- Exclusion of capital gains on home sales if over 65

A taxpayer 65 years of age or older, may exclude some or all of the gain realized on the sale of his principal residence. If the sale price does not exceed \$3,000, the entire gain may be excluded. If the price is greater than \$5,000, then an amount bearing the same ratio to the entire gain as \$35,000 bears to the entire price may be excluded. IRC Sec. 121.

- Additional exemption for over 65

An additional personal exemption is allowed for a taxpayer who is 65 or older. IRC Sec. 151(c).

- Credit for the elderly

Subject to limitations, individuals are allowed a tax credit equal to 15 percent of their retirement income. For those under 65, retirement income includes only the taxable portion of the public retirement benefits; for those 65 or over, pensions, annuities, certain bond and other interest, gross rents, and dividends are defined as retirement income. Retirement income eligible for the credit is limited to \$2,500 for an individual; however, married taxpayers may take a credit on as much as \$3,750 if they file a joint return. For persons age 65 and over, this maximum amount of the credit base is reduced by one-half of adjusted gross income in excess of \$7,500 for a single person and \$10,000 for a married couple filing a joint return, plus amounts received as exempt social security and exempt retirement income. IRC Sec. 37.

- Exclusion of interest on life insurance savings

Interest accumulating on the reserves of a life insurance policy thereby reducing the premiums of the policyholder is not included in the policyholder's income. Only if the policy is surrendered before death is a portion of the interest subject to tax. IRC Sec. 101(a) and case law interpreting Treas. Reg. 1.451.2.

- Exclusion of sick pay

An exclusion is provided of up to \$5,200 a year in wage substitutes for retirees under age 65 who are permanently and totally disabled. This amount is reduced dollar-for-dollar for adjusted gross income in excess of \$15,000. The former sick pay exclusion was virtually eliminated by the 1976 Tax Reform Act. IRC Sec. 105(d).

603: Unemployment insurance

- Exclusion of unemployment insurance benefits

Taxpayers may exclude unemployment compensation benefits from gross income. I.T. 3230, 1928-2 C.B. 136; Rev. Rul. 70-280, 1970-1 C.B. 13.

- Exclusion of income of trusts to finance supplementary unemployment benefits

Employer payments into qualified supplementary unemployment insurance benefit trusts are not taxable income to the employees when paid into the trusts. The earnings of the trusts are also exempt. Benefit payments are taxable. IRC Sec. 501(c)(17).

**604: Public assistance and other****- Exclusion of public assistance benefits**

Public assistance payments for general welfare purposes are not taxable income. See for example, Rev. Rul. 71-425, 1971-2 C.B. 76.

**- Excess of percentage standard deduction over minimum standard deduction**

Taxpayers who do not itemize deductions may take a standard deduction calculated as a percentage of adjusted gross income. The deduction is subject to both a maximum and minimum dollar amount. The latter is known as the low-income allowance. The extent to which the percentage standard deduction exceeds the low-income allowance is a tax expenditure. IRC Sec. 141.

**- Additional exemption for the blind**

Blind taxpayers (but not blind dependents) receive an exemption in addition to their normal exemption. IRC Sec. 151(d).

**- Earned income credit****- Nonrefundable portion**

A tax credit worth a maximum of 10 percent of the first \$4,000 of earned income and declining to zero at \$8,000 of adjusted gross income is available to low-income workers who have dependent children and maintain a household. IRC Sec. 43.

**- Refundable portion**

If the earned income credit exceeds the tax liability, the excess is paid to the taxpayer as a tax refund. IRC Sec. 43.

**- Deductibility of casualty losses**

To the extent it exceeds \$100, the uninsured portion of losses attributable to theft, fire, storm, shipwreck, or other casualty may be deducted as an itemized deduction. IRC Sec. 165(c)(3).

**700 Veterans' Benefits and Services****701: Income security for veterans**

- Exclusion of veterans' disability compensation

All benefits administered by the Veterans Administration are exempt from income tax. 38 USC 3101.

- Exclusion of veterans' pensions

All benefits administered by the Veterans Administration are exempt from income tax. 38 USC 3101.

#### 702: Veterans' education, training, and rehabilitation

- Exclusion of GI bill benefits

All benefits administered by the Veterans Administration are exempt from income tax. 38 USC 3101.

### 800 General Government

#### 806: Other general government

- Credit and deductions for political contributions

A taxpayer is allowed a tax credit equal to half of his political contributions up to a limit of \$25 for an individual or \$50 for a married couple filing jointly. Alternatively, a taxpayer may take an itemized deduction of up to \$100 for an individual or \$200 for a married couple filing jointly. IRC Sections 41 and 218.

### 850 Revenue Sharing and General Purpose Fiscal Assistance

#### 852: Other general purpose fiscal assistance

- Exclusion of interest on general purpose state and local debt

Interest on the obligations of state and local government is excluded from gross income. IRC Sec. 103.

- Exclusion of income earned in U.S. possessions

If certain conditions are met, a U.S. corporation or citizen engaged in the active conduct of trade or business within a U.S. possession is subject to U.S. tax only on U.S. source income. IRS Sections 931-934.

- Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)

An individual can claim certain state and municipal sales, income, and personal property tax payments as itemized deductions. IRC Sec. 164.

### 900 Interest

#### 901: Interest on the Public Debt

- Deferral of interest on savings bonds

The increase in redemption value that accrues on noninterest bearing U.S. obligations issued at a discount (largely Series E savings Bonds) is equivalent to accrual of interest. The taxpayer may defer tax on accrued interest until the bond matures or is transferred unless the bond is exchanged for a Series H bond, in which case the tax on the accrued interest is further deferred until the H bond is redeemed. IRC Sec. 454.