5. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. So-called tax expenditures may be defined as provisions of the Federal tax laws with exclusions, exemptions, deductions, credits deferrals, or special tax rates. Underlying the "tax expenditure" concept is the notion that the Federal Government would otherwise collect additional revenues but for these provisions. It assumes an arbitrary tax base is available to the Government in its entirety as a resource to be spent. Because of the breadth of this arbitrary tax base, the Administration believes that the concept of "tax expenditure" is of questionable analytic value. The discussion below is based on materials and formats developed and included in previous budgets. The Administration intends to reconsider this presentation in the future.

The largest tax expenditures tend to be associated with the individual income tax. For example, sizeable deductions and exclusions 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 for the estimated 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.

Tax expenditures relating to the individual and corporate income taxes are considered first in this chapter. They are estimated for fiscal years 2000–2006 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 of the chapter on performance measures and economic effects presents information related to assessment of the effect of tax expenditures on the achievement of program performance goals. This section is a complement to the government-wide performance plan required by the Government Performance and Results Act of 1993 (see the Budget volume, which considers the Federal Government's spending, regulatory, and tax policies across functional areas).

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon tax law enacted as of December 31, 2000. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2000. 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 2000–2006 are displayed according to 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 tables.

Table 5–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes. Listing the 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 pro-

visions 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 2002 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

The estimates shown for individual tax expenditures in Tables 5–1, 5–2, and 5–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these 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 activity or of other tax provisions 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 tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost 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, because 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 effects reported in Table 5–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates 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, because 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. Although 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.

Present-Value Estimates

Discounted present-value estimates of revenue effects 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 effects, net of future tax payments, that follow from activities undertaken during calendar year 2000 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2000 would cause a deferral of tax payments on wages in 2000 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2000 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. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES [1]

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense								
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,140	2,160	2,190	2,210	2,240	2,260	2,290	11,190
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,500	2,680	2,850	3,010	3,180	3,350	3,550	15,940
3	Exclusion of certain allowances for Federal employees abroad	680	720	750	790	830	870	920	4,160
4	Exclusion of income of foreign sales corporations	3,890	0	0	0	0	0	0	0
5	Extraterritorial income exclusion	0	4,490	4,810	5,150	5,500	5,880	6,290	27,630
6	Inventory property sales source rules exception	2,170	2,280	2,390	2,510	2,630	2,760	2,900	13,190
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	0	0	0	0	540
	General science, space, and technology:								
9	Expensing of research and experimentation expenditures (normal tax method)	1,680	1,650	1,680	1,770	1,880	1,980	2,100	9,410
10	Credit for increasing research activities	1,630	6,050	6,760	5,390	4,710	2,720	1,160	20,740
	Energy:								
11	Expensing of exploration and development costs, fuels	20	70	70	100	110	110	100	490
12	Excess of percentage over cost depletion, fuels	340	340	340	340	340	350	350	1,720
13	Alternative fuel production credit	970	920	860	540	130	130	130	1,790
14	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	70	70	80	80	80	90	90	420
16	Exclusion of interest on energy facility bonds	90	90	90	100	110	130	140	570
17	Enhanced oil recovery credit	310	370	440	530	630	770	910	3,280
18	New technology credit	40	60	70	90	90	90	90	430
19	Alcohol fuel credits [2]	20	20	20	20	20	20	20	100
20	Tax credit and deduction for clean-fuel burning vehicles	60	60	50	30	0	–30	–50	0
21	Exclusion from income of conservation subsidies provided by public utilities	90	80	80	80	90	90	90	430
	Natural resources and environment:								
22	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	20	20	100
23	Excess of percentage over cost depletion, nonfuel minerals	270	280	300	310	320	330	350	1,610
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	400	400	410	450	510	560	610	2,540
25	Capital gains treatment of certain timber income	70	70	80	80	80	90	90	420
26	Expensing of multiperiod timber growing costs	570	580	610	630	640	660	680	3,220
27	Investment credit and seven-year amortization for reforestation expenditures	0	0	0	0	10	10	10	30
28	Tax incentives for preservation of historic structures	190	200	210	220	240	250	260	1,180
	Agriculture:								
29	Expensing of certain capital outlays	160	160	160	170	170	180	180	860
30	Expensing of certain multiperiod production costs	110	110	120	120	120	130	130	620
31	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	700	740	780	820	860	900	950	4,310
33	Income averaging for farmers	50	50	50	50	60	60	60	280
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
35	Exemption of credit union income	1,550	1,650	1,770	1,890	2,020	2,160	2,280	10,120
36	Excess bad debt reserves of financial institutions	70	60	50	30	20	10	0	110
37	Exclusion of interest on life insurance savings	13,950	15,170	16,520	17,990	19,610	21,370	23,330	98,820
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	230	240	250	270	280	300	310	1,410
40	Small life insurance company deduction	100	100	100	100	100	100	100	500
	Housing:								
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	790	800	820	870	990	1,090	1,200	4,970
42	Exclusion of interest on rental housing bonds	160	160	170	170	200	230	260	1,030
43	Deductibility of mortgage interest on owner-occupied homes	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	1,010	1,035	1,050	1,070	1,090	1,110	1,130	5,450
46	Capital gains exclusion on home sales	18,540	19,095	19,670	20,260	20,870	21,490	22,140	104,430
47	Exception from passive loss rules for $25,000 of rental loss	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	3,210	3,310	3,460	3,600	3,790	3,940	4,080	18,870
49	Accelerated depreciation on rental housing (normal tax method)	4,740	5,140	5,520	5,830	6,040	6,140	6,210	29,740
	Commerce:								
50	Cancellation of indebtedness	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	40,520	41,720	42,950	44,220	45,530	46,870	48,260	227,830
53	Capital gains exclusion of small corporation stock	40	70	90	120	160	200	250	820
54	Step-up basis of capital gains at death	27,090	28,240	29,370	30,540	31,760	33,030	34,360	159,060
55	Carryover basis of capital gains on gifts	180	190	200	210	220	230	240	1,100

Table 5–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
56	Ordinary income treatment of loss from small business corporation stock sale	35	40	40	40	40	40	40	200
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	3,260	3,170	3,290	2,880	2,860	2,730	3,220	14,980
58	Accelerated depreciation of machinery and equipment (normal tax method)	30,660	33,050	35,400	37,680	39,760	41,530	43,330	197,700
59	Expensing of certain small investments (normal tax method)	2,100	2,570	2,690	2,670	2,570	2,480	2,510	12,920
60	Amortization of start-up costs (normal tax method)	200	200	200	210	220	220	220	1,070
61	Graduated corporation income tax rate (normal tax method)	6,480	6,700	7,140	7,460	7,540	7,760	7,960	37,860
62	Exclusion of interest on small issue bonds	290	300	310	330	360	410	450	1,860
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	1,880	1,980	2,090	2,190	2,300	2,420	2,550	11,550
65	Exclusion for employer-provided transit passes	190	220	260	310	350	400	440	1,760
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
67	Exclusion of interest for airport, dock, and similar bonds	620	630	640	690	780	850	950	3,910
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320
69	Empowerment zones and enterprise communities	310	320	660	1,140	1,210	1,340	1,480	5,830
70	New markets tax credit	0	10	90	200	310	440	640	1,680
71	Expensing of environmental remediation costs	160	350	410	330	30	–130	–80	560
	Education, training, employment, and social services:								
	Education:								
72	Exclusion of scholarship and fellowship income (normal tax method)	1,110	1,120	1,130	1,140	1,150	1,160	1,180	5,760
73	HOPE tax credit	4,210	4,480	4,610	4,280	4,110	4,360	4,630	21,990
74	Lifetime Learning tax credit	2,420	2,570	2,580	2,960	4,490	4,460	4,660	19,150
75	Education Individual Retirement Accounts	20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest	360	370	380	380	390	400	410	1,960
77	Deferral for state prepaid tuition plans	100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	210	230	230	240	270	290	330	1,360
79	Exclusion of interest on bonds for private nonprofit educational facilities	520	540	550	580	650	740	810	3,330
80	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290
81	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	10	10	10	10	10	50
82	Parental personal exemption for students age 19 or over	950	1,010	1,070	1,110	1,170	1,220	1,270	5,840
83	Deductibility of charitable contributions (education)	2,730	2,830	2,930	3,090	3,200	3,300	3,540	16,060
84	Exclusion of employer-provided educational assistance	240	260	90	0	0	0	0	90
	Training, employment, and social services:								
85	Work opportunity tax credit	390	400	300	180	80	30	10	600
86	Welfare-to-work tax credit	50	70	70	50	20	10	0	150
87	Exclusion of employer provided child care	670	700	730	760	810	850	900	4,050
88	Adoption assistance	120	130	120	30	30	20	20	220
89	Assistance for adopted foster children	160	190	210	240	250	260	270	1,230
90	Exclusion of employee meals and lodging (other than military)	680	710	740	780	810	850	890	4,070
91	Child credit [3]	19,330	19,310	18,980	18,410	18,000	17,430	16,790	89,610
92	Credit for child and dependent care expenses	2,390	2,360	2,330	2,300	2,280	2,250	2,220	11,380
93	Credit for disabled access expenditures	40	40	50	50	50	50	50	250
94	Deductibility of charitable contributions, other than education and health	20,150	21,020	22,030	23,160	24,240	25,380	26,780	121,590
95	Exclusion of certain foster care payments	550	570	300	630	660	700	730	3,020
96	Exclusion of parsonage allowances	330	350	370	400	430	460	490	2,150
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	76,530	84,350	92,230	99,800	107,620	115,770	124,690	540,110
98	Self-employed medical insurance premiums	1,340	1,510	1,760	2,470	3,580	3,900	4,220	15,930
99	Workers' compensation insurance premiums	4,620	4,850	5,090	5,350	5,620	5,900	6,190	28,150
100	Medical Savings Accounts	20	20	30	20	20	20	20	110
101	Deductibility of medical expenses	4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	1,080	1,100	1,130	1,210	1,350	1,490	1,660	6,840
103	Deductibility of charitable contributions (health)	2,910	3,000	3,100	3,270	3,380	3,480	3,740	16,970
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810
105	Special Blue Cross/Blue Shield deduction	230	250	280	320	290	280	250	1,420
	Income security:								
106	Exclusion of railroad retirement system benefits	360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits	5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)	360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners	80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions	120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:								
111	Employer plans	89,120	93,220	97,510	103,010	108,480	114,220	121,990	545,210
112	Individual Retirement Accounts	15,200	15,920	16,600	17,230	17,770	18,220	18,520	88,340

Table 5–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES[1]—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
113	Keogh plans	5,500	5,830	6,180	6,540	6,930	7,330	7,750	34,730
	Exclusion of other employee benefits:								
114	Premiums on group term life insurance	1,720	1,750	1,780	1,830	1,860	1,900	1,930	9,300
115	Premiums on accident and disability insurance	200	210	220	230	240	250	260	1,200
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50
	Special ESOP rules	1,240	1,290	1,340	1,400	1,460	1,540	1,610	7,350
118	Additional deduction for the blind	30	30	30	30	40	40	40	180
119	Additional deduction for the elderly	1,920	1,990	2,060	2,130	2,210	2,260	2,350	11,010
120	Tax credit for the elderly and disabled	30	30	30	30	30	30	30	150
121	Deductibility of casualty losses	230	250	260	280	290	300	320	1,450
122	Earned income tax credit[4]	4,644	4,692	4,693	5,225	5,456	5,688	5,965	27,297
	Social Security:								
	Exclusion of social security benefits:								
123	Social Security benefits for retired workers	18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled	2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors	3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:								
126	Exclusion of veterans death benefits and disability compensation	3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions	70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits	80	90	90	100	100	110	110	510
129	Exclusion of interest on veterans housing bonds	40	40	40	40	40	50	50	220
	General purpose fiscal assistance:								
130	Exclusion of interest on public purpose State and local bonds	22,600	23,050	23,510	23,980	24,460	24,950	25,450	122,350
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
132	Tax credit for corporations receiving income from doing business in U.S. possessions	2,470	2,520	2,560	2,580	2,610	2,630	1,060	11,440
	Interest:								
133	Deferral of interest on U.S. savings bonds	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:								
	Public purposes	22,600	23,050	23,510	23,980	24,460	24,950	25,450	122,350
	Energy facilities	90	90	90	100	110	130	140	570
	Water, sewage, and hazardous waste disposal facilities	400	400	410	450	510	560	610	2,540
	Small-issues	290	300	310	330	360	410	450	1,860
	Owner-occupied mortgage subsidies	790	800	820	870	990	1,090	1,200	4,970
	Rental housing	160	160	170	170	200	230	260	1,030
	Airports, docks, and similar facilities	620	630	640	690	780	850	950	3,910
	Student loans	210	230	230	240	270	290	330	1,360
	Private nonprofit educational facilities	520	540	550	580	650	740	810	3,330
	Hospital construction	1,080	1,100	1,130	1,210	1,350	1,490	1,660	6,840
	Veterans' housing	40	40	40	40	40	50	50	220
	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 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 ESTIMATES OF TAX EXPENDITURES [1]

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense																
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	....	....	....	....	....	....	....	....	2,140	2,160	2,190	2,210	2,240	2,260	2,290	11,190
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,500	2,680	2,850	3,010	3,180	3,350	3,550	15,940
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	680	720	750	790	830	870	920	4,160
4	Exclusion of income of foreign sales corporations	3,890	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....
5	Extraterritorial income exclusion	....	4,490	4,810	5,150	5,500	5,880	6,290	27,630	....	....	....	....	....	....	....	....
6	Inventory property sales source rules exception	2,170	2,280	2,390	2,510	2,630	2,760	2,900	13,190	....	....	....	....	....	....	....	....
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680	....	....	....	....	....	....	....	....
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	....	....	....	....	540	....	....	....	....	....	....	....	....
	General science, space, and technology:																
9	Expensing of research and experimentation expenditures (normal tax method)	1,650	1,620	1,650	1,740	1,840	1,940	2,060	9,230	30	30	30	30	40	40	40	180
10	Credit for increasing research activities	1,620	5,990	6,700	5,340	4,670	2,700	1,160	20,570	10	60	60	50	40	20	....	170
	Energy:																
11	Expensing of exploration and development costs, fuels	20	60	60	80	90	90	80	400	....	10	10	20	20	20	20	90
12	Excess of percentage over cost depletion, fuels	290	290	290	290	290	300	300	1,470	50	50	50	50	50	50	50	250
13	Alternative fuel production credit	930	880	820	520	120	120	120	1,700	40	40	40	20	10	10	10	90
14	Exception from passive loss limitation for working interests in oil and gas properties	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	....	....	....	....	....	....	....	....	70	70	80	80	80	90	90	420
16	Exclusion of interest on energy facility bonds	20	20	20	20	30	40	40	150	70	70	70	80	80	90	100	420
17	Enhanced oil recovery credit	280	340	400	480	580	700	830	2,990	30	30	40	50	50	70	80	290
18	New technology credit	40	60	70	90	90	90	90	430	....	....	....	....	....	....	....	....
19	Alcohol fuel credits [2]	10	10	10	10	10	10	10	50	10	10	10	10	10	10	10	50
20	Tax credit and deduction for clean-fuel burning vehicles	50	50	40	20	....	–30	–40	–10	10	10	10	10	....	....	–10	10
21	Exclusion from income of conservation subsidies provided by public utilities	....	....	....	....	....	....	....	....	90	80	80	80	90	90	90	430
	Natural resources and environment:																
22	Expensing of exploration and development costs, nonfuel minerals	20	20	20	20	20	20	20	100	....	....	....	....	....	....	....	....
23	Excess of percentage over cost depletion, nonfuel minerals	250	260	280	290	300	310	330	1,510	20	20	20	20	20	20	20	100
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	100	100	120	130	140	150	640	300	300	310	330	380	420	460	1,900
25	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	70	70	80	80	80	90	90	420
26	Expensing of multiperiod timber growing costs	280	290	310	320	330	340	360	1,660	290	290	300	310	310	320	320	1,560
27	Investment credit and seven-year amortization for reforestation expenditures	....	....	....	....	....	....	....	....	....	....	....	....	10	10	10	30
28	Tax incentives for preservation of historic structures	170	180	190	200	210	220	230	1,050	20	20	20	20	30	30	30	130
	Agriculture:																
29	Expensing of certain capital outlays	20	20	20	20	20	20	20	100	140	140	140	150	150	160	160	760
30	Expensing of certain multiperiod production costs	10	10	20	20	20	20	20	100	100	100	100	100	100	110	110	520
31	Treatment of loans forgiven for solvent farmers	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
32	Capital gains treatment of certain income	....	....	....	....	....	....	....	....	700	740	780	820	860	900	950	4,310
33	Income averaging for farmers	....	....	....	....	....	....	....	....	50	50	50	50	60	60	60	280
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
	Commerce and housing:																
	Financial institutions and insurance:																
35	Exemption of credit union income	1,550	1,650	1,770	1,890	2,020	2,160	2,280	10,120	....	....	....	....	....	....	....	....
36	Excess bad debt reserves of financial institutions	70	60	50	30	20	10	....	110	....	....	....	....	....	....	....	....
37	Exclusion of interest on life insurance savings	490	530	580	630	690	750	820	3,470	13,460	14,640	15,940	17,360	18,920	20,620	22,510	95,350
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	230	240	250	270	280	300	310	1,410	....	....	....	....	....	....	....	....
40	Small life insurance company deduction	100	100	100	100	100	100	100	500	....	....	....	....	....	....	....	....
	Housing:																
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	200	210	220	250	270	290	1,240	590	600	610	650	740	820	910	3,730
42	Exclusion of interest on rental housing bonds	40	40	40	40	50	60	70	260	120	120	130	130	150	170	190	770
43	Deductibility of mortgage interest on owner-occupied homes	....	....	....	....	....	....	....	....	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	....	....	....	....	....	....	....	....	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	260	270	270	280	280	290	290	1,410	750	765	780	790	810	820	840	4,040
46	Capital gains exclusion on home sales	....	....	....	....	....	....	....	....	18,540	19,095	19,670	20,260	20,870	21,490	22,140	104,430
47	Exception from passive loss rules for $25,000 of rental loss	....	....	....	....	....	....	....	....	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	2,410	2,490	2,600	2,710	2,850	2,960	3,070	14,190	800	820	860	890	940	980	1,010	4,680
49	Accelerated depreciation on rental housing (normal tax method)	340	370	400	420	430	440	450	2,140	4,400	4,770	5,120	5,410	5,610	5,700	5,760	27,600
	Commerce:																
50	Cancellation of indebtedness	....	....	....	....	....	....	....	....	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	....	....	....	....	....	....	....	....	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	....	....	....	....	....	....	....	....	40,520	41,720	42,950	44,220	45,530	46,870	48,260	227,830
53	Capital gains exclusion of small corporation stock	....	....	....	....	....	....	....	....	40	70	90	120	160	200	250	820
54	Step-up basis of capital gains at death	....	....	....	....	....	....	....	....	27,090	28,240	29,370	30,540	31,760	33,030	34,360	159,060
55	Carryover basis of capital gains on gifts	....	....	....	....	....	....	....	....	180	190	200	210	220	230	240	1,100
56	Ordinary income treatment of loss from small business corporation stock sale	....	....	....	....	....	....	....	....	35	40	40	40	40	40	40	200
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	1,650	1,530	1,540	1,360	1,210	1,130	1,230	6,470	1,610	1,640	1,750	1,520	1,650	1,600	1,990	8,510
58	Accelerated depreciation of machinery and equipment (normal tax method)	28,020	30,230	32,400	34,530	36,470	38,110	39,770	181,280	2,640	2,820	3,000	3,150	3,290	3,420	3,560	16,420
59	Expensing of certain small investments (normal tax method)	630	810	880	870	840	810	820	4,220	1,470	1,760	1,810	1,800	1,730	1,670	1,690	8,700
60	Amortization of start-up costs (normal tax method)	120	120	120	130	130	130	130	640	80	80	80	80	90	90	90	430
61	Graduated corporation income tax rate (normal tax method)	6,480	6,700	7,140	7,460	7,540	7,760	7,960	37,860	....	....	....	....	....	....	....	....
62	Exclusion of interest on small issue bonds	70	80	80	90	90	100	110	470	220	220	230	240	270	310	340	1,390

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Transportation:																
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
64	Exclusion of reimbursed employee parking expenses									1,880	1,980	2,090	2,190	2,300	2,420	2,550	11,550
65	Exclusion for employer-provided transit passes									190	220	260	310	350	400	440	1,760
	Community and regional development:																
66	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
67	Exclusion of interest for airport, dock, and similar bonds	160	160	160	180	200	210	240	990	460	470	480	510	580	640	710	2,920
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320								
69	Empowerment zones and enterprise communities	80	80	210	300	310	350	370	1,540	230	240	450	840	900	990	1,110	4,290
70	New markets tax credit			20	50	80	110	160	420		10	70	150	230	330	480	1,260
71	Expensing of environmental remediation costs	130	290	340	280	40	–110	–70	480	30	60	70	50	–10	–20	–10	80
	Education, training, employment, and social services:																
	Education:																
72	Exclusion of scholarship and fellowship income (normal tax method)									1,110	1,120	1,130	1,140	1,150	1,160	1,180	5,760
73	HOPE tax credit									4,210	4,480	4,610	4,280	4,110	4,360	4,630	21,990
74	Lifetime Learning tax credit									2,420	2,570	2,580	2,960	4,490	4,460	4,660	19,150
75	Education Individual Retirement Accounts									20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest									360	370	380	380	390	400	410	1,960
77	Deferral for state prepaid tuition plans									100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	50	60	60	60	70	70	80	340	160	170	170	180	200	220	250	1,020
79	Exclusion of interest on bonds for private nonprofit educational facilities	130	140	140	150	160	190	200	840	390	400	410	430	490	550	610	2,490
80	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290								
81	Exclusion of interest on savings bonds redeemed to finance educational expenses									10	10	10	10	10	10	10	50
82	Parental personal exemption for students age 19 or over									950	1,010	1,070	1,110	1,170	1,220	1,270	5,840
83	Deductibility of charitable contributions (education)	600	600	590	630	620	590	690	3,120	2,130	2,230	2,340	2,460	2,580	2,710	2,850	12,940
84	Exclusion of employer-provided educational assistance									240	260	90					90
	Training, employment, and social services:																
85	Work opportunity tax credit	350	360	270	160	70	30	10	540	40	40	30	20	10			60
86	Welfare-to-work tax credit	40	60	60	40	20	10		130	10	10	10	10				20
87	Exclusion of employer provided child care									670	700	730	760	810	850	900	4,050
88	Adoption assistance									120	130	120	30	30	20	20	220
89	Assistance for adopted foster children									160	190	210	240	250	260	270	1,230
90	Exclusion of employee meals and lodging (other than military)									680	710	740	780	810	850	890	4,070
91	Child credit [3]									19,330	19,310	18,980	18,410	18,000	17,430	16,790	89,610
92	Credit for child and dependent care expenses									2,390	2,360	2,330	2,300	2,280	2,250	2,220	11,380
93	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	30	30	40	40	40	40	40	200
94	Deductibility of charitable contributions, other than education and health	750	740	730	790	760	730	860	3,870	19,400	20,280	21,300	22,370	23,480	24,650	25,920	117,720
95	Exclusion of certain foster care payments									550	570	300	630	660	700	730	3,020
96	Exclusion of parsonage allowances									330	350	370	400	430	460	490	2,150

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Health:																
97	Exclusion of employer contributions for medical insurance premiums and medical care									76,530	84,350	92,230	99,800	107,620	115,770	124,690	540,110
98	Self-employed medical insurance premiums									1,340	1,510	1,760	2,470	3,580	3,900	4,220	15,930
99	Workers' compensation insurance premiums									4,620	4,850	5,090	5,350	5,620	5,900	6,190	28,150
100	Medical Savings Accounts									20	20	30	20	20	20	20	110
101	Deductibility of medical expenses									4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	270	280	290	310	340	370	410	1,720	810	820	840	900	1,010	1,120	1,250	5,120
103	Deductibility of charitable contributions (health)	730	720	710	760	740	710	830	3,750	2,180	2,280	2,390	2,510	2,640	2,770	2,910	13,220
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810								
105	Special Blue Cross/Blue Shield deduction	230	250	280	320	290	280	250	1,420								
	Income security:																
106	Exclusion of railroad retirement system benefits									360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits									5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)									360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners									80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions									120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:																
111	Employer plans									89,120	93,220	97,510	103,010	108,480	114,220	121,990	545,210
112	Individual Retirement Accounts									15,200	15,920	16,600	17,230	17,770	18,220	18,520	88,340
113	Keogh plans									5,500	5,830	6,180	6,540	6,930	7,330	7,750	34,730
	Exclusion of other employee benefits:																
114	Premiums on group term life insurance									1,720	1,750	1,780	1,830	1,860	1,900	1,930	9,300
115	Premiums on accident and disability insurance									200	210	220	230	240	250	260	1,200
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50								
117	Special ESOP rules	940	980	1,020	1,070	1,120	1,180	1,240	5,630	300	310	320	330	340	360	370	1,720
118	Additional deduction for the blind									30	30	30	30	40	40	40	180
119	Additional deduction for the elderly									1,920	1,990	2,060	2,130	2,210	2,260	2,350	11,010
120	Tax credit for the elderly and disabled									30	30	30	30	30	30	30	150
121	Deductibility of casualty losses									230	250	260	280	290	300	320	1,450
122	Earned income tax credit [4]									4,644	4,692	4,963	5,225	5,436	5,688	5,965	27,297
	Social Security:																
	Exclusion of social security benefits:																
123	Social Security benefits for retired workers									18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled									2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors									3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:																
126	Exclusion of veterans death benefits and disability compensation									3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions									70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits									80	90	90	100	100	110	110	510
129	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	30	40	40	170
	General purpose fiscal assistance:																
130	Exclusion of interest on public purpose State and local bonds	5,730	5,840	5,960	6,080	6,200	6,320	6,450	31,010	16,870	17,210	17,550	17,900	18,260	18,630	19,000	91,340
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes									42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090

Table 5–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES [1]—Continued

(In millions of dollars)

		Corporations								Individuals							
		2000	2001	2002	2003	2004	2005	2006	2002–2006	2000	2001	2002	2003	2004	2005	2006	2002–2006
132	Tax credit for corporations receiving income from doing business in U.S. possessions	2,470	2,520	2,560	2,580	2,610	2,630	1,060	11,440	....	....	....	....	....	....	....	....
	Interest:																
133	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,730	5,840	5,960	6,080	6,200	6,320	6,450	31,010	16,870	17,210	17,550	17,900	18,260	18,630	19,000	91,340
	Energy facilities	20	20	20	20	30	40	40	150	70	70	70	80	80	90	100	420
	Water, sewage, and hazardous waste disposal facilities	100	100	100	120	130	140	150	640	300	300	310	330	380	420	460	1,900
	Small-issues	70	80	80	90	90	100	110	470	220	220	230	240	270	310	340	1,390
	Owner-occupied mortgage subsidies	200	200	210	220	250	270	290	1,240	590	600	610	650	740	820	910	3,730
	Rental housing	40	40	40	40	50	60	70	260	120	120	130	130	150	170	190	770
	Airports, docks, and similar facilities	160	160	160	180	200	210	240	990	460	470	480	510	580	640	710	2,920
	Student loans	50	60	60	60	70	70	80	340	160	170	170	180	200	220	250	1,020
	Private nonprofit educational facilities	130	140	140	150	160	190	200	840	390	400	410	430	490	550	610	2,490
	Hospital construction	270	280	290	310	340	370	410	1,720	810	820	840	900	1,010	1,120	1,250	5,120
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	30	30	40	40	170
	Credit for holders of zone academy bonds	10	20	40	50	60	70	70	290	....	....	....	....	....	....	....	....

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Table 5–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2002 PROJECTED REVENUE EFFECT

(In millions of dollars)

Provision	2002	2002–2006
Net exclusion of pension contributions and earnings: Employer Plans	97,510	545,210
Exclusion of employer contributions for medical insurance premiums and medical care	92,230	540,110
Deductibility of mortgage interest on owner-occupied homes	65,750	353,520
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	48,730	276,090
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	42,950	227,830
Accelerated depreciation of machinery and equipment (normal tax method)	35,400	197,700
Step-up basis of capital gains at death	29,370	159,060
Deductibility of State and local property tax on owner-occupied homes	25,570	146,070
Exclusion of interest on public purpose State and local bonds	23,510	122,350
Deductibility of charitable contributions, other than education and health	22,030	121,590
Exclusion of Social Security benefits for retired workers	19,930	106,120
Capital gains exclusion on home sales	19,670	104,430
Child credit	18,980	89,610
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	16,600	88,340
Exclusion of interest on life insurance savings	16,520	98,820
Graduated corporation income tax rate (normal tax method)	7,140	37,860
Deferral of income from controlled foreign corporations (normal tax method)	7,000	39,680
Credit for increasing research activities	6,760	20,740
Net exclusion of pension contributions and earnings: Keough Plans	6,180	34,730
Exclusion of workers' compensation benefits	5,810	31,700
Accelerated depreciation on rental housing (normal tax method)	5,520	29,740
Workers' compensation insurance premiums	5,090	28,150
Earned income tax credit	4,963	27,297
Deductibility of medical expenses	4,870	27,420
Extraterritorial income exclusion	4,810	27,630
HOPE tax credit	4,610	21,990
Exception from passive loss rules for $25,000 of rental loss	4,220	19,020
Exclusion of Social Security benefits for dependents and survivors	4,210	23,830
Credit for low-income housing investments	3,460	18,870
Exclusion of veterans death benefits and disability compensation	3,460	19,140
Accelerated depreciation of buildings other than rental housing (normal tax method)	3,290	14,980
Exclusion of Social Security benefits for disabled	3,160	19,760
Deductibility of charitable contributions (health)	3,100	16,970
Deductibility of charitable contributions (education)	2,930	16,060
Exclusion of income earned abroad by U.S. citizens	2,850	15,940
Expensing of certain small investments (normal tax method)	2,690	12,920
Lifetime Learning tax credit	2,580	19,150
Tax credit for corporations receiving income from doing business in U.S. possessions	2,560	11,440
Inventory property sales source rules exception	2,390	13,190
Credit for child and dependent care expenses	2,330	11,380
Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,190	11,190
Exclusion of reimbursed employee parking expenses	2,090	11,550
Additional deduction for the elderly	2,060	11,010
Exclusion of premiums on group term life insurance	1,780	9,300
Exemption of credit union income	1,770	10,120
Self-employed medical insurance premiums	1,760	15,930
Expensing of research and experimentation expenditures (normal tax method)	1,680	9,410
Special ESOP rules	1,340	7,350
Exclusion of scholarship and fellowship income (normal tax method)	1,130	5,760
Exclusion of interest on hospital construction bonds	1,130	6,840
Parental personal exemption for students age 19 or over	1,070	5,840
Deferral of income from post 1987 installment sales	1,050	5,450
Alternative fuel production credit	860	1,790
Exclusion of interest on owner-occupied mortgage subsidy bonds	820	4,970
Capital gains treatment of certain income	780	4,310
Exclusion of certain allowances for Federal employees abroad	750	4,160
Exclusion of employee meals and lodging (other than military)	740	4,070
Exclusion of employer provided child care	730	4,050
Empowerment zones and enterprise communities	660	5,830
Exclusion of interest for airport, dock, and similar bonds	640	3,910
Expensing of multiperiod timber growing costs	610	3,220
Exclusion of interest on bonds for private nonprofit educational facilities	550	3,330
Deferred taxes for financial firms on certain income earned overseas	540	540
Deferral of interest on U.S. savings bonds	520	2,860
Enhanced oil recovery credit	440	3,280
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	410	2,540
Expensing of environmental remediation costs	410	560
Exclusion of public assistance benefits (normal tax method)	390	2,090
Deductibility of student-loan interest	380	1,960

Table 5–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2002 PROJECTED REVENUE EFFECT—Continued

(In millions of dollars)

Provision	2002	2002–2006
Exclusion of parsonage allowances	370	2,150
Exclusion of railroad retirement system benefits	360	1,800
Excess of percentage over cost depletion, fuels	340	1,720
Exclusion of interest on small issue bonds	310	1,860
Excess of percentage over cost depletion, nonfuel minerals	300	1,610
Work opportunity tax credit	300	600
Exclusion of certain foster care payments	300	3,020
Special Blue Cross/Blue Shield deduction	280	1,420
Exclusion for employer-provided transit passes	260	1,760
Deductibility of casualty losses	260	1,450
Tax exemption of certain insurance companies owned by tax-exempt organizations	250	1,410
Exclusion of interest on student-loan bonds	230	1,360
Exclusion of premiums on accident and disability insurance	220	1,200
Tax incentives for preservation of historic structures	210	1,180
Assistance for adopted foster children	210	1,230
Carryover basis of capital gains on gifts	200	1,100
Amortization of start-up costs (normal tax method)	200	1,070
Deferral for state prepaid tuition plans	180	1,280
Exclusion of interest on rental housing bonds	170	1,030
Expensing of certain capital outlays	160	860
Tax credit for orphan drug research	130	810
Exclusion of military disability pensions	130	670
Expensing of certain multiperiod production costs	120	620
Adoption assistance	120	220
Small life insurance company deduction	100	500
Exclusion of interest on energy facility bonds	90	570
Capital gains exclusion of small corporation stock	90	820
New markets tax credit	90	1,680
Exclusion of employer-provided educational assistance	90	90
Exclusion of GI bill benefits	90	510
Capital gains treatment of royalties on coal	80	420
Exclusion from income of conservation subsidies provided by public utilities	80	430
Capital gains treatment of certain timber income	80	420
Exceptions from imputed interest rules	80	400
Exclusion of veterans pensions	80	440
Expensing of exploration and development costs, fuels	70	490
New technology credit	70	430
Welfare-to-work tax credit	70	150
Exclusion of special benefits for disabled coal miners	70	300
Exemption of certain mutuals' and cooperatives' income	60	320
Tax credit and deduction for clean-fuel burning vehicles	50	....
Income averaging for farmers	50	280
Excess bad debt reserves of financial institutions	50	110
Education Individual Retirement Accounts	50	410
Credit for disabled access expenditures	50	250
Ordinary income treatment of loss from small business corporation stock sale	40	200
Credit for holders of zone academy bonds	40	290
Exclusion of interest on veterans housing bonds	40	220
Investment credit for rehabilitation of structures (other than historic)	30	150
Medical Savings Accounts	30	110
Additional deduction for the blind	30	180
Tax credit for the elderly and disabled	30	150
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Alcohol fuel credits	20	100
Expensing of exploration and development costs, nonfuel minerals	20	100
Deferral of tax on shipping companies	20	100
Treatment of loans forgiven for solvent farmers	10	50
Deferral of gain on sale of farm refiners	10	50
Special alternative tax on small property and casualty insurance companies	10	50
Cancellation of indebtedness	10	70
Exclusion of interest on savings bonds redeemed to finance educational expenses	10	50
Income of trusts to finance supplementary unemployment benefits	10	50
Exclusion of income of foreign sales corporations	....	....
Investment credit and seven-year amortization for reforestation expenditures	....	30

Table 5–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2000
(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	6,360
2	Deferred taxes for financial firms on income earned overseas	1,130
3	Expensing of research and experimentation expenditures (normal tax method)	1,650
4	Expensing of exploration and development costs—fuels	140
5	Expensing of exploration and development costs—nonfuels	10
6	Expensing of multiperiod timber growing costs	340
7	Expensing of certain multiperiod production costs—agriculture	250
8	Expensing of certain capital outlays—agriculture	280
9	Deferral of income on life insurance and annuity contracts	21,220
10	Accelerated depreciation of rental housing (normal tax method)	4,470
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	460
12	Accelerated depreciation of machinery and equipment (normal tax method)	35,760
13	Expensing of certain small investments (normal tax method)	1,140
14	Amortization of start-up costs (normal tax method)	180
15	Deferral of tax on shipping companies	20
16	Deferral for state prepaid tuition plans	110
17	Credit for holders of zone academy bonds	160
18	Credit for low-income housing investments	2,490
19	Exclusion of pension contributions—employer plans	121,100
20	Exclusion of IRA contributions and earnings	5,930
21	Exclusion of contributions and earnings for Keogh plans	4,320
22	Exclusion of interest on public-purpose bonds	19,670
23	Exclusion of interest on non-public purpose bonds	5,170
24	Deferral of interest on U.S. savings bonds	410

Outlay Equivalents

The concept of “outlay equivalents” is another theoretical 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 provision. The outlay-equivalent measure allows the cost of the tax expenditure to be compared with a direct Federal outlay. Outlay equivalents are reported in Table 5–5.

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]
(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
	National Defense								
1	Exclusion of benefits, allowances, and certain pays to armed forces personnel	2,490	2,510	2,540	2,570	2,600	2,620	2,650	12,980
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,460	3,700	3,950	4,170	4,400	4,640	4,910	22,070
3	Exclusion of certain allowances for Federal employees abroad	920	970	1,020	1,070	1,120	1,180	1,240	5,630
4	Exclusion of income of foreign sales corporations	5,990	....	....	....	....	....	....	....
5	Extraterritorial income exclusion	....	6,910	7,410	7,920	8,470	9,050	9,670	42,520
6	Inventory property sales source rules exception	3,340	3,500	3,670	3,860	4,050	4,250	4,460	20,290
7	Deferral of income from controlled foreign corporations (normal tax method)	6,200	6,600	7,000	7,450	7,900	8,400	8,930	39,680
8	Deferred taxes for financial firms on certain income earned overseas	1,190	1,290	540	....	....	....	....	540
	General science, space, and technology:								
9	Expensing of research and experimentation expenditures (normal tax method)	1,680	1,650	1,680	1,770	1,880	1,980	2,100	9,410
10	Credit for increasing research activities	2,510	9,320	10,390	8,300	7,240	4,190	1,790	31,910
	Energy:								
11	Expensing of exploration and development costs, fuels	30	90	90	130	150	140	130	640
12	Excess of percentage over cost depletion, fuels	450	450	460	460	460	470	470	2,320
13	Alternative fuel production credit	1,310	1,230	1,150	730	170	170	170	2,390
14	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
15	Capital gains treatment of royalties on coal	90	100	100	110	110	120	120	560
16	Exclusion of interest on energy facility bonds	130	130	130	140	160	190	210	1,090
17	Enhanced oil recovery credit	410	500	590	710	860	1,030	1,230	4,420
18	New technology credit	50	80	100	120	130	120	120	590

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
19	Alcohol fuel credits [2]	20	20	20	20	20	20	20	100
20	Tax credit and deduction for clean-fuel burning vehicles	80	90	70	40	10	–40	–60	20
21	Exclusion from income of conservation subsidies provided by public utilities	110	110	110	110	120	120	120	580
	Natural resources and environment:								
22	Expensing of exploration and development costs, nonfuel minerals	30	30	30	30	30	30	30	150
23	Excess of percentage over cost depletion, nonfuel minerals	340	350	370	380	400	420	430	2,000
24	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	570	570	590	650	750	830	900	3,720
25	Capital gains treatment of certain timber income	90	100	100	110	110	120	120	560
26	Expensing of multiperiod timber growing costs	740	770	800	820	840	870	890	4,220
27	Investment credit and seven-year amortization for reforestation expenditures	....	....	....	10	10	10	10	40
28	Tax incentives for preservation of historic structures	190	200	210	220	240	250	260	1,180
	Agriculture:								
29	Expensing of certain capital outlays	200	200	200	210	210	220	220	1,060
30	Expensing of certain multiperiod production costs	140	140	150	150	150	150	150	750
31	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	940	990	1,040	1,100	1,150	1,210	1,270	5,770
33	Income averaging for farmers	60	60	60	70	70	70	70	340
34	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
35	Exemption of credit union income	2,310	2,460	2,640	2,820	3,010	3,220	3,400	15,090
36	Excess bad debt reserves of financial institutions	80	70	60	40	20	10	....	130
37	Exclusion of interest on life insurance savings	13,950	15,170	16,520	17,990	19,610	21,370	23,330	98,820
38	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
39	Tax exemption of certain insurance companies owned by tax-exempt organizations	300	310	320	340	360	380	400	1,800
40	Small life insurance company deduction	130	130	130	130	130	130	130	650
	Housing:								
41	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,130	1,140	1,170	1,270	1,440	1,600	1,790	7,270
42	Exclusion of interest on rental housing bonds	230	230	240	240	290	340	390	1,500
43	Deductibility of mortgage interest on owner-occupied homes	60,270	63,190	65,750	68,050	70,470	73,100	76,150	353,520
44	Deductibility of State and local property tax on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
45	Deferral of income from post 1987 installment sales	1,000	1,020	1,040	1,060	1,080	1,100	1,120	5,400
46	Capital gains exclusion on home sales	23,170	23,870	24,590	25,320	26,090	26,870	27,670	130,540
47	Exception from passive loss rules for $25,000 of rental loss	4,720	4,450	4,220	4,000	3,790	3,600	3,410	19,020
48	Credit for low-income housing investments	4,350	4,500	4,690	4,900	5,150	5,360	5,540	25,640
49	Accelerated depreciation on rental housing (normal tax method)	4,740	5,140	5,520	5,830	6,040	6,140	6,210	29,740
	Commerce:								
50	Cancellation of indebtedness	30	20	10	10	10	20	20	70
51	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
52	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	54,030	55,630	57,270	58,960	60,700	62,500	64,340	303,770
53	Capital gains exclusion of small corporation stock	50	90	120	170	220	270	330	1,110
54	Step-up basis of capital gains at death	36,120	37,650	39,160	40,720	42,350	44,040	45,810	212,080
55	Carryover basis of capital gains on gifts	180	190	200	210	220	230	240	1,100
56	Ordinary income treatment of loss from small business corporation stock sale	40	50	50	50	60	60	60	280
57	Accelerated depreciation of buildings other than rental housing (normal tax method)	3,260	3,170	3,290	2,880	2,860	2,730	3,220	14,980
58	Accelerated depreciation of machinery and equipment (normal tax method)	30,660	33,050	35,400	37,680	39,760	41,530	43,330	197,700
59	Expensing of certain small investments (normal tax method)	2,100	2,570	2,690	2,670	2,570	2,480	2,510	12,920
60	Amortization of start-up costs (normal tax method)	200	200	200	210	220	220	220	1,070
61	Graduated corporation income tax rate (normal tax method)	9,960	10,300	10,980	11,470	11,600	11,940	12,250	58,240
62	Exclusion of interest on small issue bonds	410	430	440	480	520	600	670	2,710
	Transportation:								
63	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
64	Exclusion of reimbursed employee parking expenses	2,420	2,560	2,690	2,830	2,970	3,130	3,280	14,900
65	Exclusion for employer-provided transit passes	260	300	360	430	490	550	610	2,440
	Community and regional development:								
66	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
67	Exclusion of interest for airport, dock, and similar bonds	890	900	920	990	1,140	1,250	1,410	5,710
68	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	60	70	70	320
69	Empowerment zones and enterprise communities	310	320	660	1,140	1,210	1,340	1,480	5,830
70	New markets tax credit	....	10	120	250	390	560	810	2,130
71	Expensing of environmental remediation costs	200	440	510	410	40	–160	–100	700
	Education, training, employment, and social services:								
	Education:								
72	Exclusion of scholarship and fellowship income (normal tax method)	1,220	1,230	1,240	1,250	1,270	1,280	1,290	6,330
73	HOPE tax credit	5,400	5,750	5,910	5,490	5,260	5,590	5,930	28,180

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX[1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
74	Lifetime Learning tax credit	3,110	3,290	3,310	3,800	5,750	5,720	5,980	24,560
75	Education Individual Retirement Accounts	20	30	50	60	80	100	120	410
76	Deductibility of student-loan interest	430	440	450	460	470	480	490	2,350
77	Deferral for state prepaid tuition plans	100	130	180	230	250	290	330	1,280
78	Exclusion of interest on student-loan bonds	300	330	330	340	390	420	490	1,970
79	Exclusion of interest on bonds for private nonprofit educational facilities	740	770	790	840	950	1,090	1,200	4,870
80	Credit for holders of zone academy bonds	10	30	50	70	90	100	100	410
81	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
82	Parental personal exemption for students age 19 or over	1,060	1,120	1,180	1,230	1,290	1,350	1,410	6,460
83	Deductibility of charitable contributions (education)	3,770	3,890	4,110	4,310	4,450	4,650	4,970	22,490
84	Exclusion of employer-provided educational assistance	300	320	110	....	....	....	....	110
	Training, employment, and social services:								
85	Work opportunity tax credit	390	400	300	180	80	30	10	600
86	Welfare-to-work tax credit	50	70	70	50	20	10	....	150
87	Exclusion of employer provided child care	890	930	970	1,020	1,080	1,140	1,200	5,410
88	Adoption assistance	150	160	150	40	40	30	20	280
89	Assistance for adopted foster children	180	210	240	270	280	290	300	1,380
90	Exclusion of employee meals and lodging (other than military)	830	870	910	950	990	1,030	1,080	4,960
91	Child credit[3]	25,770	25,750	25,310	24,550	24,000	23,240	23,240	120,340
92	Credit for child and dependent care expenses	3,190	3,150	3,110	3,080	3,340	3,000	2,970	15,500
93	Credit for disabled access expenditures	60	60	70	70	70	70	80	360
94	Deductibility of charitable contributions, other than education and health	27,070	28,280	29,760	31,300	32,810	34,460	36,340	164,670
95	Exclusion of certain foster care payments	630	660	690	730	760	800	840	3,820
96	Exclusion of parsonage allowances	410	440	470	500	530	570	610	2,680
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	98,640	108,840	119,110	129,040	139,290	150,010	161,800	699,250
98	Self-employed medical insurance premiums	1,660	1,870	2,200	3,080	4,480	4,880	5,290	19,930
99	Workers' compensation insurance premiums	5,780	6,060	6,370	6,690	7,020	7,370	7,740	35,190
100	Medical Savings Accounts	30	30	30	30	30	30	20	140
101	Deductibility of medical expenses	4,250	4,560	4,870	5,170	5,480	5,790	6,110	27,420
102	Exclusion of interest on hospital construction bonds	1,540	1,570	1,620	1,750	1,980	2,190	2,470	10,010
103	Deductibility of charitable contributions (health)	4,000	4,140	4,380	4,520	4,650	4,860	5,210	23,620
104	Tax credit for orphan drug research	100	110	130	140	160	180	200	810
105	Special Blue Cross/Blue Shield deduction	320	250	390	460	410	390	350	2,000
	Income security:								
106	Exclusion of railroad retirement system benefits	360	360	360	360	360	360	360	1,800
107	Exclusion of workers' compensation benefits	5,120	5,560	5,810	6,070	6,320	6,600	6,900	31,700
108	Exclusion of public assistance benefits (normal tax method)	360	370	390	400	420	430	450	2,090
109	Exclusion of special benefits for disabled coal miners	80	70	70	60	60	60	50	300
110	Exclusion of military disability pensions	120	120	130	130	130	140	140	670
	Net exclusion of pension contributions and earnings:								
111	Employer plans	104,170	109,010	114,010	120,710	127,260	134,160	143,530	639,670
112	Individual Retirement Accounts	20,310	21,350	22,370	23,320	24,200	24,960	25,560	120,410
113	Keogh plans	6,980	7,400	7,840	8,300	8,780	9,290	9,830	44,040
	Exclusion of other employee benefits:								
114	Premiums on group term life insurance	2,070	2,110	2,150	2,200	2,240	2,290	2,330	11,210
115	Premiums on accident and disability insurance	250	260	270	290	300	320	330	1,510
116	Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10	10	50
117	Special ESOP rules	1,340	1,400	1,460	1,530	1,600	1,690	1,770	8,050
118	Additional deduction for the blind	40	40	40	40	40	40	50	210
119	Additional deduction for the elderly	2,320	2,410	2,490	2,570	2,680	2,730	2,840	13,310
120	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
121	Deductibility of casualty losses	260	270	290	310	320	330	350	1,600
122	Earned income tax credit[4]	5,160	5,214	5,515	5,806	6,062	6,320	6,628	30,331
	Social Security:								
	Exclusion of social security benefits:.								
123	Social Security benefits for retired workers	18,250	19,070	19,930	20,520	21,050	21,840	22,780	106,120
124	Social Security benefits for disabled	2,640	2,880	3,160	3,490	3,910	4,360	4,840	19,760
125	Social Security benefits for dependents and survivors	3,910	4,030	4,210	4,440	4,730	5,070	5,380	23,830
	Veterans benefits and services:								
126	Exclusion of veterans death benefits and disability compensation	3,090	3,290	3,460	3,640	3,820	4,010	4,210	19,140
127	Exclusion of veterans pensions	70	70	80	80	90	90	100	440
128	Exclusion of GI bill benefits	80	90	90	100	100	110	100	500
129	Exclusion of interest on veterans housing bonds	60	60	60	60	60	70	70	320
	General purpose fiscal assistance:								

Table 5–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX [1]—Continued

(In millions of dollars)

		Outlay Equivalents							
		2000	2001	2002	2003	2004	2005	2006	2002–2006
130	Exclusion of interest on public purpose State and local bonds	32,380	33,030	33,690	34,370	35,050	35,750	36,470	175,330
131	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
132	Tax credit for corporations receiving income from doing business in U.S. possessions	3,530	3,600	3,650	3,690	3,720	3,760	1,510	16,330
	Interest:								
133	Deferral of interest on U.S. savings bonds	470	490	520	540	570	600	630	2,860
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,140	23,920	25,570	27,220	29,080	30,980	33,220	146,070
	Nonbusiness State and local taxes other than on owner-occupied homes	42,650	45,730	48,730	51,780	55,030	58,390	62,160	276,090
	Exclusion of interest on State and local bonds for:								
	Public purposes	32,380	33,030	33,690	34,370	35,050	35,750	36,470	175,330
	Energy facilities	130	130	130	140	160	190	210	1,090
	Water, sewage, and hazardous waste disposal facilities	570	570	590	650	750	830	900	3,720
	Small-issues	410	430	440	480	520	600	670	2,710
	Owner-occupied mortgage subsidies	1,130	1,140	1,170	1,270	1,440	1,600	1,790	7,270
	Rental housing	230	230	240	240	290	340	390	1,500
	Airports, docks, and similar facilities	890	900	920	990	1,140	1,250	1,410	5,710
	Student loans	300	330	330	340	390	420	490	1,970
	Private nonprofit educational facilities	740	770	790	840	950	1,090	1,200	4,870
	Hospital construction	1,540	1,570	1,620	1,750	1,980	2,190	2,470	10,010
	Veterans' housing	60	60	60	60	60	70	70	320
	Credit for holders of zone academy bonds	10	30	50	70	90	100	100	410

[1] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of ''income'' that is larger in scope than is ''income'' as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

[2] 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: 2000 $840; 2001 $880; 2002 $930; 2003 $950; 2004 $960; 2005 $960; and in 2006 $960.

[3] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $810; 2001 $790; 2002 $760; 2003 $720; 2004 $660; 2005 $630; and in 2006 $590.

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2000 $26,099; 2001 $25,923; 2002 $26,983; 2003 $27,875; 2004 $28,545; 2005 $29,373; and in 2006 $30,165.

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 $10 million. Provisions with estimates that rounded to zero in each year are not included in the table.

Tax Expenditure Baselines

A tax expenditure is an exception to the baseline provisions of the tax structure. The 1974 Congressional Budget Act did not specify the baseline provisions of the tax law. Deciding whether provisions are 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 is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but 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 only when it is 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 meas-

uring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

Although 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.[1] 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.[2]
- *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.

Performance Measures and the Economic Effects of Tax Expenditures

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. However, tax expenditures may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA[3] calls on the Executive branch to undertake a series of analyses to assess the effect of specific tax expenditures on the achievement of agencies' performance objectives.

The Executive Branch is continuing to focus on the availability of data needed to assess the effects of the tax expenditures designed to increase savings. Treasury's Office of Tax Analysis and Statistics of Income Division (IRS) have developed the specifications for a new sample of individual income tax filers as one part of this effort. This new "panel" sample will follow the same taxpayers over a period of at least ten years. The first year of this panel sample will be drawn from tax returns filed in 2000 for tax year 1999. The sample will capture the changing demographic and economic circumstances of individuals and the effects of changes in tax law over an extended period of time. Data from the sample will therefore permit more extensive, and better, analyses of many tax provisions than can be performed using only annual ("cross-section") data. In particular, data from this panel sample will enhance our ability to analyze the effect of tax expenditures

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

[2] 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. In addition, costs of earning income may be limited under the alternative minimum tax.

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

designed to increase savings. Other efforts by OMB, Treasury, and other agencies to improve data available for the analysis of savings tax expenditures will continue over the next several years.

Comparison 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.[4] 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 cases. In addition, some tax expenditures actually simplify the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used—e.g., deductions; credits; exemptions; deferrals; floors; ceilings; phase-ins; 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 economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, targeting personal exemptions and credits can complicate filing and decisionmaking. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. 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 may not receive the same level of scrutiny afforded to other programs.

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 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 more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor)—generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures, because they can generally be changed by the executive branch without legislation. Like tax expenditures, regulations often rely largely 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, although 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 Federal outlays or receipts. Thus, like tax expenditures, they may escape the type of scrutiny that outlay programs receive. However, most regulations are subjected to a formal benefit-cost analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

Some policy objectives are achieved using multiple approaches. For example, minimum wage legislation, the earned income tax credit, and the food stamp program are regulatory, tax expenditure, and direct outlay programs, respectively, all having the objective of improving the economic welfare of low-wage workers.

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., the exclusion for up to $500,000 of capital gains on home sales); 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

[4] Although this section focuses upon tax expenditures under the income tax, tax expenditures also arise under the unified transfer, payroll, and excise tax systems. Such provisions 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.

above, may have more than one objective. For example, accelerated depreciation may encourage investment. 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). Effects on the incomes of members of particular groups 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 provisions. In addition, such assessments can raise significant challenges in economic modeling.

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 service in a combat zone or qualified hazardous duty area 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 goals such as promoting tax neutrality. These include the exclusion for income earned abroad by non-governmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

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 (e.g., research spending, exploration activity, equipment) might 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 size of tax expenditure. Measures could also indicate the 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 tax expenditures 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 exclusion for 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 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 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 grants 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 pooling of risks. 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.

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). 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 provided at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. 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 earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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, although 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. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported upon in this chapter follow. These descriptions relate to current law and do not reflect proposals made elsewhere in the Budget.

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 service in a combat zone or qualified hazardous duty area are excluded from income subject to tax.

International Affairs

2. ***Income earned abroad.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement in 2000 may exclude up to $76,000 in foreign earned income from U.S. taxes. The exclusion increases to $78,000 in 2001 and to $80,000 in 2002. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($65,983 in 2000).

3. ***Exclusion of certain allowances for federal employees abroad.***—U.S. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income certain special allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education, and the cost of travel to and from the United States.

4. ***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. The FSC provisions were generally repealed by the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, effective for transactions after September 30, 2000.

5. ***Extraterritorial income exclusion***[5]***.***—For purposes of calculating U.S. tax liability, a taxpayer may exclude from gross income the qualifying foreign trade income attributable to foreign trading gross receipts. The exclusion generally applies to income from the sale or lease of qualifying foreign trade property and certain types of services income. The exclusion is generally available for transactions entered into after September 30, 2000.

6. ***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 allocates earnings between the United States and abroad equally, which may increase foreign source income use of foreign tax credits.

7. ***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 considered to be 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.

8. ***Exceptions under subpart F for active financing income.***—Consistent with the rules applicable to U.S.-controlled foreign corporations, financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2001 can be deferred.

General Science, Space, and Technology

9. ***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.

10. ***R&E credit.***—The research and experimentation (R&E) 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" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative credit regime. Under the alternative credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. The credit applies to research conducted before July 1, 2004 and extends to research conducted in Puerto Rico and the U.S. possessions.

Energy

11. ***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

[5] The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of "income" that is larger in scope than is "income" as defined under general U.S. income tax principles. For that reason, the tax expenditure estimates include, for example, estimates related to the exclusion of extraterritorial income, as well as other exclusions, notwithstanding that such exclusions define income under the general rule of U.S. income taxation.

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.

12. ***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.

13. ***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.

14. ***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.

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

16. ***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.

17. ***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.

18. ***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, biomass, and poultry waste facilities. The renewable resources credit applies only to electricity produced by a facility placed in service on or before December 31, 2001.

19. ***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 2000; 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.

20. ***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.

21. ***Exclusion of utility conservation subsidies.***—Non-business customers can exclude from gross income subsidies received from public utilities for expenditures on energy conservation measures.

Natural Resources and Environment

22. ***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.

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

24. ***Sewage, water, solid and hazardous waste facility 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.

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

26. ***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.

27. ***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 may be amortized is not reduced by any of the allowable investment credit.

28. ***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

29. ***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.

30. ***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.

31. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, a 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 reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

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

33. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming.

34. ***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.

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.

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

36. ***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.

37. ***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.

38. ***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 $2.1 million of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

39. ***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.

40. ***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.

41. ***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 these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds, is $50 per capita ($150 million minimum) per State in 2000, $62.50 per capita ($187.5 million minimum) in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle homebuyers 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.

42. ***Rental housing bonds.***—Interest earned on State and local government bonds used to finance mul-

tifamily 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.

43. ***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.

44. ***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.

45. ***Installment sales.***—Dealers in real and personal property (i.e., sellers who 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 million is, therefore, a tax expenditure.

46. ***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.

47. ***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.

48. ***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 in 2000. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

49. ***Accelerated depreciation of rental property.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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, a 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.

50. ***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.

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

52. ***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 most assets held for more than 1 year, the top capital gains tax rate is 20 percent. For assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years is 18 percent. On January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized.

For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate is 10 percent. After December 31, 2000,

the top capital gains tax rate for assets held by these taxpayers for more than 5 years is 8 percent.

53. ***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.

54. ***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.

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

56. ***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.

57. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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.

58. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to 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.

59. ***Expensing of certain small investments.***—In 2000, qualifying investments in tangible property up to $20,000 can be expensed rather than depreciated over time. The expensing limit increases to $24,000 in 2001 and to $25,000 in 2003. To the extent that qualifying investment during the year exceeds $200,000, the amount eligible for expensing is decreased. In 2000, the amount expensed is completely phased out when qualifying investments exceed $220,000.

60. ***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.

61. ***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 $75,000. 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.

62. ***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

63. ***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.

64. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2000, the maximum amount of the parking exclusion is $175 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

65. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in

lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2000, the maximum amount of the exclusion is $65 (indexed) per month. In 2002, the maximum amount of the exclusion increases to $100 (indexed) per month.

Community and Regional Development

66. ***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.

67. ***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.

68. ***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.

69. ***Empowerment zones, enterprise communities, and renewal 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, accelerated depreciation, and certain capital gains incentives. In addition, certain first-time buyers of a principal residence in the District of Columbia can receive a tax credit on homes purchased on or before December 31, 2003, and investors in certain D.C. property can receive a capital gains break. The Community Renewal Tax Relief Act of 2000 created the renewal communities tax benefits, which begin on January 1, 2002 and expire on December 31, 2009. The Act also created additional empowerment zones, increased the tax benefits for empowerment zones, and extended the expiration date of (1) empowerment zones from December 31, 2004 to December 31, 2009, and (2) the D.C. homebuyer credit from December 31, 2001 to December 31, 2003.

70. ***New markets tax credit.***—Taxpayers who invest in a community development entity (CDE) after December 31, 2000 are eligible for a tax credit. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2007. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm whose primary mission is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The Community Renewal Tax Relief Act of 2000 created the new markets tax credit.

71. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, rather than capitalize the costs, even though the expenses may increase the value of the property significantly. The expensing only applies to clean-up costs incurred on or before December 31, 2003. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2001 to December 31, 2003. The Act also expanded the number of qualified sites.

Education, Training, Employment, and Social Services

72. ***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).

73. ***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).

74. ***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 before January 1, 2003, 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.

75. ***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 sin-

gles). 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.

76. ***Student-loan interest.***—In 2000, taxpayers may claim an above-the-line deduction of up to $2,000 on interest paid on an education loan. The maximum deduction increases to $2,500 in 2001. Interest may only be deducted for the first five years in which interest payments 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).

77. ***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.

78. ***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.

79. ***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.

80. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2001.

81. ***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 $81,100 and $111,100 ($54,100 and $69,100 for singles) in 2000.

82. ***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.

83. ***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.

84. ***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 on or before December 31, 2001.

85. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2001 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent for employment of less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

86. ***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 on or before December 31, 2001.

87. ***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.

88. ***Assistance for adopted foster children.***—Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income.

89. ***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). The credit is phased-out ratably for taxpayers with modified AGI between $75,000 and $115,000. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit. Both of the current tax benefits expire at the end of 2001, except for the tax credit for expenses associated with special needs adoptions, which is permanent.

90. ***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.

91. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $500 child credit. 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.

92. ***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 single parents and by divorced or separated parents who have custody of children. 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.

93. ***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.

94. ***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.

95. ***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.

96. ***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

97. ***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.

98. ***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 60 percent in 2000 and 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter.

99. ***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.

100. ***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, 2002. The Community Renewal Tax Relief Act of 2000 extended the expiration date from December 31, 2000 to December 31, 2002.

101. ***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.

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

103. ***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.

104. ***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.

105. ***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

106. ***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.

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

108. ***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.

109. ***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.

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

111. ***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.

112. ***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 federal government's Thrift Savings Plan).

In 2000, an employee could exclude up to $10,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k). In 2000, 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 $52,000 ($32,000 for singles). The AGI limit increases annually until it reaches $80,000 in 2007 ($50,000 in 2005 for singles). In 2000, the IRA deduction is phased out for taxpayers with AGI between $52,000 and $62,000 ($32,000 and $42,000 for singles). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 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 59½, (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).

113. ***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.

114. ***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.

115. ***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.

116. ***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.

117. ***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.

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

119. ***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.

120. ***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.

121. ***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.

122. ***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 $6,920 of earned income in 2000. The credit is 40 percent of the first $9,720 of income for a family with two or more qualifying children. When the taxpayer's income exceeds $12,690, 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 $27,413 of modified adjusted gross income ($31,152 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 2000, the credit is 7.65 percent of the first $4,610 of earned income. When the taxpayer's income exceeds $5,770, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,380 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

123. ***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.

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

125. ***Social Security benefits for dependents and survivors.***—Benefit payments from the Social Security Trust Fund for dependents and survivors are excluded from a beneficiary's gross income.

Veterans Benefits and Services

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

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

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

129. ***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

130. ***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), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

131. ***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.

132. ***Business income earned in U.S. possessions.***—U.S. corporations operating in a U.S. possession (e.g., Puerto Rico) can claim a credit against some or all of their U.S. tax liability on possession business income. The credit expires December 31, 2005.

Interest

133. ***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 (indexed) 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 2000, this credit allows each taxpayer to make a $675,000 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 2006.[6]
- *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.

[6] An additional tax, at a flat rate of 55 percent, is imposed on lifetime, generation-skipping transfers in excess of $1 million (indexed). 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.

Tax Expenditures by Function

The estimates of tax expenditures in the Federal unified transfer tax for fiscal years 2000–2006 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 $300,000 in 2000 and increases to $400,000 in 2001 and to $500,000 in 2002.

Agriculture

2. ***Special-use valuation of farms.***—In 2000, up to $750,000 (indexed) 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.

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 gross 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. A 2-percent interest rate (non-deductible) is applied to the first $1 million (indexed) of deferred taxable value.

Commerce and Housing

4. ***Special-use valuation of closely-held businesses.***—The special-use valuation rule available for 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 cannot exceed $675,000. The combined value of the exclusion and the exemption value of the unified credit cannot exceed $1.3 million. 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 under the estate tax.

8. ***Charitable contributions, other than education and health.***—Bequests to charitable, religious, and certain other nonprofit organizations can be deducted under the estate tax.

Health

9. ***Charitable contributions to health institutions.***—Bequests to health institutions can be deducted under the estate tax.

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. ESTIMATES FOR TAX EXPENDITURES IN THE FEDERAL UNIFIED TRANSFER TAX

(In millions of dollars)

	Description	2000	2001	2002	2003	2004	2005	2006	2002–2006
	Natural Resources and Environment:								
1	Donations of conservation easements	....	....	....	10	10	10	20	50
	Agriculture:								
2	Special use valuation of farm real property	110	110	120	120	130	130	130	630
3	Tax deferral of closely held farms	....	....	10	10	20	20	30	90
	Commerce:								
4	Special use valuation of real property used in closely held businesses	10	10	10	10	10	10	10	50
5	Tax deferral of closely held business	–20	30	60	80	100	130	140	510
6	Exclusion for family owned businesses	130	140	150	160	170	170	170	820
	Education, training, employment, and social services:								
7	Deduction for charitable contributions (education)	780	880	960	990	1,030	1,060	1,100	5,140
8	Deduction for charitable contributions (other than education and health)	2,300	2,600	2,830	2,930	3,050	3,120	3,260	15,190
	Health:								
9	Deduction for charitable contributions (health)	700	800	870	900	930	960	1,000	4,660
	General government:								
10	Credit for State death taxes	6,420	6,720	7,030	7,340	7,660	8,000	8,350	38,380