5. TAX EXPENDITURES

Tax expenditures are revenue losses due to preferential provisions of the Federal tax laws, such as special exclusions, exemptions, deductions, credits, deferrals, or tax rates. They are alternatives to other policy instruments, such as spending or regulatory programs, as means of achieving Federal policy goals. Tax expenditures are created for a variety of reasons, including to encourage certain activities, to improve fairness, to ease compliance with and administration of the tax system, and to reduce certain tax-induced distortions. The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of tax expenditures be included in the budget.

The largest tax expenditures tend to be associated with the individual income tax. For example, tax preferences are provided for pension contributions and earnings, employer contributions for medical insurance, mortgage interest payments on owner-occupied homes, capital gains, and payments of State and local individual income and property taxes. Tax expenditures under the corporate income tax tend to be related to the rate of cost recovery for various investments; as is discussed below, the extent to which these provisions are classified as tax expenditures varies according to the conceptual baseline used. Charitable contributions and credits for State taxes on bequests are the largest tax expenditures under the unified transfer (i.e., estate and gift) tax.

Because of potential interactions among provisions, this chapter does not present a grand total revenue loss estimate for tax expenditures. Moreover, past tax changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset. Nevertheless, in aggregate, tax expenditures have revenue impacts of hundreds of billions of dollars, and are some of the most important ways in which the Federal Government affects economic decisions and social welfare.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter. They are estimated for fiscal years 1998–2004 using three methods of accounting: revenue loss, outlay equivalent, and present value. The present value approach provides estimates of the revenue losses for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects. Tax expenditures relating to the unified transfer tax are considered in a section at the end of the chapter.

The section in this chapter on Performance Measures and the Economic Effects of Tax Expenditures presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section was prepared under the Government Performance and Results Act of 1993 and is included by reference in the government-wide performance plan required by this Act (see also Sections III, IV, and VI of the Budget volume). Tax expenditures are also discussed in Section VI of the Budget, which considers the Federal Government's spending, regulatory, and tax policies across functional areas.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

The Treasury Department prepared all tax expenditure estimates presented here based upon tax law enacted as of December 31, 1998. The analysis includes new tax expenditures that were enacted in the Tax and Trade Relief Extension Act of 1998. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 1998. Due to the time required to estimate the large number of tax expenditures, the estimates are based on mid-session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay components and hence are updated to reflect the economic assumptions used elsewhere in the budget.

The total revenue loss estimates for tax expenditures for fiscal years 1998–2004 are displayed by the budget's functional categories in table 5–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and discussion of general features of the tax expenditure concept.

As in prior years, two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify tax expenditures. For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue losses for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the estimates.

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be stockholders, employees, customers, or others, depending on economic forces.

Table 5–3 ranks the major tax expenditures by fiscal year 2000 revenue loss. This table merges several individual entries provided in table 5–1; for example, table 5–3 contains one merged entry for charitable contributions instead of the three separate entries found in table 5–1.

Interpreting Tax Expenditure Estimates

Tax expenditure revenue loss estimates do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing the special provisions, for the following reasons:

- Eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5–1 are the totals of individual and corporate income tax revenue losses reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5–1 (as well as those in Table 5–5, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- Revenues raised by changes to tax expenditures are sensitive to timing effects and effective dates. Changes in some provisions would yield their full potential revenue gains relatively quickly, whereas changes to other provisions would only gradually yield their full revenue potential, as certain deductions or exemptions would likely be grandfathered.
- The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 5–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- Repeal of some provisions could affect overall levels of income and rates of economic growth. In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

Present-Value Estimates

Discounted present-value estimates of revenue losses are presented in Table 5–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue losses, net of future tax payments, that follow from activities undertaken during calendar year 1999 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 1999 would cause a deferral of tax payments on wages in 1999 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 1999 pension contribution and accrued earnings will be paid out and taxes will be due; these receipts are included in the present-value estimate. In general, this conceptual approach is similar to the one used for reporting the budgetary effects of credit programs, where direct loans and guarantees in a given year affect future cash flows.

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,095	2,120	2,140	2,160	2,180	2,200	2,220	10,900
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	1,990	2,235	2,500	2,800	3,125	3,460	3,830	15,715
3	Exclusion of income of foreign sales corporations	2,150	2,250	2,400	2,550	2,700	2,900	3,100	13,650
4	Inventory property sales source rules exception	1,000	1,050	1,100	1,150	1,250	1,350	1,450	6,300
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150
6	Deferred taxes for financial firms on certain income earned overseas	400	1,075	65	0	0	0	0	65
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	260	330	510	610	675	735	765	3,295
8	Credit for increasing research activities	2,125	1,655	980	425	180	60	0	1,645
	Energy:								
9	Expensing of exploration and development costs, fuels	–110	–70	–10	–15	0	30	40	45
10	Excess of percentage over cost depletion, fuels	250	260	265	270	275	280	290	1,380
11	Alternative fuel production credit	860	810	760	720	675	435	125	2,715
12	Exception from passive loss limitation for working interests in oil and gas properties	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	60	65	65	70	70	75	80	360
14	Exclusion of interest on energy facility bonds	110	110	110	115	115	115	115	570
15	Enhanced oil recovery credit	140	160	180	210	240	275	320	1,225
16	New technology credit	25	30	35	40	40	35	35	185
17	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
18	Tax credit and deduction for clean-fuel burning vehicles	75	80	90	95	90	75	60	410
19	Exclusion from income of conservation subsidies provided by public utilities	80	80	80	75	75	75	80	385
	Natural resources and environment:								
20	Expensing of exploration and development costs, nonfuel minerals	25	25	25	25	25	30	30	135
21	Excess of percentage over cost depletion, nonfuel minerals	225	240	245	255	270	280	295	1,345
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	440	440	445	455	455	460	465	2,280
23	Capital gains treatment of certain timber income	60	65	65	70	70	75	80	360
24	Expensing of multiperiod timber growing costs	485	500	510	530	550	570	590	2,750
25	Investment credit and seven-year amortization for reforestation expenditures	10	10	10	10	15	15	15	65
26	Tax incentives for preservation of historic structures	215	235	255	275	285	305	315	1,435
	Agriculture:								
27	Expensing of certain capital outlays	65	70	70	75	75	80	85	385
28	Expensing of certain multiperiod production costs	80	85	85	90	95	100	105	475
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	605	630	655	685	715	750	785	3,590
31	Income averaging for farmers	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	785	840	905	970	1,040	1,120	1,200	5,235
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25
35	Exclusion of interest on life insurance savings	13,465	14,200	14,990	15,810	16,680	17,595	18,840	83,915
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	225	240	260	275	310	325	1,410
38	Small life insurance company deduction	100	100	100	105	105	110	100	520
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	860	875	880	885	900	905	915	4,485
40	Exclusion of interest on rental housing bonds	150	150	150	150	155	155	155	765
41	Deductibility of mortgage interest on owner-occupied homes	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	975	995	1,015	1,035	1,055	1,075	1,095	5,275
44	Capital gains exclusion on home sales	17,475	18,000	18,540	19,095	19,670	20,260	20,870	98,435
45	Exception from passive loss rules for $25,000 of rental loss	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	3,120	3,225	3,335	3,485	3,540	3,620	3,615	17,595
47	Accelerated depreciation on rental housing (normal tax method)	2,405	2,740	3,095	4,170	4,590	4,495	4,570	20,920
	Commerce:								
48	Cancellation of indebtedness	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	38,275	39,415	40,585	41,795	43,035	44,310	45,625	215,350
51	Capital gains exclusion of small corporation stock	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	24,570	25,800	27,090	28,240	29,370	30,545	31,765	147,010
53	Carryover basis of capital gains on gifts	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	35	35	35	40	40	40	40	195
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	6,270	4,895	3,430	2,385	2,365	1,875	585	10,640

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
56	Accelerated depreciation of machinery and equipment (normal tax method)	28,885	32,505	35,465	36,830	36,985	36,510	35,855	181,645
57	Expensing of certain small investments (normal tax method)	1,185	1,235	1,275	1,175	1,730	1,605	995	6,780
58	Amortization of start-up costs (normal tax method)	205	215	220	225	225	230	240	1,140
59	Graduated corporation income tax rate (normal tax method)	5,400	5,360	5,360	5,620	6,120	6,680	7,120	30,900
60	Exclusion of interest on small issue bonds	295	300	305	305	305	310	310	1,535
	Transportation:								
61	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75
62	Exclusion of reimbursed employee parking expenses	1,560	1,595	1,630	1,690	1,750	1,815	1,885	8,770
63	Exclusion for employer-provided transit passes	70	80	95	105	130	155	170	655
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	695	705	710	715	725	730	740	3,620
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255
67	Empowerment zones and enterprise communities	290	380	430	435	415	305	290	1,875
68	Expensing of environmental remediation costs	90	110	145	60	–10	–25	–35	135
	Education, training, employment, and social services:								
	Education:								
69	Exclusion of scholarship and fellowship income (normal tax method)	910	955	995	1,040	1,085	1,135	1,185	5,440
70	HOPE tax credit	200	4,015	4,855	5,325	5,730	5,765	5,950	27,625
71	Lifetime Learning tax credit	110	2,510	2,655	2,970	3,015	3,355	4,565	16,560
72	Education Individual Retirement Accounts	20	100	230	380	540	710	885	2,745
73	Deductibility of student-loan interest	70	245	265	315	360	385	425	1,750
74	Deferral for State prepaid tuition plans	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	235	235	240	245	245	250	250	1,230
76	Exclusion of interest on bonds for private nonprofit educational facilities	560	570	570	575	580	590	595	2,910
77	Credit for holders of zone academy bonds	0	10	20	30	35	35	35	155
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	15	15	15	15	20	80
79	Parental personal exemption for students age 19 or over	875	915	965	1,015	1,055	1,105	1,155	5,295
80	Child credit [2]	3,525	18,740	18,725	18,430	18,160	17,745	17,155	90,215
81	Deductibility of charitable contributions (education)	2,880	2,940	3,065	3,195	3,350	3,505	3,680	16,795
82	Exclusion of employer-provided educational assistance	215	215	210	15	0	0	0	225
	Training, employment, and social services:								
83	Work opportunity tax credit	170	335	330	160	40	5	0	535
84	Welfare-to-work tax credit	15	35	35	20	10	5	0	70
85	Exclusion of employer-provided child care	1,325	1,385	1,445	1,510	1,575	1,645	1,715	7,890
86	Adoption assistance	125	295	345	390	385	235	170	1,525
87	Exclusion of employee meals and lodging (other than military)	620	650	680	710	740	775	810	3,715
88	Credit for child and dependent care expenses	2,485	2,455	2,425	2,395	2,365	2,340	2,310	11,835
89	Credit for disabled access expenditures	45	50	50	50	55	60	60	275
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25
91	Deductibility of charitable contributions, other than education and health	18,580	19,150	20,055	21,005	22,050	23,150	24,335	110,595
92	Exclusion of certain foster care payments	35	35	40	40	45	45	50	220
93	Exclusion of parsonage allowances	315	340	360	385	410	440	470	2,065
	Health:								
94	Exclusion of employer contributions for medical insurance premiums and medical care	67,920	72,535	77,670	83,095	88,830	94,960	101,520	446,075
95	Self-employed medical insurance premiums	765	980	1,310	1,405	1,550	2,055	2,905	9,225
96	Workers' compensation insurance premiums	4,260	4,420	4,585	4,755	4,935	5,120	5,315	24,710
97	Medical Savings Accounts	15	20	25	25	20	20	15	105
98	Deductibility of medical expenses	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	1,160	1,170	1,185	1,190	1,205	1,220	1,230	6,030
100	Deductibility of charitable contributions (health)	2,560	2,630	2,730	2,860	3,000	3,145	3,300	15,035
101	Tax credit for orphan drug research	40	50	55	60	70	80	90	355
02	Special Blue Cross/Blue Shield deduction	210	230	250	280	325	290	250	1,395
	Income security:								
103	Exclusion of railroad retirement system benefits	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:								
108	Employer plans	82,215	82,195	84,350	86,670	89,155	91,810	94,455	446,440
109	Individual Retirement Accounts	10,565	10,770	11,170	11,440	11,550	11,485	11,270	56,915
110	Keogh plans	3,930	4,025	4,255	4,495	4,750	5,010	5,285	23,795
	Exclusion of other employee benefits:								
111	Premiums on group term life insurance	2,030	2,075	2,120	2,170	2,220	2,270	2,335	11,115

Table 5–1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Total revenue loss from corporate and individual Income taxes							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
112	Premiums on accident and disability insurance	175	185	195	205	215	225	235	1,075
113	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
114	Special ESOP rules	920	950	980	1,020	1,060	1,100	1,140	5,300
115	Additional deduction for the blind	30	30	30	30	35	35	35	165
116	Additional deduction for the elderly	1,690	1,720	1,740	1,795	1,880	1,945	2,020	9,380
117	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
118	Deductibility of casualty losses	225	235	245	255	270	280	290	1,340
119	Earned income tax credit [3]	6,351	5,118	4,971	5,142	5,275	5,471	5,672	26,531
	Social Security:								
	Exclusion of social security benefits:								
120	Social Security benefits for retired workers	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445
122	Social Security benefits for dependents and survivors	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:								
123	Exclusion of veterans death benefits and disability compensation	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	40	40	40	40	40	40	40	200
	General purpose fiscal assistance:								
127	Exclusion of interest on public purpose bonds	20,050	20,250	20,450	20,660	20,865	21,075	21,285	104,335
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015
	Interest:								
130	Deferral of interest on U.S. savings bonds	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:								
	Public purpose State and local debt	20,050	20,250	20,450	20,660	20,865	21,075	21,285	104,335
	IDBs for certain energy facilities	110	110	110	115	115	115	115	570
	IDBs for pollution control and sewage and waste disposal facilities	440	440	445	455	455	460	465	2,280
	Small-issue IDBs	295	300	305	305	305	310	310	1,535
	Owner-occupied mortgage revenue bonds	860	875	880	885	900	905	915	4,485
	State and local debt for rental housing	150	150	150	150	155	155	155	765
	IDBs for airports, docks, and sports and convention facilities	695	705	710	715	725	730	740	3,620
	State and local student loan bonds	235	235	240	245	245	250	250	1,230
	State and local debt for private nonprofit educational facilities	560	570	570	575	580	590	595	2,910
	State and local debt for private nonprofit health facilities	1,160	1,170	1,185	1,190	1,205	1,220	1,230	6,030
	State and local debt for veterans housing	40	40	40	40	40	40	40	200

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

Note: Provisions with estimates denoted ''normal tax method'' have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $5 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	......	......	......	......	......	......	......	......	2,095	2,120	2,140	2,160	2,180	2,200	2,220	10,900
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	......	......	......	......	......	......	......	......	1,990	2,235	2,500	2,800	3,125	3,460	3,830	15,715
3	Exclusion of income of foreign sales corporations	2,150	2,250	2,400	2,550	2,700	2,900	3,100	13,650	......	......	......	......	......	......	......	......
4	Inventory property sales source rules exception	1,000	1,050	1,100	1,150	1,250	1,350	1,450	6,300	......	......	......	......	......	......	......	......
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150	......	......	......	......	......	......	......	......
6	Deferred taxes for financial firms on certain income earned overseas	400	1,075	65	0	0	0	0	65	......	......	......	......	......	......	......	......
	General science, space, and technology:																
7	Expensing of research and experimentation expenditures (normal tax method)	255	325	500	600	665	720	750	3,235	5	5	10	10	10	15	15	60
8	Credit for increasing research activities	2,095	1,625	965	425	180	60	0	1,630	30	30	15	0	0	0	0	15
	Energy:																
9	Expensing of exploration and development costs, fuels	–90	–55	–10	–15	0	25	30	30	–20	–15	0	0	0	5	10	15
10	Excess of percentage over cost depletion, fuels	200	205	210	215	220	225	235	1,105	50	55	55	55	55	55	55	275
11	Alternative fuel production credit	815	765	720	680	640	420	120	2,580	45	45	40	40	35	15	5	135
12	Exception from passive loss limitation for working interests in oil and gas properties	......	......	......	......	......	......	......	......	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	......	......	......	......	......	......	......	......	60	65	65	70	70	75	80	360
14	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150	80	80	80	85	85	85	85	420
15	Enhanced oil recovery credit	130	150	170	195	225	260	300	1,150	10	10	10	15	15	15	20	75
16	New technology credit	25	30	35	40	40	35	35	185	......	......	......	......	......	......	......	......
17	Alcohol fuel credits [1]	10	10	10	10	10	10	10	50	5	5	5	5	5	5	5	25
18	Tax credit and deduction for clean-fuel burning vehicles	60	65	75	80	75	60	50	340	15	15	15	15	15	15	10	70
19	Exclusion from income of conservation subsidies provided by public utilities	......	......	......	......	......	......	......	......	80	80	80	75	75	75	80	385
	Natural resources and environment:																
20	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	25	25	110	5	5	5	5	5	5	5	25
21	Excess of percentage over cost depletion, nonfuel minerals	180	190	195	205	215	225	235	1,075	45	50	50	50	55	55	60	270
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	115	115	115	120	120	120	120	595	325	325	330	335	335	340	345	1,685
23	Capital gains treatment of certain timber income	......	......	......	......	......	......	......	......	60	65	65	70	70	75	80	360
24	Expensing of multiperiod timber growing costs	300	310	315	330	340	355	365	1,705	185	190	195	200	210	215	225	1,045
25	Investment credit and seven-year amortization for reforestation expenditures	......	......	......	......	......	......	......	......	10	10	10	10	15	15	15	65
26	Tax incentives for preservation of historic structures	175	195	210	225	235	250	260	1,180	40	40	45	50	50	55	55	255
	Agriculture:																
27	Expensing of certain capital outlays	10	10	10	10	10	10	10	50	55	60	60	65	65	70	75	335
28	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	50	70	75	75	80	85	90	95	425
29	Treatment of loans forgiven for solvent farmers	......	......	......	......	......	......	......	......	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	......	......	......	......	......	......	......	......	605	630	655	685	715	750	785	3,590
31	Income averaging for farmers	......	......	......	......	......	......	......	......	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60								
	Commerce and housing:																
	Financial institutions and insurance:																
33	Exemption of credit union income	785	840	905	970	1,040	1,120	1,200	5,235	......	......	......	......	......	......	......	......
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25	......	......	......	......	......	......	......	......
35	Exclusion of interest on life insurance savings	200	210	225	235	250	260	275	1,245	13,265	13,990	14,765	15,575	16,430	17,335	18,565	82,670
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25	......	......	......	......	......	......	......	......
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	210	225	240	260	275	310	325	1,410	......	......	......	......	......	......	......	......

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
38	Small life insurance company deduction	100	100	100	105	105	110	100	520	....	....	....	....	....	....	....	....
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	225	230	230	230	235	235	240	1,170	635	645	650	655	665	670	675	3,315
40	Exclusion of interest on rental housing bonds	40	40	40	40	40	40	40	200	110	110	110	110	115	115	115	565
41	Deductibility of mortgage interest on owner-occupied homes	....	....	....	....	....	....	....	....	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	....	....	....	....	....	....	....	....	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	255	260	265	270	275	280	285	1,375	720	735	750	765	780	795	810	3,900
44	Capital gains exclusion on home sales	....	....	....	....	....	....	....	....	17,475	18,000	18,540	19,095	19,670	20,260	20,870	98,435
45	Exception from passive loss rules for $25,000 of rental loss	....	....	....	....	....	....	....	....	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	2,340	2,420	2,500	2,615	2,655	2,715	2,710	13,195	780	805	835	870	885	905	905	4,400
47	Accelerated depreciation on rental housing (normal tax method)	1,650	1,880	2,125	2,845	3,135	3,090	3,155	14,350	755	860	970	1,325	1,455	1,405	1,415	6,570
	Commerce:																
48	Cancellation of indebtedness	....	....	....	....	....	....	....	....	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	....	....	....	....	....	....	....	....	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	....	....	....	....	....	....	....	....	38,275	39,415	40,585	41,795	43,035	44,310	45,625	215,350
51	Capital gains exclusion of small corporation stock	....	....	....	....	....	....	....	....	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	....	....	....	....	....	....	....	....	24,570	25,800	27,090	28,240	29,370	30,545	31,765	147,010
53	Carryover basis of capital gains on gifts	....	....	....	....	....	....	....	....	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	....	....	....	....	....	....	....	....	35	35	35	40	40	40	40	195
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,635	3,620	2,550	1,785	1,720	1,360	450	7,865	1,635	1,275	880	600	645	515	135	2,775
56	Accelerated depreciation of machinery and equipment (normal tax method)	22,025	24,645	26,800	27,835	28,050	27,790	27,380	137,855	6,860	7,860	8,665	8,995	8,935	8,720	8,475	43,790
57	Expensing of certain small investments (normal tax method)	805	840	875	820	1,200	1,125	730	4,750	380	395	400	355	530	480	265	2,030
58	Amortization of start-up costs (normal tax method)	120	125	130	130	130	135	140	665	85	90	90	95	95	95	100	475
59	Graduated corporation income tax rate (normal tax method)	5,400	5,360	5,360	5,620	6,120	6,680	7,120	30,900	....	....	....	....	....	....	....	....
60	Exclusion of interest on small issue bonds	75	80	80	80	80	80	80	400	220	220	225	225	225	230	230	1,135
	Transportation:																
61	Deferral of tax on shipping companies	15	15	15	15	15	15	15	75	....	....	....	....	....	....	....	....
62	Exclusion of reimbursed employee parking expenses	....	....	....	....	....	....	....	....	1,560	1,595	1,630	1,690	1,750	1,815	1,885	8,770
63	Exclusion for employer-provided transit passes	....	....	....	....	....	....	....	....	70	80	95	105	130	155	170	655
	Community and regional development:																
64	Investment credit for rehabilitation of structures (other than historic)	15	15	15	15	15	15	15	75	15	15	15	15	15	15	15	75
65	Exclusion of interest for airport, dock, and similar bonds	180	185	185	185	190	190	195	945	515	520	525	530	535	540	545	2,675
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255	....	....	....	....	....	....	....	....
67	Empowerment zones and enterprise communities	135	185	205	190	170	130	115	810	155	195	225	245	245	175	175	1,065
68	Expensing of environmental remediation costs	75	90	120	50	–10	–20	–30	110	15	20	25	10	0	–5	–5	25
	Education, training, employment, and social services:																
	Education:																
69	Exclusion of scholarship and fellowship income (normal tax method)	....	....	....	....	....	....	....	....	910	955	995	1,040	1,085	1,135	1,185	5,440
70	HOPE tax credit	....	....	....	....	....	....	....	....	200	4,015	4,855	5,325	5,730	5,765	5,950	27,625
71	Lifetime Learning tax credit	....	....	....	....	....	....	....	....	110	2,510	2,655	2,970	3,015	3,355	4,565	16,560
72	Education Individual Retirement Accounts	....	....	....	....	....	....	....	....	20	100	230	380	540	710	885	2,745
73	Deductibility of student-loan interest	....	....	....	....	....	....	....	....	70	245	265	315	360	385	425	1,750
74	Deferral for State prepaid tuition plans	....	....	....	....	....	....	....	....	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	60	60	65	65	65	65	65	325	175	175	175	180	180	185	185	905
76	Exclusion of interest on bonds for private nonprofit educational facilities	145	150	150	150	150	155	155	760	415	420	420	425	430	435	440	2,150

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
77	Credit for holders of zone academy bonds	0	10	20	30	35	35	35	155								
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	....	....	....	....	....	....	....	....	10	10	15	15	15	15	20	80
79	Parental personal exemption for students age 19 or over	....	....	....	....	....	....	....	....	875	915	965	1,015	1,055	1,105	1,155	5,295
80	Child credit [2]	....	....	....	....	....	....	....	....	3,525	18,740	18,725	18,430	18,160	17,745	17,155	90,215
81	Deductibility of charitable contributions (education)	970	970	990	1,020	1,065	1,105	1,160	5,340	1,910	1,970	2,075	2,175	2,285	2,400	2,520	11,455
82	Exclusion of employer-provided educational assistance	....	....	....	....	....	....	....	....	215	215	210	15	0	0	0	225
	Training, employment, and social services:																
83	Work opportunity tax credit	145	285	280	135	35	5	0	455	25	50	50	25	5	0	0	80
	Welfare-to-work tax credit	15	30	30	15	10	5	0	60	0	5	5	5	0	0	0	10
85	Exclusion of employer-provided child care	....	....	....	....	....	....	....	....	1,325	1,385	1,445	1,510	1,575	1,645	1,715	7,890
86	Adoption assistance	....	....	....	....	....	....	....	....	125	295	345	390	385	235	170	1,525
87	Exclusion of employee meals and lodging (other than military)	....	....	....	....	....	....	....	....	620	650	680	710	740	775	810	3,715
88	Credit for child and dependent care expenses	....	....	....	....	....	....	....	....	2,485	2,455	2,425	2,395	2,365	2,340	2,310	11,835
89	Credit for disabled access expenditures	15	15	15	15	15	20	20	85	30	35	35	35	40	40	40	190
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25								
91	Deductibility of charitable contributions, other than education and health	1,190	1,190	1,215	1,255	1,310	1,360	1,425	6,565	17,390	17,960	18,840	19,750	20,740	21,790	22,910	104,030
92	Exclusion of certain foster care payments	....	....	....	....	....	....	....	....	35	35	40	40	45	45	50	220
93	Exclusion of parsonage allowances	....	....	....	....	....	....	....	....	315	340	360	385	410	440	470	2,065
	Health:																
94	Exclusion of employer contributions for medical insurance premiums and medical care	....	....	....	....	....	....	....	....	67,920	72,535	77,670	83,095	88,830	94,960	101,520	446,075
95	Self-employed medical insurance premiums	....	....	....	....	....	....	....	....	765	980	1,310	1,405	1,550	2,055	2,905	9,225
96	Workers' compensation insurance premiums	....	....	....	....	....	....	....	....	4,260	4,420	4,585	4,755	4,935	5,120	5,315	24,710
97	Medical Savings Accounts	....	....	....	....	....	....	....	....	15	20	25	25	20	20	15	105
98	Deductibility of medical expenses	....	....	....	....	....	....	....	....	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	305	305	310	310	315	320	320	1,575	855	865	875	880	890	900	910	4,455
100	Deductibility of charitable contributions (health)	610	610	620	640	670	695	730	3,355	1,950	2,020	2,110	2,220	2,330	2,450	2,570	11,680
101	Tax credit for orphan drug research	40	50	55	60	70	80	90	355	....	....	....	....	....	....	....	....
102	Special Blue Cross/Blue Shield deduction	210	230	250	280	325	290	250	1,395	....	....	....	....	....	....	....	....
	Income security:																
103	Exclusion of railroad retirement system benefits	....	....	....	....	....	....	....	....	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	....	....	....	....	....	....	....	....	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	....	....	....	....	....	....	....	....	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	....	....	....	....	....	....	....	....	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	....	....	....	....	....	....	....	....	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:																
108	Employer plans	....	....	....	....	....	....	....	....	82,215	82,195	84,350	86,670	89,155	91,810	94,455	446,440
109	Individual Retirement Accounts	....	....	....	....	....	....	....	....	10,565	10,770	11,170	11,440	11,550	11,485	11,270	56,915
110	Keogh plans	....	....	....	....	....	....	....	....	3,930	4,025	4,255	4,495	4,750	5,010	5,285	23,795
	Exclusion of other employee benefits:																
111	Premiums on group term life insurance	....	....	....	....	....	....	....	....	2,030	2,075	2,120	2,170	2,220	2,270	2,335	11,115
112	Premiums on accident and disability insurance	....	....	....	....	....	....	....	....	175	185	195	205	215	225	235	1,075
113	Income of trusts to finance supplementary unemployment benefits	....	....	....	....	....	....	....	....	5	5	5	5	5	5	5	25
114	Special ESOP rules	660	680	700	730	760	790	820	3,800	260	270	280	290	300	310	320	1,500
115	Additional deduction for the blind	....	....	....	....	....	....	....	....	30	30	30	30	35	35	35	165
116	Additional deduction for the elderly	....	....	....	....	....	....	....	....	1,690	1,720	1,740	1,795	1,880	1,945	2,020	9,380
117	Tax credit for the elderly and disabled	....	....	....	....	....	....	....	....	40	40	40	40	40	40	40	200
118	Deductibility of casualty losses	....	....	....	....	....	....	....	....	225	235	245	255	270	280	290	1,340
119	Earned income tax credit [3]	....	....	....	....	....	....	....	....	6,351	5,118	4,971	5,142	5,275	5,471	5,672	26,531
	Social Security:																
	Exclusion of social security benefits:																
120	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	....	....	....	....	....	....	....	....	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued

(In millions of dollars)

		Revenue Loss															
		Corporations								Individuals							
		1998	1999	2000	2001	2002	2003	2004	2000–2004	1998	1999	2000	2001	2002	2003	2004	2000–2004
122	Social Security benefits for dependents and survivors	......	......	......	......	......	......	......	......	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:																
123	Exclusion of veterans death benefits and disability compensation	......	......	......	......	......	......	......	......	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	......	......	......	......	......	......	......	......	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	......	......	......	......	......	......	......	......	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150
	General purpose fiscal assistance:																
127	Exclusion of interest on public purpose bonds	5,240	5,295	5,345	5,400	5,455	5,510	5,565	27,275	14,810	14,955	15,105	15,260	15,410	15,565	15,720	77,060
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	......	......	......	......	......	......	......	......	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015	......	......	......	......	......	......	......	......
	Interest:																
130	Deferral of interest on U.S. savings bonds	......	......	......	......	......	......	......	......	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	......	......	......	......	......	......	......	......	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	......	......	......	......	......	......	......	......	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:																
	Public purpose State and local debt	5,240	5,295	5,345	5,400	5,455	5,510	5,565	27,275	14,810	14,955	15,105	15,260	15,410	15,565	15,720	77,060
	IDBs for certain energy facilities	30	30	30	30	30	30	30	150	80	80	80	85	85	85	85	420
	IDBs for pollution control and sewage and waste disposal facilities	115	115	115	120	120	120	120	595	325	325	330	335	335	340	345	1,685
	Small-issue IDBs	75	80	80	80	80	80	80	400	220	220	225	225	225	230	230	1,135
	Owner-occupied mortgage revenue bonds	225	230	230	230	235	235	240	1,170	635	645	650	655	665	670	675	3,315
	State and local debt for rental housing	40	40	40	40	40	40	40	200	110	110	110	110	115	115	115	565
	IDBs for airports, docks, and sports and convention facilities	180	185	185	185	190	190	195	945	515	520	525	530	535	540	545	2,675
	State and local student loan bonds	60	60	65	65	65	65	65	325	175	175	175	180	180	185	185	905
	State and local debt for private nonprofit educational facilities	145	150	150	150	150	155	155	760	415	420	420	425	430	435	440	2,150
	State and local debt for private nonprofit health facilities	305	305	310	310	315	320	320	1,575	855	865	875	880	890	900	910	4,455
	State and local debt for veterans housing	10	10	10	10	10	10	10	50	30	30	30	30	30	30	30	150

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $5 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS

(In millions of dollars)

Provision	2000	2000–2004
Net exclusion of pension contributions and earnings: Employer plans	84,350	446,440
Exclusion of employer contributions for medical insurance premiums and medical care	77,670	446,075
Deductibility of mortgage interest on owner-occupied homes	55,100	303,145
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	40,585	215,350
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	37,000	209,840
Accelerated depreciation of machinery and equipment (normal tax method)	35,465	181,645
Step-up basis of capital gains at death	27,090	147,010
Deductibility of charitable contributions, total	25,850	142,425
Exclusion of interest on public purpose bonds	20,450	104,335
Deductibility of State and local property tax on owner-occupied homes	19,495	107,935
Child credit [2]	18,725	90,215
Capital gains exclusion on home sales	18,540	98,435
Exclusion of Social Security benefits for retired workers	18,125	100,990
Exclusion of interest on life insurance savings	14,990	83,915
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	11,170	56,915
Deferral of income from controlled foreign corporations (normal tax method)	6,200	35,150
Exclusion of workers' compensation benefits	5,475	30,855
Graduated corporation income tax rate (normal tax method)	5,360	30,900
Earned income tax credit [3]	4,971	26,531
HOPE tax credit	4,855	27,625
Exclusion of interest on non-public purpose State and local debt	4,635	23,625
Workers' compensation insurance premiums	4,585	24,710
Net exclusion of pension contributions and earnings: Keogh plans	4,255	23,795
Exception from passive loss rules for $25,000 of rental loss	4,215	18,950
Tax credit for corporations receiving income from doing business in U.S. possessions	4,120	21,015
Deductibility of medical expenses	3,985	22,460
Exclusion of Social Security benefits for dependents and survivors	3,910	21,190
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,430	10,640
Credit for low-income housing investments	3,335	17,595
Accelerated depreciation on rental housing (normal tax method)	3,095	20,920
Exclusion of veterans death benefits and disability compensation	3,070	16,775
Lifetime Learning tax credit	2,655	16,560
Exclusion of Social Security benefits for disabled	2,615	15,445
Exclusion of income earned abroad by U.S. citizens	2,500	15,715
Credit for child and dependent care expenses	2,425	11,835
Exclusion of income of foreign sales corporations	2,400	13,650
Exclusion of benefits and allowances to armed forces personnel	2,140	10,900
Exclusion of other employee benefits: Premiums on group term life insurance	2,120	11,115
Additional deduction for the elderly	1,740	9,380
Exclusion of reimbursed employee parking expenses	1,630	8,770
Exclusion of employer-provided child care	1,445	7,890
Self-employed medical insurance premiums	1,310	9,225
Expensing of certain small investments (normal tax method)	1,275	6,780
Inventory property sales source rules exception	1,100	6,300
Deferral of interest on U.S. savings bonds	1,065	5,885
Deferral of income from post-1987 installment sales	1,015	5,275
Exclusion of scholarship and fellowship income (normal tax method)	995	5,440
Credit for increasing research activities	980	1,645
Special ESOP rules	980	5,300
Parental personal exemption for students age 19 or over	965	5,295
Exemption of credit union income	905	5,235
Alternative fuel production credit	760	2,715
Exclusion of employee meals and lodging (other than military)	680	3,715
Capital gains treatment of certain income	655	3,590
Expensing of research and experimentation expenditures (normal tax method)	510	3,295
Expensing of multiperiod timber growing costs	510	2,750
Excess of percentage over cost depletion, fuels and nonfuel minerals	510	2,725
Empowerment zones and enterprise communities	430	1,875
Exclusion of railroad retirement system benefits	425	2,155
Exclusion of parsonage allowances	360	2,065
Exclusion of public assistance benefits (normal tax method)	360	1,950
Adoption assistance	345	1,525
Work opportunity tax credit	330	535
Deductibility of student-loan interest	265	1,750
Tax incentives for preservation of historic structures	255	1,435
Special Blue Cross/Blue Shield deduction	250	1,395
Deductibility of casualty losses	245	1,340
Tax exemption of certain insurance companies owned by tax-exempt organizations	240	1,410
Education Individual Retirement Accounts	230	2,745

Table 5–3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS—Continued

(In millions of dollars)

Provision	2000	2000–2004
Amortization of start-up costs (normal tax method)	220	1,140
Exclusion of employer-provided educational assistance	210	225
Exclusion of other employee benefits: Premiums on accident and disability insurance	195	1,075
Carryover basis of capital gains on gifts	185	1,015
Deferral for State prepaid tuition plans	180	1,395
Enhanced oil recovery credit	180	1,225
Exceptions from imputed interest rules	160	815
Expensing of environmental remediation costs	145	135
Exclusion of military disability pensions	130	690
Small life insurance company deduction	100	520
Exclusion for employer-provided transit passes	95	655
Tax credit and deduction for clean-fuel burning vehicles	90	410
Exclusion of GI bill benefits	85	460
Expensing of certain multiperiod production costs	85	475
Exclusion from income of conservation subsidies provided by public utilities	80	385
Exclusion of special benefits for disabled coal miners	75	340
Income averaging for farmers	75	400
Exclusion of veterans pensions	70	395
Expensing of certain capital outlays	70	385
Capital gains treatment of certain timber income	65	360
Deferred taxes for financial firms on certain income earned overseas	65	65
Capital gains treatment of royalties on coal	65	360
Tax credit for orphan drug research	55	355
Credit for disabled access expenditures	50	275
Exemption of certain mutuals' and cooperatives' income	50	255
Exclusion of certain foster care payments	40	220
Tax credit for the elderly and disabled	40	200
Exception from passive loss limitation for working interests in oil and gas properties	35	190
New technology credit	35	185
Ordinary income treatment of loss from small business corporation stock sale	35	195
Welfare-to-work tax credit	35	70
Investment credit for rehabilitation of structures (other than historic)	30	150
Additional deduction for the blind	30	165
Medical Savings Accounts	25	105
Expensing of exploration and development costs, nonfuel minerals	25	135
Cancellation of indebtedness	20	100
Credit for holders of zone academy bonds	20	155
Deferral of tax on shipping companies	15	75
Exclusion of interest on savings bonds redeemed to finance educational expenses	15	80
Alcohol fuel credits [1]	15	75
Treatment of loans forgiven for solvent farmers	10	50
Excess bad debt reserves of financial institutions	10	25
Deferral of gain on sale of farm refiners	10	60
Investment credit and seven-year amortization for reforestation expenditures	10	65
Capital gains exclusion of small corporation stock	5	25
Expensing of costs of removing certain architectural barriers to the handicapped	5	25
Income of trusts to finance supplementary unemployment benefits	5	25
Special alternative tax on small property and casualty insurance companies	5	25
Expensing of exploration and development costs, fuels	(10)	45

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $23,239; 1999 $26,273; 2000 $26,882; 2001 $27,667; 2002 $28,632; 2003 $29,566; and 2004 $30,578.

Note: Provisions with estimates denoted ''normal tax method'' have no revenue loss under the reference tax law method. All estimates have been rounded to the nearest $5 million. Provisions with estimates that rounded to zero in each year are not included in the able.

Note: Three categories in the table are aggregated: Deductibility of chartable contributions, exclusion of interest for non-public purpose State and local debt, and excess of percentage over cost depletion, fuels and nonfuel minerals.

Table 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 1998

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	5,700
2	Deferred taxes for financial firms on income earned overseas	550
3	Expensing of research and experimentation expenditures (normal tax method)	1,650
4	Expensing of exploration and development costs—fuels	90
5	Expensing of exploration and development costs—nonfuels	20
6	Expensing of multiperiod timber growing costs	250
7	Expensing of certain multiperiod production costs—agriculture	90
8	Expensing of certain capital outlays—agriculture	75
9	Deferral of income on life insurance and annuity contracts	20,615
10	Accelerated depreciation of rental housing (normal tax method)	3,415
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	560
12	Accelerated depreciation of machinery and equipment (normal tax method)	39,670
13	Expensing of certain small investments (normal tax method)	1,375
14	Amortization of start-up costs (normal tax method)	180
15	Deferral of tax on shipping companies	15
16	Credit for holders of zone academy bonds	180
17	Credit for low-income housing investments	2,745
18	Exclusion of pension contributions—employer plans	84,430
19	Exclusion of IRA contributions and earnings	13,285
20	Exclusion of contributions and earnings for Keogh plans	3,555
21	Exclusion of interest on public-purpose bonds	22,360
22	Exclusion of interest on non-public purpose bonds	3,435
23	Deferral of interest on U.S. savings bonds	390

Outlay Equivalents

The concept of "outlay equivalents" complements "revenue losses" as a measure of the budget effect of tax expenditures. It is the amount of outlay that would be required to provide the taxpayer the same after-tax income as would be received through the tax preference. The outlay equivalent measure allows a comparison of the cost of the tax expenditure with that of a direct Federal outlay. Outlay equivalents are reported in table 5–5.

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.[1]

[1] Budget outlay figures generally reflect the pre-tax price of the resources. In some instances, however, Government purchases or subsidies are exempted from tax by a special tax provision. When this occurs, the outlay figure understates the resource cost of the program and is, therefore, not comparable with other outlay amounts. For example, the outlays for certain military personnel allowances are not taxed. If this form of compensation were treated as part of the employee's taxable income, the Defense Department would have to make larger cash payments to its military personnel to leave them as well off after tax as they are now. The tax subsidy must be added to the tax-exempt budget outlay to make this element of national defense expenditures comparable with other outlays.

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Outlay Equivalents							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
	National Defense:								
1	Exclusion of benefits and allowances to armed forces personnel	2,445	2,470	2,495	2,520	2,545	2,570	2,595	12,725
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,640	2,965	3,315	3,710	4,145	4,590	5,080	20,840
3	Exclusion of income of foreign sales corporations	3,310	3,460	3,700	3,920	4,150	4,460	4,770	21,000
4	Inventory property sales source rules exception	1,550	1,620	1,690	1,770	1,920	2,080	2,230	9,690
5	Deferral of income from controlled foreign corporations (normal tax method)	5,500	5,800	6,200	6,600	7,000	7,450	7,900	35,150
6	Deferred taxes for financial firms on income earned overseas	400	1,075	65	0	0	0	0	65
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	260	330	510	610	675	735	765	3,295
8	Credit for increasing research activities	3,270	2,550	1,500	650	275	90	15	2,530
	Energy:								
9	Expensing of exploration and development costs, fuels	(130)	(90)	(20)	(25)	0	40	45	40
10	Excess of percentage over cost depletion, fuels	285	295	300	310	320	325	335	1,590
11	Alternative fuel production credit	1,100	1,030	975	915	860	555	165	3,470
12	Exception from passive loss limitation for working interests in oil and gas properties	30	35	35	35	40	40	40	190
13	Capital gains treatment of royalties on coal	80	85	85	95	95	100	105	480
14	Exclusion of interest on energy facility bonds	155	155	155	165	165	165	165	815
15	Enhanced oil recovery credit	215	245	285	325	375	425	490	1,900
16	New technology credit	30	40	45	50	55	55	40	245
17	Alcohol fuel credits [1]	15	15	15	15	15	15	15	75
18	Tax credit and deduction for clean-fuel burning vehicles	95	105	115	130	120	95	65	525
19	Exclusion from income of conservation subsidies provided by public utilities	110	110	105	105	100	105	105	520
	Natural resources and environment:								
20	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	40	40	170
21	Excess of percentage over cost depletion, nonfuel minerals	275	280	300	310	325	340	350	1,625
22	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	630	630	640	650	650	655	665	3,260
23	Capital gains treatment of certain timber income	80	85	85	95	95	100	105	480
24	Expensing of multiperiod timber growing costs	485	500	510	530	550	570	590	2,750
25	Investment credit and seven-year amortization for reforestation expenditures	15	15	15	15	15	15	15	75
26	Tax incentives for preservation of historic structures	215	235	255	275	285	305	315	1,435
	Agriculture:								
27	Expensing of certain capital outlays	65	70	70	75	75	80	85	385
28	Expensing of certain multiperiod production costs	80	85	85	90	95	100	105	475
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	805	840	875	915	955	1,000	1,045	4,790
31	Income averaging for farmers	10	75	75	80	80	80	85	400
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	15	15	60
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,000	1,070	1,150	1,235	1,325	1,425	1,530	6,665
34	Excess bad debt reserves of financial institutions	70	30	10	5	5	5	0	25
35	Exclusion of interest on life insurance savings	13,465	14,200	14,990	15,810	16,680	17,595	18,840	83,915
36	Special alternative tax on small property and casualty insurance companies	5	5	5	5	5	5	5	25
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	290	315	335	345	365	415	450	1,910
38	Small life insurance company deduction	140	140	140	150	150	150	150	740
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,230	1,255	1,260	1,270	1,290	1,295	1,315	6,430
40	Exclusion of interest on rental housing bonds	215	215	215	215	220	220	220	1,090
41	Deductibility of mortgage interest on owner-occupied homes	51,700	52,990	55,100	57,590	60,415	63,425	66,615	303,145
42	Deductibility of State and local property tax on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
43	Deferral of income from post-1987 installment sales	975	995	1,015	1,035	1,055	1,075	1,095	5,275
44	Capital gains exclusion on home sales	21,845	22,500	23,175	23,870	24,590	25,325	26,090	123,050
45	Exception from passive loss rules for $25,000 of rental loss	4,735	4,455	4,215	4,000	3,785	3,575	3,375	18,950
46	Credit for low-income housing investments	4,065	4,210	4,340	4,540	4,610	4,720	4,705	22,915
47	Accelerated depreciation on rental housing (normal tax method)	2,405	2,740	3,095	4,170	4,590	4,495	4,570	20,920
	Commerce:								
48	Cancellation of indebtedness	50	30	20	15	20	20	25	100
49	Exceptions from imputed interest rules	155	160	160	160	165	165	165	815
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	51,035	52,555	54,115	55,725	57,380	59,080	60,835	287,135
51	Capital gains exclusion of small corporation stock	0	5	5	5	5	5	5	25
52	Step-up basis of capital gains at death	32,760	34,400	36,120	37,655	39,160	40,725	42,355	196,015
53	Carryover basis of capital gains on gifts	170	175	185	195	205	210	220	1,015
54	Ordinary income treatment of loss from small business corporation stock sale	45	45	45	55	55	55	55	265
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	6,270	4,895	3,430	2,385	2,365	1,875	585	10,640

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
56	Accelerated depreciation of machinery and equipment (normal tax method)	28,885	32,505	35,465	36,830	36,985	36,510	35,855	181,645
57	Expensing of certain small investments (normal tax method)	1,185	1,235	1,275	1,175	1,730	1,605	995	6,780
58	Amortization of start-up costs (normal tax method)	205	215	220	225	225	230	240	1,140
59	Graduated corporation income tax rate (normal tax method)	7,400	7,340	7,340	7,700	8,385	9,150	9,755	42,330
60	Exclusion of interest on small issue bonds	425	430	435	435	435	445	445	2,195
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,010	2,060	2,105	2,180	2,260	2,345	2,430	11,320
63	Exclusion for employer-provided transit passes	95	115	130	150	180	215	240	915
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	995	1,010	1,015	1,025	1,040	1,045	1,060	5,185
66	Exemption of certain mutuals' and cooperatives' income	45	50	50	50	50	50	55	255
67	Empowerment zones and enterprise communities	290	380	430	435	415	305	290	1,875
68	Expensing of environmental remediation costs	120	145	195	80	(15)	(35)	(45)	180
	Education, training, employment, and social services:								
	Education:								
69	Exclusion of scholarship and fellowship income (normal tax method)	1,015	1,060	1,105	1,155	1,210	1,265	1,320	6,055
70	HOPE tax credit	255	5,150	6,225	6,830	7,345	7,390	7,625	35,415
71	Lifetime Learning tax credit	140	3,215	3,405	3,805	3,865	4,305	5,850	21,230
72	Education Individual Retirement Accounts	25	125	295	480	685	895	1,120	3,475
73	Deductibility of student-loan interest	90	305	330	390	450	485	530	2,185
74	Deferral for State prepaid tuition plans	85	125	180	235	285	330	365	1,395
75	Exclusion of interest on student-loan bonds	340	340	345	350	350	360	360	1,765
76	Exclusion of interest on bonds for private nonprofit educational facilities	800	820	820	825	835	845	850	4,175
77	Credit for holders of zone academy bonds	0	15	30	45	50	50	50	225
78	Exclusion of interest on savings bonds redeemed to finance educational expenses	15	15	20	20	20	20	30	110
79	Parental personal exemption for students age 19 or over	970	1,010	1,070	1,125	1,165	1,225	1,280	5,865
80	Child credit [2]	4,700	24,985	24,965	24,575	24,215	23,660	22,875	120,290
81	Deductibility of charitable contributions (education)	3,995	4,090	4,250	4,435	4,650	4,870	5,125	23,330
82	Exclusion of employer-provided educational assistance	270	270	260	20	0	0	0	280
	Training, employment, and social services:								
83	Work opportunity tax credit	170	335	330	160	40	5	0	535
84	Welfare-to-work tax credit	15	35	35	20	10	5	0	70
85	Exclusion of employer-provided child care	1,765	1,845	1,925	2,015	2,100	2,195	2,285	10,520
86	Adoption assistance	155	355	415	470	460	285	205	1,835
87	Exclusion of employee meals and lodging (other than military)	760	795	830	865	905	945	990	4,535
88	Credit for child and dependent care expenses	3,315	3,275	3,235	3,195	3,155	3,115	3,080	15,780
89	Credit for disabled access expenditures	60	65	65	65	75	80	85	370
90	Expensing of costs of removing certain architectural barriers to the handicapped	0	5	5	5	5	5	5	25
91	Deductibility of charitable contributions, other than education and health	25,000	25,780	27,015	28,320	29,770	31,310	32,980	149,395
92	Exclusion of certain foster care payments	45	45	50	50	50	55	60	265
93	Exclusion of parsonage allowances	390	415	445	475	505	540	580	2,545
	Health:								
94	Exclusion of employer contributions for medical insurance premiums and medical care	86,925	92,985	99,735	106,890	114,465	122,580	131,280	574,950
95	Self-employed medical insurance premiums	935	1,195	1,600	1,715	1,890	2,505	3,545	11,255
96	Workers' compensation insurance premiums	5,320	5,520	5,730	5,945	6,170	6,400	6,645	30,890
97	Medical Savings Accounts	20	30	30	35	30	30	25	150
98	Deductibility of medical expenses	3,615	3,775	3,985	4,215	4,475	4,750	5,035	22,460
99	Exclusion of interest on hospital construction bonds	1,665	1,680	1,695	1,705	1,725	1,750	1,765	8,640
100	Deductibility of charitable contributions (health)	3,520	3,600	3,760	3,930	4,120	4,330	4,560	20,700
101	Tax credit for orphan drug research	60	75	80	90	105	115	130	520
102	Special Blue Cross/Blue Shield deduction	280	310	335	375	435	385	335	1,865
	Income security:								
103	Exclusion of railroad retirement system benefits	420	420	425	425	430	435	440	2,155
104	Exclusion of workers' compensation benefits	5,140	5,330	5,475	5,940	6,205	6,480	6,755	30,855
105	Exclusion of public assistance benefits (normal tax method)	440	345	360	375	390	405	420	1,950
106	Exclusion of special benefits for disabled coal miners	85	80	75	70	70	65	60	340
107	Exclusion of military disability pensions	120	125	130	135	140	140	145	690
	Net exclusion of pension contributions and earnings:								
108	Employer plans	106,170	106,840	109,760	112,750	116,015	119,475	122,975	580,975
109	Individual Retirement Accounts	14,115	14,475	15,095	15,570	15,855	15,940	15,845	78,305
110	Keogh plans	5,010	5,105	5,400	5,705	6,025	6,360	6,710	30,200
	Exclusion of other employee benefits:								
111	Premiums on group term life insurance	2,690	2,750	2,815	2,880	2,945	3,015	3,085	14,740

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		1998	1999	2000	2001	2002	2003	2004	2000–2004
112	Premiums on accident and disability insurance	225	235	250	260	275	290	305	1,380
113	Income of trusts to finance supplementary unemployment benefits	5	5	5	5	5	5	5	25
114	Special ESOP rules	1,280	1,320	1,360	1,415	1,470	1,530	1,585	7,360
115	Additional deduction for the blind	35	35	35	35	40	40	45	195
116	Additional deduction for the elderly	2,045	2,085	2,105	2,175	2,275	2,355	2,440	11,350
117	Tax credit for the elderly and disabled	50	50	50	50	50	50	55	255
118	Deductibility of casualty losses	245	260	270	285	295	310	320	1,480
119	Earned income tax credit [3]	7,056	5,687	5,523	5,714	5,861	6,079	6,303	29,480
	Social Security:								
	Exclusion of social security benefits:								
120	Social Security benefits for retired workers	16,780	17,210	18,125	19,045	20,100	21,260	22,460	100,990
121	Social Security benefits for disabled	2,265	2,420	2,615	2,820	3,060	3,325	3,625	15,445
122	Social Security benefits for dependents and survivors	3,725	3,785	3,910	4,065	4,235	4,405	4,575	21,190
	Veterans benefits and services:								
123	Exclusion of veterans death benefits and disability compensation	2,820	2,940	3,070	3,210	3,350	3,495	3,650	16,775
124	Exclusion of veterans pensions	65	65	70	75	80	85	85	395
125	Exclusion of GI bill benefits	65	75	85	90	90	95	100	460
126	Exclusion of interest on veterans housing bonds	60	60	60	60	60	60	60	300
	General purpose fiscal assistance:								
127	Exclusion of interest on public purpose bonds	28,720	29,005	29,290	29,595	29,890	30,190	30,490	149,455
128	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
129	Tax credit for corporations receiving income from doing business in U.S. possessions	3,960	4,000	4,120	4,245	4,285	4,150	4,215	21,015
	Interest:								
130	Deferral of interest on U.S. savings bonds	965	1,015	1,065	1,115	1,175	1,235	1,295	5,885
	Addendum—Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	17,770	18,595	19,495	20,535	21,625	22,635	23,645	107,935
	Nonbusiness State and local taxes other than on owner-occupied homes	32,795	34,925	37,000	39,235	41,715	44,490	47,400	209,840
	Exclusion of interest on:								
	Public purpose State and local debt	28,720	29,005	29,290	29,595	29,890	30,190	30,490	149,455
	IDBs for certain energy facilities	155	155	155	165	165	165	165	815
	IDBs for pollution control and sewage and waste disposal facilities	630	630	640	650	650	655	665	3,260
	Small-issue IDBs	425	430	435	435	435	445	445	2,195
	Owner-occupied mortgage revenue bonds	1,230	1,255	1,260	1,270	1,290	1,295	1,315	6,430
	State and local debt for rental housing	215	215	215	215	220	220	220	1,090
	IDBs for airports, docks, and sports and convention facilities	995	1,010	1,015	1,025	1,040	1,045	1,060	5,185
	State and local student loan bonds	340	340	345	350	350	360	360	1,765
	State and local debt for private nonprofit educational facilities	800	820	820	825	835	845	850	4,175
	State and local debt for private nonprofit health facilities	1,665	1,680	1,695	1,705	1,725	1,750	1,765	8,640
	State and local debt for veterans housing	60	60	60	60	60	60	60	300

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 1998 $680; 1999 $725; 2000 $755; 2001 $765; 2002 $790; 2003 $805; and 2004 $830.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $0; 1999 $415; 2000 $528; 2001 $496; 2002 $483; 2003 $453; and 2004 $425.

[3] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect on outlays (in millions of dollars) is as follows: 1998 $23,240; 1999 $25,650; 2000 $26,525; 2001 $27,265; 2002 $27,975; 2003 $28,705; and 2004 $29,655.

Note: Provisions with estimates denoted normal tax method have no revenue loss under the reference tax law method.

All estimates have been rounded to the nearest $5 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is a preferential exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act does not, however, specify the baseline provisions of the tax law. Deciding whether provisions are preferential exceptions, therefore, is a matter of judgement. As in prior years, this year's tax expenditure estimates are presented using two baselines: the normal tax baseline, which is used by the Joint Committee on Taxation, and the reference tax law baseline, which has been reported by the Administration since 1983.

The normal tax baseline is patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. The normal tax baseline allows personal exemptions, a standard deduction, and deductions of the expenses incurred in earning income. It is not limited to a particular structure of tax rates, or by a specific definition of the taxpaying unit.

The reference tax law baseline is also patterned on a comprehensive income tax, but in practice is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

Both the normal and reference tax baselines allow several major departures from a pure comprehensive income tax. For example:

- Income is taxable when realized in exchange. Thus, neither the deferral of tax on unrealized capital gains nor the tax exclusion of imputed income (such as the rental value of owner-occupied housing or farmers' consumption of their own produce) is regarded as a tax expenditure. Both accrued and imputed income would be taxed under a comprehensive income tax.
- There is a separate corporation income tax. Under a comprehensive income tax, corporate income would be taxed only once—at the shareholder level, whether or not distributed in the form of dividends.
- Values of assets and debt are not adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline, the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

While the reference law and normal tax baselines are generally similar, areas of difference include:

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.[2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines.[3]
- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

In addition to these areas of difference, the Joint Committee on Taxation considers a somewhat broader set of tax expenditures under its normal tax baseline than is considered here.

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[2] Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

[3] In the case of individuals who hold "passive" equity interests in businesses, however, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined to be one in which the holder of the interest, usually a partnership interest, does not actively perform managerial or other participatory functions. The taxpayer may generally report no larger deductions for a year than will reduce taxable income from such activities to zero. Deductions in excess of the limitation may be taken in subsequent years, or when the interest is liquidated.

Performance Measures and the Economic Effects of Tax Expenditures

Under the Government Performance and Results Act of 1993 (GPRA), Federal agencies are directed to develop both strategic and annual plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Achieving most of these objectives will largely be the result of direct expenditures of funds. However, tax expenditures may also contribute to goal achievement.

The Senate Governmental Affairs Committee report on this Act[4] called on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of the goals and objectives in these strategic and annual plans. As described in OMB's May 1997 report on this Act,[5] Treasury in 1997 initiated pilot studies of three specific tax expenditures in order to explore evaluation methods and resource needs associated with evaluating the relationship between tax expenditures and performance goals. Tax expenditures were selected within the Office of Tax Analysis in each of the three main areas—individual, business, and international taxation. The specific provisions considered were: the tax exemption for worker's compensation benefits; the tax credit for non-conventional fuels; and the tax exclusion for certain amounts of income earned by Americans living abroad. The results of these studies are summarized in the context of the three specific provisions in the section that follows, which provides provision descriptions.

Over the next few years, the Administration's plan is to undertake additional studies that will focus on the availability of the data needed to assess the effects of selected significant tax expenditures, primarily those designed to increase savings. In addition, summarized data on the beneficiaries and other economic properties of such provisions will be developed where feasible. This effort will complement information published by the Joint Committee on Taxation and the Senate Budget Committee on the rationale, beneficiaries, and effects of tax expenditures.[6] One finding of the pilot studies is that much of the data needed for thorough analysis is not currently available. Hence, assessment of data needs and availability from Federal statistical agencies, program-agency studies, or private-sector sources, and, when feasible, publication of data on selected tax expenditures should prove valuable to broader efforts to assess the effects tax expenditures and to compare their effectiveness with outlay, regulatory and other tax polices as means of achieving objectives.

Comparisons of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available.[7] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many, though not all, cases. In addition, tax expenditures may help simplify the tax system, as where they leave certain income sources untaxed (e.g, exemptions for employer fringe benefits or exclusions for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities, which benefit recipients; the beneficiaries experience reduced taxes that are offset by higher taxes (or spending reductions) elsewhere. Regulatory or tax-disincentive policies, which can also modify behavior, would have a different distributional impact. Finally, a variety of tax expenditure tools can be used—e.g., deductions, credits, exemptions and deferrals; floors and ceilings; and phase-ins and phase-outs, dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range means that tax expenditures can be flexible and can have very different distributional and cost-effectiveness properties.

Tax expenditures also have limitations. In some cases they can add to the complexity of the tax system, which can raise both administrative and compliance costs; for example, various holding periods and tax rates for capital gains can complicate filing and decisionmaking. Also, the income tax system does not gather information on wealth, in contrast to certain loan programs that are based on recipients' assets and income. In addition, the tax system may have little or no contact with persons who have no or very low incomes, and incentives for such persons may need to take the form of refunds. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program; for example, grant or direct Federal service delivery programs can prioritize which activities are addressed with what amount of resources in a way that is difficult to emulate with tax expenditures. Finally, tax expenditures tend to escape the budget scrutiny afforded to other programs. For instance, a program funded by a tax expenditure does not increase government outlays as a share of national product and it may even decrease receipts as a share of output. However, the effective government compensation to a service provider can be identical to that of a spending program under which the outlay (and possibly the receipts) share of GDP may increase.

Outlay programs, in contrast, have advantages where direct government service provision is particularly warranted—such as equipping and providing the armed forces or administering the system of justice. Outlay

[4] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

[5] Director of the Office of Management and Budget, "The Government Performance and Results Act," Report to the President and the Congress, May 1997.

[6] Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 1999–1993," JCS-7–98, December 14, 1998; and Committee on the Budget, United States Senate, "Tax Expenditures: Compendium of Background Material on Individual Provisions," prepared by the Congressional Research Service (S. Prt. 104–69, December 1996).

[7] While this section focuses upon tax expenditures under the income tax, tax preferences also arise under the unified transfer, payroll, and excise tax systems. Such preferences can be useful when they relate to the base of those taxes, such as an excise tax exemption for certain types of consumption deemed meritorious.

programs may also be specifically designed to meet the needs of low-income families who would not otherwise be subject to income taxes or need to file a return. Outlay programs may also receive more year-to-year oversight and fine tuning, through the legislative and executive budget process. In addition, many different types of spending programs—including direct government provision; credit programs; and payments to State and local governments, the private sector, or individuals in the form of grants or contracts—provide flexibility for policy design. On the other hand, certain outlay programs—such as direct government service provision—may rely less directly on economic incentives and private-market provision than tax incentives, which may reduce the relative efficiency of spending programs for some goals. Spending programs also require resources to be raised via taxes, user charges, or government borrowing. Finally, spending programs, particularly on the discretionary side, may respond less readily to changing activity levels and economic conditions than tax expenditures.

Regulations have a key distributional difference from outlay and tax-expenditure programs in that the immediate distributional burden of the regulation typically falls on the regulated party (i.e., the intended actor)—generally in the private sector. While the regulated parties can pass costs along through product or input prices, the initial incidence is on the regulated party. Regulations can be fine-tuned more quickly than tax expenditures, as they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often largely rely upon voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest, relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives. This reliance can diminish their economic efficiency, though this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect the Federal budget and outlays and receipts as a percentage of national output. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal type of benefit-cost analysis that goes well beyond the analysis required for outlay and tax-expenditure programs. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

There are examples of policy objectives that employ multiple approaches. Minimum wage legislation, the earned income tax credit, and the food stamp program are examples of programs that utilize regulatory, tax expenditure, and direct outlay approaches, respectively, in order to improve the economic welfare of low-wage workers. Their relative strengths and weaknesses have merited significant attention.

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. These include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of social security income); reducing private compliance costs and government administrative costs (e.g., favorable treatment of certain employer-provided fringe benefits); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited. Also, many tax expenditures, including those cited above, may have more than one objective. For example, favorable treatment of employer-provided pensions might be argued to have aspects of most, or even all, of the goals mentioned above. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

Performance measurement is generally concerned with inputs, outputs, and outcomes. In the case of tax expenditures, the principal input is usually the tax revenue loss. Outputs are quantitative or qualitative measures of goods and services, or changes in income and investment, directly produced by these inputs. Outcomes, in turn, represent the changes in the economy, society, or environment that are the ultimate goals of programs.

Thus, for a provision that reduces taxes on certain investment activity, an increase in the amount of investment would likely be a key output. The resulting production from that investment, and, in turn, the associated improvements in national income, welfare, or security, could be the outcomes of interest. For other provisions, such as those designed to address a potential inequity or unintended consequence in the tax code, an important performance measure might be how they change effective tax rates (the discounted present-value of taxes owed on new investments or incremental earnings) or excess burden (an economic measure of the distortions caused by taxes). Distributional effects on incomes may be an important measure for certain provisions.

An overview of evaluation issues by budget function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many of the provisions for some time. In addition, such assessments can raise significant challenges in economic modeling. For these reasons, and related time, staffing, and resource constraints, the evaluation process is likely to take a number of years and to include qualitative assessments and estimated ranges of effects, in many cases, as opposed to point estimates.

National defense.—Some tax expenditures are intended to assist governmental activities. For example, tax preferences for military benefits reflect, among other things, the view that benefits such as housing, subsistence, and moving expenses are intrinsic aspects of military service, and are provided, in part, for the benefit of the employer, the U.S. Government. Tax benefits for combat service are intended to reduce tax burdens on military personnel undertaking hazardous service for the Nation. A portion of the tax expenditure associated with foreign earnings is targeted to benefit U.S. Government civilian personnel working abroad by offsetting the living costs that can be higher than those in the United States. These tax expenditures should be considered together with direct agency budget costs in making programmatic decisions.

International affairs.—Tax expenditures are also aimed at promoting U.S. exports. These include the exclusion for income earned abroad by nongovernmental employees and preferences for income from exports and U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues. In addition to determining their effectiveness in markets of the benefitting firms, analysis should consider the extent to which macroeconomic factors lead to offsetting effects, such as increased imports, which could moderate any net effects on employment, national output, and trade deficits. Similar issues arise in the case of export promotion programs supported by outlays.

General science, space and technology; energy; natural resources and the environment; agriculture; and commerce and housing.—A series of tax expenditures reduces the cost of investment, both in specific activities—such as research and experimentation, extractive industries, and certain financial activities—and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, it could be useful to consider the strength of the incentives by measuring their effects on the cost of capital (the interest rate which investments must yield to cover their costs) and effective tax rates. The impact of these provisions on the amounts of corresponding forms of investment—such as research spending, exploration activity, or equipment—could also be estimated. In some cases, such as research, there is evidence that the investment can provide significant positive externalities—that is, economic benefits that are not reflected in the market transactions between private parties. It could be useful to quantify these externalities and compare them with the degree of tax subsidy provided. Measures could also indicate the provisions' effects on production from these investments—such as numbers or values of patents, energy production and reserves, and industrial production. Issues to be considered include the extent to which the preferences increase production (as opposed to benefitting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel production on imports from various regions, or the effects of various energy sources on the environment).

Housing investment also benefits from tax expenditures, including the mortgage interest deduction and preferential treatment of capital gains on homes. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing. In addition, the mortgage interest deduction offsets the taxable nature of investment income received by homeowners, so the relationship between the deduction and such earnings is also relevant to evaluation of this provision. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains preference for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

Transportation.—Employer-provided parking is a fringe benefit that, for the most part, is excluded from taxation. The tax expenditure revenue loss estimates reflect the cost of parking that is leased by employers for employees; an estimate is not currently available for the value of parking owned by employers and provided to their employees. The exclusion for employer-provided transit passes is intended to promote use of this mode of transportation, which has environmental and congestion benefits. The tax treatments of these different benefits could be compared with alternative transportation policies.

Community and regional development.—A series of tax expenditures is intended to promote community and regional development by reducing the costs of financing specialized infrastructure, such as airports, docks, and stadiums. Empowerment zone and enterprise community provisions are designed to promote activity in disadvantaged areas. These provisions can be compared with grant and other policies designed to spur economic development.

Education, training, employment, and social services.—Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of charitable activities. The education incentives can be compared with loans, grants, and other programs designed to promote higher education and training. The child credits are intended to adjust the tax system for the costs of raising children; as such, they could be compared to other Federal tax and spending policies, including related features of the tax system, such as personal exemptions (which are not defined as a tax expenditure). Evaluation of charitable activities requires consideration of the beneficiaries of these activities, who are generally not the parties receiving the tax reduction.

Health.—Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and the distribution of this coverage across different income groups. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated. The distribution of employer-provided health insurance is not readily evident from tax return information; thus, the distribution of benefits from this exclusion must be imputed using tax as well as other forms of information.

Income security, social security, and veterans benefits and services.—Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). In considering the provisions' distributional effects, it may be useful to consider beneficiaries' incomes while retired and over their entire lifetimes. Interactions with other programs, including social security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the benefits of the firm-level contributions back to individuals.

Other provisions principally have income distribution, rather than incentive, effects. For example, tax-favored treatment of social security benefits, certain veterans benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The distribution of these benefits may be a useful performance measure. The earned-income tax credit, in contrast, should be evaluated both for its effects on labor force participation and its distributional properties.

General purpose fiscal assistance and interest.—The tax-exemption for public purpose State and local bonds reduces the costs of borrowing for a variety of purposes; borrowing for non-public purposes is reflected under other budget functions. The deductibility of certain State and local taxes reflected under this function primarily relates to personal income taxes; property tax deductibility is reflected under the commerce and housing function. Tax preferences for Puerto Rico and other U.S. possessions are also included here. These provisions can be compared with other tax and spending policies as means of benefitting fiscal and economic conditions in the States, localities, and possessions. Finally, the tax deferral for interest on U.S. savings bonds benefits savers who invest in these instruments; the extent of these benefits and any effects on Federal borrowing costs could be evaluated.

The above illustrative discussion, while broad, is nevertheless incomplete, both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. Particularly over the next few years, a significant portion of this effort is likely to be devoted to data issues. Because the compilation of data is resource intensive, and must be balanced with other objectives (including minimizing information collection burdens), careful planning will be essential. Given the challenges inherent in this work, the nature of the analyses is likely to evolve and improve over the next several years.

Other Considerations

The tax expenditure analysis could be extended beyond the income and transfer taxes to include payroll and excise taxes. The exclusion of certain forms of compensation from the wage base, for instance, reduces payroll taxes, as well as income taxes. Payroll tax exclusions are complex to analyze, however, because they also affect social insurance benefits. Certain targeted excise tax provisions might also be considered tax expenditures. In this case challenges include determining an appropriate baseline.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow.

National Defense

1. ***Benefits and allowances to armed forces personnel.***—The housing and meals provided military personnel, either in cash or in kind, as well as certain amounts of pay related to combat service, are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad.***—In 1998, a U.S. citizen or resident alien who resides or stays overseas for at least 11 of the past 12 months may exclude $72,000 per year of foreign-earned income. The exclusion limit increases in $2,000 annual increments until it reaches $80,000 in 2002. Eligible taxpayers also may exclude or deduct reasonable housing costs in excess of one-sixth of the salary of a civil servant at grade GS-14,

step 1 ($61,656 in 1998). Federal employees working abroad are not eligible for the foreign-earned income exclusion. Federal employees, however, may exclude certain allowances from their taxable income.

The exclusion for certain income earned abroad was one of the tax expenditures examined by the Department of the Treasury in its pilot performance evaluations this year. This tax expenditure consists of two specific components: section 911 of the tax code, which covers private-sector employees, and section 912, which covers civilian government employees.[8]

The benefits for private-sector employees account for about 85 percent of the combined revenue loss from the two tax expenditures. The private-sector provision is intended to promote U.S. exports, help make U.S. companies competitive when doing business abroad, and to offset the costs of living abroad, which can be higher than costs in the United States. Because American workers in higher-tax nations can offset their U.S. taxes through use of the foreign tax credit, in practice the provision primarily benefits U.S. citizens who work in nations with income taxes that are lower than U.S. taxes. Using tax-return data from 1987, Treasury finds that 70 percent of the benefit of the provision goes to taxpayers with income (defined here as adjusted gross income plus the exclusion) above $50,000; over 98 percent of the housing exclusion, went to this group of taxpayers.

The provision benefitting civilian government employees is intended to help them maintain their standard of living when stationed abroad by compensating them for the higher costs of living abroad. To the extent that this compensation is carried out via the tax code, as opposed to agency appropriations, costs are shifted from outlays to revenue losses.

3. ***Income of Foreign Sales Corporations.***—The Foreign Sales Corporation (FSC) provisions exempt from tax a portion of U.S. exporters' foreign trading income to reflect the FSC's sales functions as foreign corporations. These provisions conform to the General Agreement on Tariffs and Trade.

4. ***Sales source rule exceptions.***—The worldwide income of U.S. persons is taxable by the United States and a credit for foreign taxes paid is allowed. The amount of foreign taxes that can be credited is limited to the pre-credit U.S. tax on the foreign source income. The sales source rules for inventory property allow U.S. exporters to use more foreign tax credits by allowing the exporters to attribute a larger portion of their earnings abroad than would be the case if the allocation of earnings was based on actual economic activity.

5. ***Income of U.S.-controlled foreign corporations.***—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not distributed to a U.S. shareholder as tax-deferred income.

6. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. This provision was originally enacted in the Taxpayer Relief Act of 1997, was canceled by a line-item veto by the President, and was restored by the Supreme Court decision declaring the line-item veto unconstitutional.

General Science, Space, and Technology

7. ***Expensing R&E expenditures.***—Research and experimentation (R&E) projects can be viewed as investments because, if successful, their benefits accrue for several years. It is often difficult, however, to identify whether a specific R&E project is successful and, if successful, what its expected life will be. Under the normal tax method, the expensing of R&E expenditures is viewed as a tax expenditure. The baseline assumed for the normal tax method is that all R&E expenditures are successful and have an expected life of five years.

8. ***R&E credit.***—The research and experimentation (R&E) credit, which expired on June 30, 1998, was reinstated (retroactively) in the Tax and Trade Relief Extension Act of 1998 for one year (through June 30, 1999). The tax credit is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" (limited to a maximum of .16) by the average amount of the company's gross receipts for the 1984 to 1988 period. Certain start-up companies are assigned a fixed-base percentage of .03 for the first five taxable years, which is gradually phased out in years 6 through 10 and replaced by the firm's actual fixed-base percentage. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime, the credit rate is reduced and the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply. A credit with a separate threshold is provided for a taxpayer's payments to universities for basic research.

Energy

9. ***Exploration and development costs.***—For successful investments in domestic oil and gas wells, intangible drilling costs (e.g., wages, the costs of using machinery for grading and drilling, the cost of unsalvageable materials used in constructing wells) may be expensed rather than amortized over the productive life of the property. Integrated oil companies may deduct only 70 percent of such costs and must amortize the remaining 30 percent over five years. The same rule applies to the exploration and development costs of surface stripping and the construction of shafts and tunnels for other fuel minerals.

[8] Section 911 was also the subject of a January 1993 Treasury report to Congress, "Taxation of Americans Working Overseas."

10. ***Percentage depletion.***—Independent fuel mineral producers and royalty owners are generally allowed to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under cost depletion, outlays are deducted over the productive life of the property based on the fraction of the resource extracted. Under percentage depletion, taxpayers deduct a percentage of gross income from mineral production at rates of 22 percent for uranium; 15 percent for oil, gas and oil shale; and 10 percent for coal. The deduction is limited to 50 percent of net income from the property, except for oil and gas where the deduction can be 100 percent of net property income. Production from geothermal deposits is eligible for percentage depletion at 65 percent of net income, but with no limit on output and no limitation with respect to qualified producers. Unlike depreciation or cost depletion, percentage depletion deductions can exceed the cost of the investment.

11. ***Alternative fuel production credit.***—A nontaxable credit of $3 per barrel (in 1979 dollars) of oil-equivalent production is provided for several forms of alternative fuels. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit generally expires on December 31, 2002.

Treasury reviewed the nonconventional fuel production tax credit as one of its pilot studies of tax expenditures under the Government Performance and Results Act. The provision provides a significant credit—currently about $6 per barrel of oil equivalent or $1 per thousand cubic feet of natural gas, or roughly half of the wellhead price of gas. Coalbed methane (natural gas) and gas from tight formations currently account for most of the credit. While the credit has been effective in stimulating the coalbed methane industry, increased domestic production of natural gas tends to discourage imports from stable suppliers (in particular, Canada), so there is relatively little benefit to U.S. energy security. In addition, there are indications that credit-qualified gas displaced some non-qualified domestic gas.

12. ***Oil and gas exception to passive loss limitation.***—Owners of working interests in oil and gas properties are exempt from the "passive income" limitations. As a result, the working interest-holder, who manages on behalf of himself and all other owners the development of wells and incurs all the costs of their operation, may aggregate negative taxable income from such interests with his income from all other sources.

13. ***Capital gains treatment of royalties on coal.***—Sales of certain coal under royalty contracts can be treated as capital gains rather than ordinary income.

14. ***Energy facility bonds.***—Interest earned on state and local bonds used to finance construction of certain energy facilities is tax-exempt. These bonds are generally subject to the state private-activity bond annual volume cap.

15. ***Enhanced oil recovery credit.***—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on U.S. projects. Qualifying costs include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

16. ***New technology credits.***—A credit of 10 percent is available for investment in solar and geothermal energy facilities. In addition, a credit of 1.5 cents is provided per kilowatt hour of electricity produced from renewable resources such as wind and biomass. The renewable resources credit applies only to electricity produced by a facility placed in service before July 1, 1999.

17. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 54 cents per gallon in 1998, 1999, and 2000. The Transportation Equity Act of the 21st Century made the credit 53 cents per gallon in 2001 and 2002; 52 cents per gallon in 2003 and 2004; and 51 cents per gallon in 2005, 2006, and 2007. To the extent that ethanol is mixed with taxable motor fuel to create gasohol, taxpayers may claim an exemption of the federal excise tax rather than the income tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

18. ***Credit and deduction for clean-fuel vehicles and property.***—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. Purchasers of other clean-fuel burning vehicles and owners of clean-fuel refueling property may deduct part of their expenditures. The credit and deduction are phased out from 2002 through 2005.

19. ***Exclusion of utility conservation subsidies.***—Subsidies by public utilities for non-business customer expenditures on energy conservation measures are excluded from the gross income of the customer.

Natural Resources and Environment

20. ***Exploration and development costs.***—Certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

21. ***Percentage depletion.***—Most nonfuel mineral extractors may use percentage depletion rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulphur to 5 percent for sand and gravel.

22. ***Sewage, water, and hazardous waste bonds.***—Interest earned on state and local bonds used to finance the construction of sewage, water, or hazardous waste facilities is tax-exempt. These bonds are generally subject to the state private-activity bond annual volume cap.

23. ***Capital gains treatment of certain timber.***—Certain timber sold under a royalty contract can be treated as capital gains rather than ordinary income.

24. ***Expensing multiperiod timber growing costs.***—Most of the production costs of growing timber may be expensed rather than capitalized and deducted when the timber is sold. In most other industries, these

costs are capitalized under the uniform capitalization rules.

25. ***Credit and seven-year amortization for reforestation.***—A 10-percent investment tax credit is allowed for up to $10,000 invested annually to clear land and plant trees for the production of timber. Up to $10,000 in forestation investment may also be amortized over a seven-year period rather than capitalized and deducted when the trees are sold or harvested. The amount of forestation investment that is amortizable is not reduced by any of the allowable investment credit.

26. ***Historic preservation.***—Expenditures to preserve and restore historic structures qualify for a 20-percent investment credit, but the depreciable basis must be reduced by the full amount of the credit taken.

Agriculture

27. ***Expensing certain capital outlays.***—Farmers, except for certain agricultural corporations and partnerships, are allowed to expense certain expenditures for feed and fertilizer, as well as for soil and water conservation measures. Expensing is allowed, even though these expenditures are for inventories held beyond the end of the year, or for capital improvements that would otherwise be capitalized.

28. ***Expensing multiperiod livestock and crop production costs.***—The production of livestock and crops with a production period of less than two years is exempt from the uniform cost capitalization rules. Farmers establishing orchards, constructing farm facilities for their own use, or producing any goods for sale with a production period of two years or more may elect not to capitalize costs. If they do, they must apply straight-line depreciation to all depreciable property they use in farming.

29. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, the debtor must include the amount of loan forgiveness as income or reduce his recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds his basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness never results in an income tax liability.[9] Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

30. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

31. ***Income averaging for farmers.***—The Tax and Trade Relief Extension Act of 1998 permanently extended the provision that allows taxpayers to lower their tax liability by averaging, over the prior three-year period, their taxable income from farming. Without extension, the provision generally would have expired on December 31, 2000.

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property. This provision was originally enacted in the Taxpayer Relief Act of 1997, was canceled by a line-item veto by the President, and was restored by the Supreme Court decision declaring the line-item veto unconstitutional.

Commerce and Housing

This category includes a number of tax expenditure provisions that also affect economic activity in other functional categories. For example, provisions related to investment, such as accelerated depreciation, could be classified under the energy, natural resources and environment, agriculture, or transportation categories.

33. ***Credit union income.***—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

34. ***Bad debt reserves.***—Small (less than $500 million in assets) commercial banks, mutual savings banks, and savings and loan associations may deduct additions to bad debt reserves in excess of actually experienced losses.

35. ***Deferral of income on life insurance and annuity contracts.***—Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

36. ***Small property and casualty insurance companies.***— Insurance companies that have annual net premium incomes of less than $350,000 are exempt from tax; those with $350,000 to $2,100,000 of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

37. ***Insurance companies owned by exempt organizations.***—Generally, the income generated by life and property and casualty insurance companies is subject to tax, albeit by special rules. Insurance operations conducted by such exempt organizations as fraternal societies and voluntary employee benefit associations, however, are exempt from tax.

38. Small life insurance company deduction.—Small life insurance companies (gross assets of less than $500 million) can deduct 60 percent of the first $3 million of otherwise taxable income. The deduction phases out for otherwise taxable income between $3 million and $15 million.

[9] The insolvent taxpayer's carryover losses and unused credits are extinguished first, and then his basis in assets reduced to no less than amounts still owed creditors. Finally, the remainder of the forgiven debt is excluded from tax.

39. ***Mortgage housing bonds.***—Interest earned on state and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of state and local tax-exempt bonds that can be issued to finance such private activity is limited. The combined volume cap for mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds is $50 per capita ($150 million minimum) per state. The Tax and Trade Relief Extension Act of 1998 increased the volume cap to $55 per capita ($165 million minimum) in 2003 and ratably annually thereafter until the cap reaches $75 per capita ($225 million minimum) in 2007. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a state cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

40. ***Rental housing bonds.***—Interest earned on state and local government bonds used to finance multifamily rental housing projects is tax-exempt. At least 20 percent (15 percent in targeted areas) of the units must be reserved for families whose income does not exceed 50 percent of the area's median income; or 40 percent for families with incomes of no more than 60 percent of the area median income. Other tax-exempt bonds for multifamily rental projects are generally issued with the requirement that all tenants must be low or moderate income families. Rental housing bonds are subject to the volume cap discussed in the mortgage housing bond section above.

41. ***Interest on owner-occupied homes.***—Owner-occupants of homes may deduct mortgage interest on their primary and secondary residences as itemized nonbusiness deductions. The mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence and, for debt incurred after October 13, 1987, it is limited to no more than $1 million. Interest on up to $100,000 of other debt secured by a lien on a principal or second residence is also deductible, irrespective of the purpose of borrowing, provided the debt does not exceed the fair market value of the residence. Mortgage interest deductions on personal residences are tax expenditures because the taxpayers are not required to report the value of owner-occupied housing services as gross income.

42. ***Taxes on owner-occupied homes.***—Owner-occupants of homes may deduct property taxes on their primary and secondary residences even though they are not required to report the value of owner-occupied housing services as gross income.

43. ***Installment sales.***—Dealers in real and personal property (i.e., sellers that regularly hold property for sale or resale) cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers (i.e., sellers of real property used in their business) are required to pay interest on deferred taxes attributable to their total installment obligations in excess of $5 million. Only properties with sales prices exceeding $150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than $5,000,000 is, therefore, a tax expenditure.

44. ***Capital gains exclusion on home sales.***—A homeowner can exclude from tax up to $500,000 ($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion may not be used more than once every two years.

45. ***Passive loss real estate exemption.***—In general, passive losses may not offset income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempt from this rule.

46. ***Low-income housing credit.***—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. State agencies determine who receives the credit; states are limited in the amount of credit they may authorize annually to $1.25 per resident.

47. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under the reference method. Under the normal tax method, however, a 40-year tax life for depreciable real property is the norm. Thus, statutory depreciation period for rental property of 27.5 years is a tax expenditure. In addition, tax expenditures arise from pre-1987 tax allowances for rental property.

48. ***Cancellation of indebtedness.***—Individuals are not required to report the cancellation of certain indebtedness as current income. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

49. ***Imputed interest rules.***—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument.[10] In general, any debt associated with the sale of property worth less than $250,000 is excepted from the general interest accounting rules. This general $250,000 exception is not a tax expenditure under reference law but is under normal law. Exceptions above $250,000 are a tax expenditure under reference law; these exceptions include the following: (1) sales of personal residences worth more than $250,000, and (2) sales of

[10] For example, if a borrower on December 31, 1997 issues a promise to pay $1,000 plus interest at 10 percent on December 30, 1999, for a total repayment of $1,100 and accepts $900 from a lender in exchange for the contract, the rules require that both parties (a) recognize that $900 is the amount lent, so that the effective loan interest rate is not the stated 10 percent but is 22.2 percent, and (b) report $200 as interest paid or received in 1999.

farms and small businesses worth between $250,000 and $1 million.

50. ***Capital gains (other than agriculture, timber, iron ore, and coal).***—Capital gains on assets held for more than 1 year are taxed at a lower rate than ordinary income. The lower rate on capital gains is considered a tax expenditure under the normal tax method but not under the reference law method.

For assets held for more than 1 year and sold after December 31, 1997, the top tax rate is 20 percent (10 percent for taxpayers who would otherwise pay capital gains tax at the 15-percent rate). The IRS Restructuring and Reform Act of 1998 eliminated the 28-percent capital gains rate by lowering the holding period for the 20-percent capital gains rate from 15 years to 1 year.

In addition, for assets acquired after December 31, 2000, the maximum capital gains tax rates for assets held more than 5 years are 8 percent and 18 percent (rather than 10 percent and 20 percent). On January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period.

51. ***Capital gains exclusion for small business stock.***—An exclusion of 50 percent is provided for capital gains from qualified small business stock held by individuals for more than 5 years. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock.

52. ***Step-up in basis of capital gains at death.***—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. The step-up in the heir's cost basis means that, in effect, the tax on the capital gain is forgiven.

53. ***Carryover basis of capital gains on gifts.***—When a gift is made, the transferred property carries to the donee the donor's basis—the cost that was incurred when the property was first acquired. The carryover of the donor's basis allows a continued deferral of unrealized capital gains.

54. ***Ordinary income treatment of losses from sale of small business corporate stock shares.***—Up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) may be treated as ordinary losses. Such losses would, thus, not be subject to the $3,000 annual capital loss write-off limit.

55. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under reference law. Under normal law, however, a 40-year life for non-rental-housing buildings is the norm. Thus, the 39-year depreciation period for property placed in service after February 25, 1993, the 31.5-year depreciation period for property placed in service from 1987 to February 25, 1993, and the pre-1987 depreciation periods create a tax expenditure.

56. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not cause tax expenditures under reference law. Statutory depreciation of machinery and equipment, however, is accelerated somewhat relative to the normal tax baseline, creating a tax expenditure.

57. ***Expensing of certain small investments.***—In 1998, qualifying investments in tangible property up to $18,500 can be expensed rather than depreciated over time. (The expensing limit increases annually until 2003, when it reaches $25,000). To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 1998, the amount expensed is completely phased out when qualifying investments exceed $218,500.

58. ***Business start-up costs.***—When taxpayers enter into a new business, certain start-up expenses, such as the cost of legal services, are normally incurred. Taxpayers may elect to amortize these outlays over 60 months even though they are similar to other payments made for nondepreciable intangible assets that are not recoverable until the business is sold. The normal tax method treats this amortization as a tax expenditure; the reference tax method does not.

59. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000, but less than $335,000.

The corporate tax rate is 35 percent on income over $10 million. Compared with a flat 35-percent tax rate, the 34-percent rate provides a $100,000 reduction in tax liability for corporations with taxable incomes of $10 million. This benefit is recaptured for corporations with taxable incomes exceeding $15 million by a 3-percent additional tax on income over $15 million but less than $18.33 million. Because the corporate rate schedule is part of reference tax law, it is not considered a tax expenditure under the reference method. A flat corporation income tax rate is taken as the baseline under the normal tax method; therefore the lower rates is considered a tax expenditure under this concept.

60. ***Small issue industrial development bonds.***—Interest earned on small issue industrial development bonds (IDBs) issued by state and local governments to finance manufacturing facilities is tax-exempt. Depreciable property financed with small issue IDBs must be depreciated, however, using the straight-line method. The annual volume of small issue IDBs is subject to the unified volume cap discussed in the mortgage housing bond section above.

Transportation

61. ***Deferral of tax on U.S. shipping companies.***— Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.62. ***Exclusion of reimbursed employee parking expenses.***—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee. In 1998, the maximum amount of the parking exclusion is $175 (indexed, except in 1999) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***Exclusion of employer-provided transit passes.***—Transit passes, tokens, and fare cards provided by an employer to defray an employee's commuting costs are excludable from the employee's income if the total value of the benefit does not exceed the transit limit. In 1998, the limit is $65 (indexed, except in 1999) per month.

Community and Regional Development

64. ***Rehabilitation of structures.***—A 10-percent investment tax credit is available for the rehabilitation of buildings that are used for business or productive activities and that were erected before 1936 for other than residential purposes. The taxpayer's recoverable basis must be reduced by the amount of the credit.

65. ***Airport, dock, and similar facility bonds.***— Interest earned on state and local bonds issued to finance high-speed rail facilities and government-owned airports, docks, wharves, and sport and convention facilities is tax-exempt. These bonds are not subject to a volume cap.

66. ***Exemption of income of mutuals and cooperatives.***—The incomes of mutual and cooperative telephone and electric companies are exempt from tax if at least 85 percent of their revenues are derived from patron service charges.

67. ***Empowerment zones and enterprise communities.***—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, and accelerated depreciation. A tax credit for contributions to certain community development corporations can also be available. In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit, and investors in certain D.C. property can receive a capital gains break.

68. ***Expensing of environmental remediation costs.***— Taxpayers who clean up hazardous substances at a qualified site may expense the clean-up costs, rather than capitalize the costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. he expensing only applies to clean-up costs incurred after August 5, 1997 and before January 1, 2001.

Education, Training, Employment, and Social Services

69. ***Scholarship and fellowship income.***—Scholarships and fellowships are excluded from taxable income to the extent they pay for tuition and course-related expenses of the grantee. Similarly, tuition reductions for employees of educational institutions and their families are not included in taxable income. From an economic point of view, scholarships and fellowships are either gifts not conditioned on the performance of services, or they are rebates of educational costs. Thus, under the reference law method, this exclusion is not a tax expenditure because this method does not include either gifts or price reductions in a taxpayer's gross income. The exclusion, however, is considered a tax expenditure under the normal tax method, which includes gift-like transfers of government funds in gross income (many scholarships are derived directly or indirectly from government funding).

70. ***HOPE tax credit.***— The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,000 of tuition and fees and 50 percent of the next $1,000 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. The credit is phased out ratably for taxpayers with modified AGI between $80,000 and $100,000 ($40,000 and $50,000 for singles).

71. ***Lifetime Learning tax credit.***—The non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees. For tuition and fees paid between July 1, 1998 and December 31, 2002, the maximum credit per return is $1,000. For tuition and fees paid after December 31, 2002, the maximum credit per return is $2,000. The credit is phased out ratably for taxpayers with modified AGI between $80,000 and $100,000 ($40,000 and $50,000 for singles). The credit applies to both undergraduate and graduate students.

72. ***Education Individual Retirement Accounts.***— Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA is $500 per year per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Contributions may not be made to an education IRA in any year in which a contribution has been made to a state tuition plan for the same beneficiary.

73. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 ($1,000 in 1998, $1,500 in 1999, and $2,000 in 2000) on interest paid on an education loan. Interest may only be deducted for the first five years in which interest pay-

ments are required. The maximum deduction is phased down ratably for taxpayers with modified AGI between $60,000 and $75,000 ($40,000 and $55,000 for singles). Only interest paid and due after December 31, 1997 may be deducted.

74. ***State prepaid tuition plans.***—Some states have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. Taxes on the earnings from these plans are paid by the beneficiaries and are deferred until the tuition is actually paid.

75. ***Student-loan bonds.***—Interest earned on state and local bonds issued to finance student loans is tax-exempt. The volume of all such private activity bonds that each state may issue annually is limited.

76. ***Bonds for private nonprofit educational institutions.***—Interest earned on state and local government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed. The aggregate volume of all such private activity bonds that each state may issue during any calendar year is limited.

77. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be use to improve impoverished schools. The total amount of zone academy bonds that may be issued is limited to $800 million; no bonds may be issued before January 1, 1998.

78. ***U.S. savings bonds for education.***—Interest earned on U.S. savings bonds issued after December 31, 1989 is tax-exempt if the bonds are transferred to an educational institution to pay for educational expenses. The tax exemption is phased out for taxpayers with AGI between $78,350 and $108,350 ($52,250 and $67,250 for singles) in 1998.

79. ***Dependent students age 19 or older.***—Taxpayers may claim personal exemptions for dependent children age 19 or over who (1) receive parental support payments of $1,000 or more per year, (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

80. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $500 child credit beginning January 1, 1999 ($400 in 1998). The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles). The child credit is refundable for taxpayers with three or more children.

81. ***Charitable contributions to educational institutions.***—Taxpayers may deduct contributions to nonprofit educational institutions. Taxpayers who donate capital assets to educational institutions can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

82. ***Employer-provided educational assistance.***—Employer-provided educational assistance is excluded from an employee's gross income even though the employer's costs for this assistance are a deductible business expense. This exclusion applies only to non-graduate courses beginning before July 1, 2000.

83. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work after September 30, 1996 and before July 1, 1999 and who are certified as members of various targeted groups. The Tax and Trade Relief Extension Act of 1998 extended the expiration date from July 1, 1998 to July 1, 1999. For employees hired before October 1, 1997, the amount of the credit that can be claimed is 35 percent of the first $6,000 paid during the first year of employment. For employees hired after September 30, 1997, the credit is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

84. ***Welfare-to-work tax credit.***—An employer is eligible for a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of wages in the first year of employment and 50 percent of the first $10,000 of wages in the second year of employment. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired after December 31, 1997 and before July 1, 1999. The Tax and Trade Relief Extension Act of 1998 extended the expiration date from May 1, 1999 to July 1, 1999.

85. ***Employer-provided child care.***—Employer-provided child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

86. ***Adoption credit and exclusion.***—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $5,000 per child ($6,000 for special needs adoptions, except foreign adoptions). The credit is phased-out ratably for taxpayers with modified AGI between $75,000 and $115,000. Unused credits may be carried forward. In lieu of the tax credit, taxpayers may exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The non-special needs adoption assistance and foreign special needs assistance expire on December 31, 2001.

87. ***Employer-provided meals and lodging.***—Employer-provided meals and lodging are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

88. ***Child and dependent care expenses.***—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by divorced or separated

parents who have custody of children, and by single parents. Expenditures up to a maximum $2,400 for one dependent and $4,800 for two or more dependents are eligible for the credit. The credit is equal to 30 percent of qualified expenditures for taxpayers with incomes of $10,000 or less. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income between $10,000 and $28,000.

89. ***Disabled access expenditure credit.***—Small businesses (less than $1 million in gross receipts or fewer than 31 full-time employees) can claim a 50-percent credit for expenditures in excess of $250 to remove access barriers for disabled persons. The credit is limited to $5,000.

90. ***Expensing costs of removing architectural barriers.***—Taxpayers can expense (up to $15,000 annually) the cost of removing architectural barriers to the handicapped rather than depreciate the cost over the useful life of the asset.

91. ***Charitable contributions, other than education and health.***—Taxpayers may deduct contributions to charitable, religious, and certain other nonprofit organizations. Taxpayers who donate capital assets to charitable organizations can deduct the assets' current value without being taxed on any appreciation in value. An individual's total charitable contribution generally may not exceed 50 percent of adjusted gross income; a corporation's total charitable contributions generally may not exceed 10 percent of pre-tax income.

92. ***Foster care payments.***—Foster parents provide a home and care for children who are wards of the State, under contract with the State. Compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

93. ***Parsonage allowances.***—The value of a minister's housing allowance and the rental value of parsonages are not included in a minister's taxable income.

Health

94. ***Employer-paid medical insurance and expenses.***—Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct part of their family health insurance premiums.

95. ***Self-employed medical insurance premiums.***—Self-employed taxpayers may deduct a percentage of their family health insurance premiums. Taxpayers without self-employment income are not eligible for the special percentage deduction. The deductible percentage is 45 percent in 1998, 60 percent in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

96. ***Workers' compensation insurance premiums.***—Workers' compensation insurance premiums are paid by employers and deducted as a business expense, but the premiums are not included in employee gross income.

97. ***Medical savings accounts.***—Some employees may deduct annual contributions to a medical savings account (MSA); employer contributions to MSAs (except those made through cafeteria plans) for qualified employees are also excluded from income. An employee may contribute to an MSA in a given year only if the employer does not contribute to the MSA in that year. MSAs are only available to self-employed individuals or employees covered under an employer-sponsored high deductible health plan of a small employer. The maximum annual MSA contribution is 75 percent of the deductible under the high deductible plan for family coverage (65 percent for individual coverage). Earnings from MSAs are excluded from taxable income. Distributions from an MSA for medical expenses are not taxable. The number of taxpayers who may benefit annually from MSAs is generally limited to 750,000. No new MSAs may be established after December 31, 2000.

98. ***Medical care expenses.***—Personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible.

99. ***Hospital construction bonds.***—Interest earned on state and local government debt issued to finance hospital construction is excluded from income subject to tax.

100. ***Charitable contributions to health institutions.***—Individuals and corporations may deduct contributions to nonprofit health institutions. Tax expenditures resulting from the deductibility of contributions to other charitable institutions are listed under the education, training, employment, and social services function.

101. ***Orphan drugs.***—Drug firms can claim a tax credit of 50 percent of the costs for clinical testing required by the Food and Drug Administration for drugs that treat rare physical conditions or rare diseases.

102. ***Blue Cross and Blue Shield.***—Blue Cross and Blue Shield health insurance providers in existence on August 16, 1986 and certain other nonprofit health insurers are provided exceptions from otherwise applicable insurance company income tax accounting rules that substantially reduce (or even eliminate) their tax liabilities.

Income Security

103. ***Railroad retirement benefits.***—Railroad retirement benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold. The threshold is discussed more fully under the social security function.

104. ***Workers' compensation benefits.***—Workers—compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

Treasury reviewed the Federal income tax exemption for workers' compensation wage replacement benefits as one of its pilot analyses of tax expenditures. Workers' compensation programs, with the principal exception of the program covering Federal employees, are

State programs that do not have to conform to any national criteria. While the legislative history does not explain the goal of the tax exemption, the exemption has the effect of reducing taxes on families with unexpected losses of earnings from work-related injuries or death. Because the tax exemption may have been considered in setting the levels of benefits mandated by State laws, the net benefit of the tax exemption to recipients is uncertain.

105. ***Public assistance benefits.***—Public assistance benefits are excluded from tax. The normal tax method considers cash transfers from the government as taxable and, thus, treats the exclusion for public assistance benefits as a tax expenditure.

106. ***Special benefits for disabled coal miners.***—Disability payments to former coal miners out of the Black Lung Trust Fund, although income to the recipient, are not subject to the income tax.

107. ***Military disability pensions.***—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

108. ***Employer-provided pension contributions and earnings.***—Certain employer contributions to pension plans are excluded from an employee's gross income even though the employer can deduct the contributions. In addition, the tax on the investment income earned by the pension plans is deferred until the money is withdrawn.

109. ***401(k) plans and Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different tax-preferenced retirement plans: deductible IRAs, non-deductible IRAs, Roth IRAs, and 401(k) plans (and 401(k)-type plans like 403(b) plans and the government's Thrift Savings Plan).

In 1998, an employee could exclude up to $10,000 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k). Employees can annually contribute to a deductible IRA up to $2,000 (or 100 percent of compensation, if less) or $4,000 on a joint return with only one working spouse if: (a) neither the individual nor spouse is an active participant in an employer-provided retirement plan, or (b) their AGI is below $40,000 ($25,000 for singles). The IRA deduction is phased out for taxpayers with AGI between $50,000 and $60,000 ($30,000 and $40,000 for singles). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 for singles). Taxpayers whose AGI is above the start of the IRA phase-out range or who are active participants in an employer-provided retirement plan can contribute to a non-deductible IRA. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

An employed taxpayer can make a non-deductible contribution of up to $2,000 (a non-employed spouse can also contribute up to $2,000 if a joint return is filed) to a Roth IRA. Investment income of a Roth IRA is not taxed when earned. Withdrawals from a Roth IRA are tax free if (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 59–½, (b) dies, (c) is disabled, or (d) purchases a first-time house. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). Total annual contributions to a taxpayer's deductible, non-deductible, and Roth IRAs cannot exceed $2,000 ($4,000 for joints).

110. ***Keogh plans.***—Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to a maximum of $30,000 per year. In addition, the tax on the investment income earned by Keogh plans is deferred until the money is withdrawn.

111. ***Employer-provided life insurance benefits.***—Employer-provided life insurance benefits are excluded from an employee's gross income even though the employer's costs for the insurance are a deductible business expense.

112. ***Employer-provided accident and disability benefits.***—Employer-provided accident and disability benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

113. ***Employer-provided supplementary unemployment benefits.***—Employer-provided supplementary unemployment benefits are excluded from an employee's gross income even though the employer's costs for the benefits are a deductible business expense.

114. ***Employer Stock Ownership Plan (ESOP) provisions.***—ESOPs are a special type of tax-exempt employee benefit plan. Employer-paid contributions (the value of stock issued to the ESOP) are deductible by the employer as part of employee compensation costs. They are not included in the employees' gross income for tax purposes, however, until they are paid out as benefits. The following special income tax provisions for ESOPs are intended to increase ownership of corporations by their employees: (1) annual employer contributions are subject to less restrictive limitations; (2) ESOPs may borrow to purchase employer stock, guaranteed by their agreement with the employer that the debt will be serviced by his payment (deductible by him) of a portion of wages (excludable by the employees) to service the loan; (3) employees who sell appreciated company stock to the ESOP may defer any taxes due until they withdraw benefits; and (4) dividends paid to ESOP-held stock are deductible by the employer.

115. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,000 standard deduction if single, or $800 if married.

116. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,000 standard deduction if single, or $800 if married.

117. ***Tax credit for the elderly and disabled.***—Individuals who are 65 years of age or older, or who are permanently disabled, can take a tax credit equal

to 15 percent of the sum of their earned and retirement income. Income is limited to no more than $5,000 for single individuals or married couples filing a joint return where only one spouse is 65 years of age or older, and up to $7,500 for joint returns where both spouses are 65 years of age or older. These limits are reduced by one-half of the taxpayer's adjusted gross income over $7,500 for single individuals and $10,000 for married couples filing a joint return.

118. ***Casualty losses.***—Neither the purchase of property nor insurance premiums to protect its value are deductible as costs of earning income; therefore, reimbursement for insured loss of such property is not reportable as a part of gross income. Taxpayers, however, may deduct uninsured casualty and theft losses of more than $100 each, but only to the extent that total losses during the year exceed 10 percent of AGI.

119. ***Earned income tax credit (EITC).***—The EITC may be claimed by low income workers. For a family with one qualifying child, the credit is 34 percent of the first $6,680 of earned income in 1998. The credit is 40 percent of the first $9,390 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $12,260, the credit is phased out at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out at $26,473 of modified adjusted gross income ($30,095 if two or more qualifying children are present).

The credit may also be claimed by workers who do not have children living with them. Qualifying workers must be at least age 25 and may not be claimed as a dependent on another taxpayer's return. The credit is not available to workers age 65 or older. In 1997, the credit is 7.65 percent of the first $4,460 of earned income. When the taxpayer's income exceeds $5,570, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,030 of modified adjusted gross income.

For workers with or without children, the income level at which the credit's phase-outs begin and the maximum amounts of income on which the credit can be taken are adjusted for inflation. Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

Social Security

120. ***Social Security benefits for retired workers.***—Social security benefits that exceed the beneficiary's contributions out of taxed income are deferred employee compensation and the deferral of tax on that compensation is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' social security and tier 1 railroad retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of social security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

121. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund, for disability and for dependents and survivors, are excluded from the beneficiaries' gross incomes.

122. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are excluded from the beneficiaries' gross income.

Veterans Benefits and Services

123. ***Veterans death benefits and disability compensation.***—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

124. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

125. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

126. ***Tax-exempt mortgage bonds for veterans.***—Interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income. The issuance of such bonds is limited, however, to five pre-existing State programs and to amounts based upon previous volume levels for the period January 1, 1979 to June 22, 1984. Furthermore, future issues are limited to veterans who served on active duty before 1977.

General Government

127. ***Public purpose State and local bonds.***—Interest earned on State and local government bonds issued to finance public purpose construction (e.g., schools, roads, sewers) is tax-exempt.

128. ***Deductibility of certain nonbusiness State and local taxes.***—Taxpayers may deduct State and local income taxes and property taxes even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.

129. ***Business income earned in U.S. possessions.***—U.S. corporations receiving income from investments or businesses located in a U.S. possession (e.g., Puerto Rico) can claim a credit against U.S. tax, which effectively excludes some of this income from tax. The credit expires December 31, 2005.

Interest

130. ***U.S. savings bonds.***—Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

Exceptions to the general terms of the Federal unified transfer tax favor particular transferees or dispositions of transferors, similar to Federal direct expenditure or loan programs. The transfer tax provisions identified as tax expenditures satisfy the reference law criteria for inclusion in the tax expenditure budget that were described above. There is no generally accepted normal tax baseline for transfer taxes.

Unified Transfer Tax Reference Rules

The reference tax rules for the unified transfer tax from which departures represent tax expenditures include:

- *Definition of the taxpaying unit.* The payment of the tax is the liability of the transferor whether the transfer of cash or property was made by gift or bequest.
- *Definition of the tax base.* The base for the tax is the transferor's cumulative, taxable lifetime gifts made plus the net estate at death. Gifts in the tax base are all annual transfers in excess of $10,000 to any donee except the donor's spouse. Excluded are, however, payments on behalf of family members' educational and medical expenses, as well as the cost of ceremonial gatherings and celebrations that are not in honor of the donor.
- *Property valuation.* In general, property is valued at its fair market value at the time it is transferred. This is not necessarily the case in the valuation of property for transfer tax purposes. Executors of estates are provided the option to value assets at the time of the testator's death or up to six months later.
- *Tax rate schedule.* A single graduated tax rate schedule applies to all taxable transfers. This is reflected in the name of the "unified transfer tax" that has replaced the former separate gift and estate taxes. The tax rates vary from 18 percent on the first $10,000 of aggregate taxable transfers, to 55 percent on amounts exceeding $3 million. A lifetime credit is provided against the tax in determining the final amount of transfer taxes that are due and payable. For decedents dying in 1998, this credit allows each taxpayer to make a $625,000 tax-free transfer of assets that otherwise would be liable to the unified transfer tax. This figure is scheduled to increase in steps to $1 million in 2005.[11]
- *Time when tax is due and payable.* Donors are required to pay the tax annually as gifts are made. The generation-skipping transfer tax is payable by the donees whenever they accede to the gift. The net estate tax liability is due and payable within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 1998–2004 are displayed by functional category in table 5–6. Outlay equivalent estimates are similar to revenue loss estimates for transfer tax expenditures and, therefore, are not shown separately. A description of the provisions follows.

Natural Resources and Environment

1. ***Donations of conservation easements.***—Bequests of property and easements (in perpetuity) for conservation purposes can be excluded from taxable estates. Use of the property and easements must be restricted to at least one of the following purposes: outdoor recreation or scenic enjoyment for the general public; protection of the natural habitats of fish, wildlife, plants, etc.; and preservation of historic land areas and structures. Conservation gifts are similarly excluded from the gift tax. Up to 40 percent of the value of land subject to certain conservation easements may be excluded from taxable estates; the maximum amount of the exclusion is $100,000 in 1998 and increases by $100,000 in each year through 2002.

Agriculture

2. ***Special-use valuation of farms.***—Up to $750,000 in farmland owned and operated by a decedent and/or a member of the family may be valued for estate tax purposes on the basis of its "continued use" as farmland if: (1) the value of the farmland is at least 25 percent of the gross estate; (2) the entire value of all farm property is at least 50 percent of the gross estate; and (3) family heirs to the farm agree to continue to operate the property as a farm for at least 10 years. The $750,000 limit is indexed at 1998 levels, beginning in 1999.

3. ***Tax deferral of closely held farms.***—The tax on a decedent's farm can be deferred for up to 14 years if the value of the farm is at least 35 percent of the net estate. For the first 4 years of deferral, no tax need be paid. During the last 10 years of deferral, the tax liability must be paid in equal annual installments. Throughout the 14 year period, interest is charged at a special, favorable rate. For estates of decedents dying after December 31, 1997, the applicable interest rates are lower and the interest is non-deductible.

Commerce and Housing

4. ***Special-use valuation of closely-held businesses.***—The special-use valuation rule available for

[11] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million. It is considered a generation-skipping transfer whenever the transferee is at least two generations younger than the transferor, as it would be in the case of transfers to grandchildren or great-grandchildren. The liability of this tax is on the recipients of the transfer.

family farms is also available for nonfarm family businesses. To be eligible for the special-use valuation, the same three conditions previously described must be met.

5. ***Tax deferral of closely-held businesses.***—The tax-deferral rule available for family farms is also available for nonfarm family businesses. To be eligible for the tax deferral, the value of stock in closely-held corporations must exceed 35 percent of the decedent's gross estate, less debt and funeral expenses.

6. ***Exclusion for family-owned businesses.***—Certain family-owned businesses that are bequeathed to qualified heirs can be excluded from taxable estates. The exclusion generally cannot exceed $1.3 million less the value of the unified credit. The exclusion is recaptured if certain conditions are not maintained for 10 years.

Education, Training, Employment, and Social Services

7. ***Charitable contributions to educational institutions.***—Bequests to educational institutions can be deducted from taxable estates.

8. ***Charitable contributions, other than education and health.***— Bequests to charitable, religious, and certain other nonprofit organizations can be deducted from taxable estates.

Health

9. ***Charitable contributions to health institutions.***—Bequests to health institutions can be deducted from taxable estates.

General Government

10. ***State and local death taxes.***—A credit against the federal estate tax is allowed for State taxes on bequests. The amount of this credit is determined by a rate schedule that reaches a maximum of 16 percent of the taxable estate in excess of $60,000.

Table 5–6. REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

	Description	1998	1999	2000	2001	2002	2003	2004	2000–2004
	Natural Resources and Environment:								
1	Donations of conservation easements	0	10	25	40	55	75	95	290
	Agriculture:								
2	Special use valuation of farm real property	80	95	110	115	120	125	135	605
3	Tax deferral of closely held farms	0	0	0	5	5	10	10	30
	Commerce:								
4	Special use valuation of real property used in closely held businesses	5	5	5	5	5	10	10	35
5	Tax deferral of closely held business	15	0	10	20	30	50	65	175
6	Exclusion for family owned businesses	0	490	490	495	525	530	555	2,595
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	1,115	1,195	1,245	1,305	1,395	1,470	1,560	6,975
8	Deduction for charitable contributions (other than education and health)	3,295	3,525	3,670	3,850	4,115	4,345	4,605	20,585
	Health:								
9	Deduction for charitable contributions (health)	1,010	1,080	1,125	1,180	1,260	1,330	1,410	6,305
	General government:								
10	Credit for State death taxes	4,650	4,970	5,175	5,410	5,670	5,965	6,200	28,420