6. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." The Act suggests that tax expenditures are exceptions to some norm or standard tax concept that is not specified in the law. Hence, different analyses may use different baseline tax structures; indeed, the budget presentation here provides tax expenditure estimates measured against more than one baseline.

Due, in part, to the degree of arbitrariness in the tax expenditure baseline, the Administration believes the meaningfulness of tax expenditure estimates is uncertain and that the "tax expenditure" presentation can be improved by consideration of alternative or additional tax bases. A description of an ongoing Treasury study to reevaluate the tax expenditure concept is presented at the beginning of this chapter. The tax expenditure estimates and related discussion following the description of this study, however, are based on materials and formats developed and included in previous budgets. Tax expenditure estimates under the unified transfer (i.e., estate and gift) tax have been eliminated from the presentation because there is no generally accepted normal baseline for transfer taxes and this tax has been repealed under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

The largest reported tax expenditures tend to be associated with the individual income tax. For example, sizeable deferrals, 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. Reported tax expenditures under the corporate income tax tend to be related to timing differences in 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.

Each tax expenditure estimate in this chapter was calculated assuming other parts of the tax code remained unchanged. The estimates would be different if all tax expenditures or major groups of tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, 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.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2001–2007 using three methods of accounting: revenue effects, outlay equivalent, and present value. The present value approach provides estimates of the revenue effects for tax expenditures that involve deferrals of tax payments into the future or have similar long-term effects.

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.

FUTURE REVISIONS TO THE TAX EXPENDITURE PRESENTATION

Policymakers and researchers have long recognized that certain income tax code provisions have policy purposes other than simply raising revenue and that it is useful to understand better the nature of these provisions. It is important to know the amounts of revenue associated with them, whether they are achieving desired results, and their consequences for the economy. The answers to these questions are important simply as a source of information, but also so that policymakers and the public can review these features of the income tax regularly to see if change is warranted. Thus it was that in 1974 the Congress mandated as part of the Congressional Budget Act of 1974 that the annual Federal budget presentation include a list of "tax expenditures", where tax expenditures were defined as:

> ...those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability....

Though imperfect, the tax expenditure budget has expanded our understanding of policy programs operating through the Federal income tax and, more generally, the workings of the Federal income tax.

The complexity of our economy and society on the one hand, and the complexity of the income tax on the other, suggest the need for a variety of analyses to understand their interaction better. The Treasury Department has begun an effort to review the tax expenditure presentation, and will be considering possible revisions and improvements in methodology and approach. The need for this effort was raised in the President's Fiscal Year 2002 budget submission, which noted that the current tax expenditure analysis was developed relative to an arbitrary tax base and that:

> Because of the breadth of this arbitrary tax base, the Administration believes that the concept of "tax expenditure" is of questionable analytic value.[1]

This review is intended to improve the quality and range of information available regarding the Federal income tax and its effects on the economy. The Treasury Department's efforts in this area will continue over the coming year, assisted by public debate and comment.

The Need for Change

The definition of the baseline against which tax expenditures are measured is crucial to the definition and calculation of tax expenditures. For purposes of calculating tax expenditures, the 1974 Budget Act did not specify the provisions of the baseline tax law, which, quoting further from the Fiscal Year 2002 budget, means that: "Deciding whether provisions are exceptions (from the normal baseline), therefore, is a matter of judgement." As the normal baseline and deviations from the baseline are constructed from a set of potentially subjective judgements, differences of opinion can arise as to the correct classification of specific provisions of the tax code. While the normal baseline follows a theoretically appealing measure of a comprehensive income tax in many ways, it deviates in other important ways. These deviations may reflect judgements along a number of dimensions, including administrative concerns, political judgements, social policy, and historical methods of taxing income. But these deviations inject a degree of subjectivity that can limit the value of the underlying analysis.

One problem with injecting subjective elements into the definition of the baseline income tax is that common notions of what constitutes a "normal" income tax will change over time. For example, although the tax exemption for employer-provided pensions is labeled a tax expenditure, the growing presence of tax-deferred savings vehicles in the tax code suggests that these may today be part of "normal" income tax circa 2002. It is not clear, however, whether the "normal" income tax of 2002 is more appropriate than that in place in any other year if one is interested in better understanding deviations of the current income tax from a more objective standard of a comprehensive income tax.

A highly subjective baseline also may not inform policymakers and the public about those aspects of social or economic policy that are implemented through the tax code. The Federal income tax contains many provisions for providing income support for lower-income citizens. Examples include the Earned Income Tax Credit, the Work Opportunity Credit, and the Child Tax Credit. Each of these provisions is appropriately labeled a tax expenditure in the current tax expenditure presentation. The personal exemption, which cannot be claimed by higher-income taxpayers because of a phase-out of the exemption, however, is not presently labeled a tax expenditure although it can also be viewed as a component of the income support policies effected through the income tax. In many other ways, the "normal tax" baseline may fail to capture the extent to which the tax system serves such programmatic purposes.

Finally, the public and policymakers are interested in the tax subsidies and excises imbedded in the tax code and their effects on individual behavior and on economic activity. Tax subsidies and excises arise when the relative prices of goods, services, or activities are distorted by the tax system. A highly subjective "normal tax" may shed little light on these issues.

Because of the controversy that accompanies the existing "normal tax" concept, it may be appropriate to reconsider a comprehensive income tax as a baseline for the tax expenditure budget. Comprehensive income is a well-accepted theoretical concept, and so avoids some subjectivity that plagues the "normal tax" baseline. A comprehensive measure of income, however, would not eliminate all contentious issues. Any practical implementation of a comprehensive tax base would involve judgements, e.g., about which items of theoretical income or expense are too abstract or difficult to estimate to include in the baseline, but that other analysts may see as necessary.

Focus of the Reconsideration and Revision Effort

The effort to improve the tax expenditure presentation will focus on three aspects. The first relates to the definition of an income tax or standard against which tax expenditures are identified and measured as discussed above. The study will consider redefining the baseline income concept to be more consistent with a comprehensive income tax base, as well as other alternative definitions of income.

The study will also consider issues involved in estimating "negative" tax expenditures in addition to the conventional positive tax expenditures currently reported in the Budget. A negative tax expenditure arises whenever a tax provision causes a taxpayer to pay more tax than would be consistent with the baseline income tax. Negative tax expenditures have not been identified and calculated in the past, in part because they did not appear to relate to the original purpose of the tax expenditure analysis to identify implicit spending programs operating through the tax system. Nevertheless, negative tax expenditures provide an important additional perspective and may offer a useful source of information to analysts and policy makers.

Academics and tax specialists have studied intensively whether the United States should adopt a con-

[1] Analytical Perspectives, Budget of the United States, Fiscal Year 2002, Chapter 5.

sumption tax at the Federal level, either as a source of additional revenue, or in place of some or all of the current sources of Federal revenue. Though the existing Federal individual income tax is thought of as a tax on income, in many respects it has evolved into a hybrid tax containing some elements consistent both with a comprehensive income tax and a consumption tax, as well as many elements consistent with neither an income nor a consumption tax. Therefore, the third aspect of the Treasury's effort will be to consider estimating tax expenditures relative to a hypothetical consumption tax, as well as relative to an income tax. This would allow a comparison of the Federal income tax vis-à-vis the two baseline systems. It would also serve to give additional perspective on the tax expenditure analysis by highlighting those provisions in the Federal income tax that may give rise to a tax expenditure or negative expenditure in one system but not in the other.

When completed, this review can significantly improve the overall understanding of the effects of the Federal income tax on the economy. For example, reconsideration of the income tax baseline is intended to provide a baseline definition that can better capture the numerous ways in which the tax system influences economic behavior relative to a comprehensive income tax system. Similarly, the definition and calculation of negative tax expenditures can provide useful new information about those activities subject to a tax surcharge relative to the baseline tax. Viewing these negative tax expenditures alongside the traditional tax expenditure presentation can provide important context for the overall tax expenditure budget. The calculation of tax expenditures and negative tax expenditures relative to a consumption tax budget can provide further context for the traditional tax expenditure presentation while providing important new information about the effects of the tax system on the economy. Finally, a consumption tax base analysis can help illuminate some of the central issues that would arise in any effort to enact a Federal consumption tax.

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2001. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2001. 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 effects for tax expenditures for fiscal years 2001–2007 are displayed according to the budget's functional categories in Table 6–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the 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 effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 6–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of 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 provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 6–3 ranks the major tax expenditures by the size of their FY 2003 revenue effect.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 6–1, 6–2, and 6–3 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. Such indirect effects are not reflected in the estimates.

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 6–1 are the totals of individual and corporate income tax revenue effects reported in Table 6–2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the estimates in Table 6–1 (as well as those in Table 6–5, which are also based on summing individual and corporate estimates) should be regarded as approximations.

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 6–4. 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 effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement 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 6–4 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 2001 that cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2001 would cause a deferral of tax payments on wages in 2001 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2001 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 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,160	2,190	2,210	2,240	2,260	2,290	2,310	11,310
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,450	2,540	2,660	2,690	2,760	2,810	3,170	14,090
3	Exclusion of certain allowances for Federal employees abroad	760	800	840	880	920	960	1,020	4,620
4	Extraterritorial income exclusion	4,490	4,820	5,150	5,510	5,890	6,290	6,730	29,570
5	Inventory property sales source rules exception	1,400	1,470	1,540	1,620	1,700	1,790	1,880	8,530
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	0	0	0	0	0	0
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	2,020	1,780	2,380	2,880	3,400	3,910	4,160	16,730
9	Credit for increasing research activities	5,370	6,010	4,590	4,020	2,330	990	410	12,350
	Energy:								
10	Expensing of exploration and development costs, fuels	50	60	70	90	90	100	100	450
11	Excess of percentage over cost depletion, fuels	250	260	270	290	300	310	320	1,490
12	Alternative fuel production credit	900	850	410	130	130	130	130	930
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	100	100	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	90	90	100	120	130	140	150	640
16	Enhanced oil recovery credit	310	360	440	530	640	760	910	3,280
17	New technology credit	60	80	100	100	100	90	90	480
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	50	50	50	20	–10	–50	–50	–40
20	Exclusion from income of conservation subsidies provided by public utilities	70	70	70	70	70	70	60	340
	Natural resources and environment:								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	250	260	270	290	300	300	310	1,470
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	400	420	440	480	530	580	630	2,660
24	Capital gains treatment of certain timber income	100	100	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	360	360	370	380	390	400	410	1,950
26	Tax incentives for preservation of historic structures	180	200	210	220	230	240	250	1,150
	Agriculture:								
27	Expensing of certain capital outlays	170	170	170	170	170	170	170	850
28	Expensing of certain multiperiod production costs	120	130	130	130	120	120	120	620
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	990	1,040	1,100	1,160	1,220	1,290	1,360	6,130
31	Income averaging for farmers	70	70	70	70	80	80	80	380
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,000	1,070	1,150	1,230	1,320	1,420	1,530	6,650
34	Excess bad debt reserves of financial institutions	60	50	30	20	10	0	0	60
35	Exclusion of interest on life insurance savings	16,290	17,710	19,250	20,940	22,780	24,790	26,930	114,690
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	250	260	280	290	300	1,380
38	Small life insurance company deduction	100	100	100	100	100	100	100	500
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	800	830	870	960	1,050	1,140	1,240	5,260
40	Exclusion of interest on rental housing bonds	160	170	180	200	220	240	260	1,100
41	Deductibility of mortgage interest on owner-occupied homes	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	1,040	1,050	1,080	1,100	1,120	1,140	1,160	5,600
44	Capital gains exclusion on home sales	19,090	19,670	20,260	20,860	21,490	22,140	22,800	107,550
45	Exception from passive loss rules for $25,000 of rental loss	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	3,220	3,330	3,460	3,630	3,810	3,980	4,130	19,010
47	Accelerated depreciation on rental housing (normal tax method)	5,190	5,440	5,710	5,790	5,800	5,720	5,800	28,820
	Commerce:								
48	Cancellation of indebtedness	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	67,800	61,810	60,200	56,990	56,180	50,670	49,880	273,920
51	Capital gains exclusion of small corporation stock	70	100	130	160	210	250	300	1,050
52	Step-up basis of capital gains at death	26,540	27,610	28,710	29,860	31,050	32,300	33,590	155,510
53	Carryover basis of capital gains on gifts	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	40	40	40	50	50	50	50	240
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,540	4,560	4,240	3,960	3,800	4,160	4,880	21,040

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
56	Accelerated depreciation of machinery and equipment (normal tax method)	37,860	37,130	36,480	36,790	37,430	38,520	40,930	190,150
57	Expensing of certain small investments (normal tax method)	1,670	1,430	1,420	1,390	1,360	1,480	1,720	7,370
58	Amortization of start-up costs (normal tax method)	130	160	200	240	250	270	270	1,230
59	Graduated corporation income tax rate (normal tax method)	4,940	5,590	6,210	6,580	7,120	7,450	7,880	35,240
60	Exclusion of interest on small issue bonds	310	310	330	360	390	430	470	1,980
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	1,980	2,090	2,190	2,300	2,420	2,550	2,670	12,130
63	Exclusion for employer-provided transit passes	220	280	360	410	470	540	600	2,380
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	30	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	630	640	680	750	820	890	980	4,120
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330
67	Empowerment zones, Enterprise communities, and Renewal communities	380	730	1,130	1,170	1,280	1,410	1,580	6,570
68	New markets tax credit	10	90	190	290	430	610	830	2,350
69	Expensing of environmental remediation costs	80	100	100	20	–20	–10	–10	80
	Education, training, employment, and social services:								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,210	1,200	1,210	1,240	1,330	1,380	1,390	6,550
71	HOPE tax credit	4,130	4,110	3,520	2,880	2,930	2,730	2,900	14,960
72	Lifetime Learning tax credit	2,370	2,290	2,360	3,140	2,980	2,740	2,960	14,180
73	Education Individual Retirement Accounts	30	50	80	130	220	330	470	1,230
74	Deductibility of student-loan interest	390	450	640	660	680	700	720	3,400
75	Deduction for higher education expenses	0	430	2,290	2,960	3,710	3,010	0	11,970
76	State prepaid tuition plans	190	270	340	400	460	530	590	2,320
77	Exclusion of interest on student-loan bonds	230	230	240	260	290	310	350	1,450
78	Exclusion of interest on bonds for private nonprofit educational facilities	540	550	580	640	700	760	830	3,510
79	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	1,010	1,070	1,120	1,170	1,230	1,280	1,340	6,140
82	Deductibility of charitable contributions (education)	3,830	3,980	4,200	4,440	4,600	4,840	5,030	23,110
83	Exclusion of employer-provided educational assistance	260	410	500	530	560	590	620	2,800
	Training, employment, and social services:								
84	Work opportunity tax credit	300	230	140	60	30	10	0	240
85	Welfare-to-work tax credit	90	70	40	20	10	0	0	70
86	Employer provided child care exclusion	720	740	770	810	930	1,020	1,080	4,610
87	Employer-provided child care credit	0	40	90	130	150	150	160	680
88	Assistance for adopted foster children	190	220	250	260	270	280	290	1,350
89	Adoption credit and exclusion	130	140	220	450	500	540	560	2,270
90	Exclusion of employee meals and lodging (other than military)	710	740	780	810	850	890	930	4,260
91	Child credit[2]	19,840	19,760	19,680	19,550	20,550	21,530	21,240	102,550
92	Credit for child and dependent care expenses	2,670	2,610	2,670	2,960	2,700	2,150	1,920	12,400
93	Credit for disabled access expenditures	50	50	50	50	60	60	60	280
94	Deductibility of charitable contributions, other than education and health	30,150	30,810	32,080	33,830	35,190	36,890	38,290	176,280
95	Exclusion of certain foster care payments	500	510	520	530	540	570	610	2,770
96	Exclusion of parsonage allowances	350	370	400	420	450	470	490	2,230
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	82,800	90,910	99,260	106,940	115,380	124,050	134,960	580,590
98	Self-employed medical insurance premiums	1,520	1,730	2,420	3,570	3,870	4,170	4,430	18,460
99	Workers' compensation insurance premiums	4,730	4,870	5,080	5,230	5,410	5,570	5,790	27,080
100	Medical Savings Accounts	20	20	20	20	20	20	20	100
101	Deductibility of medical expenses	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	1,100	1,130	1,190	1,310	1,440	1,570	1,700	7,210
103	Deductibility of charitable contributions (health)	4,010	4,180	4,420	4,690	4,850	5,100	5,320	24,380
104	Tax credit for orphan drug research	140	150	170	190	220	240	270	1,090
105	Special Blue Cross/Blue Shield deduction	270	300	340	310	300	270	300	1,520
	Income security:								
106	Exclusion of railroad retirement system benefits	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:								
111	Employer plans	42,070	48,070	53,080	54,500	55,630	58,980	63,320	285,510
112	401(k) plans	44,080	52,960	59,510	62,770	65,290	69,230	73,320	330,120

Table 6–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(In millions of dollars)

		Total from corporations and individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
113	Individual Retirement Accounts	18,680	18,090	18,660	19,050	18,930	19,230	18,330	94,200
114	Low and moderate income savers credit	0	550	1,960	1,940	1,900	1,800	1,280	8,880
115	Keogh plans	6,160	6,520	6,770	7,040	7,250	7,490	7,730	36,280
	Exclusion of other employee benefits:								
116	Premiums on group term life insurance	1,750	1,780	1,800	1,830	1,860	1,890	1,920	9,300
117	Premiums on accident and disability insurance	210	220	230	240	250	260	270	1,250
118	Small business retirement plan credit	0	20	50	90	120	130	150	540
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150
120	Special ESOP rules	1,290	1,340	1,420	1,490	1,570	1,640	1,730	7,850
121	Additional deduction for the blind	40	40	40	40	40	40	40	200
122	Additional deduction for the elderly	1,970	1,890	1,950	2,060	2,100	2,150	2,050	10,310
123	Tax credit for the elderly and disabled	30	30	30	30	30	30	30	150
124	Deductibility of casualty losses	210	250	310	360	410	450	490	2,020
125	Earned income tax credit [3]	4,940	4,370	4,800	4,930	5,100	5,180	5,390	25,400
	Social Security:								
	Exclusion of social security benefits:								
126	Social Security benefits for retired workers	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:								
129	Exclusion of veterans death benefits and disability compensation	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	40	40	40	40	50	50	60	240
	General purpose fiscal assistance:								
133	Exclusion of interest on public purpose State and local bonds	23,100	23,680	24,270	24,880	25,500	26,140	26,800	127,590
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	2,190	2,240	2,240	2,240	2,200	1,300	0	7,980
	Interest:								
136	Deferral of interest on U.S. savings bonds	290	300	310	330	330	350	360	1,680
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
	Nonbusiness State and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
	Exclusion of interest on State and local bonds for:								
	Public purposes	23,100	23,680	24,270	24,880	25,500	26,140	26,800	127,590
	Energy facilities	90	90	100	120	130	140	150	640
	Water, sewage, and hazardous waste disposal facilities	400	420	440	480	530	580	630	2,660
	Small-issues	310	310	330	360	390	430	470	1,980
	Owner-occupied mortgage subsidies	800	830	870	960	1,050	1,140	1,240	5,260
	Rental housing	160	170	180	200	220	240	260	1,100
	Airports, docks, and similar facilities	630	640	680	750	820	890	980	4,120
	Student loans	230	230	240	260	290	310	350	1,450
	Private nonprofit educational facilities	540	550	580	640	700	760	830	3,510
	Hospital construction	1,100	1,130	1,190	1,310	1,440	1,570	1,700	7,210
	Veterans' housing	40	40	40	40	50	50	60	240
	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420

[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 tax reasons, 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: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.

[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: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.

[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: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130; and 2007 $34,090.

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 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	....	....	....	....	....	....	....	....	2,160	2,190	2,210	2,240	2,260	2,290	2,310	11,310
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,450	2,540	2,660	2,690	2,760	2,810	3,170	14,090
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	760	800	840	880	920	960	1,020	4,620
4	Extraterritorial income exclusion	4,490	4,820	5,150	5,510	5,890	6,290	6,730	29,570	....	....	....	....	....	....	....	....
5	Inventory property sales source rules exception	1,400	1,470	1,540	1,620	1,700	1,790	1,880	8,530	....	....	....	....	....	....	....	....
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230	....	....	....	....	....	....	....	....
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	....	....	....	....	....	0	....	....	....	....	....	....	....	....
	General science, space, and technology:																
8	Expensing of research and experimentation expenditures (normal tax method)	1,980	1,750	2,330	2,820	3,330	3,830	4,080	16,390	40	30	50	60	70	80	80	340
9	Credit for increasing research activities	5,310	5,950	4,540	3,980	2,310	990	410	12,240	60	60	50	40	20	....	....	110
	Energy:																
10	Expensing of exploration and development costs, fuels	40	50	60	70	70	80	80	360	10	10	10	20	20	20	20	90
11	Excess of percentage over cost depletion, fuels	220	230	240	250	260	270	280	1,300	30	30	30	40	40	40	40	190
12	Alternative fuel production credit	860	810	390	120	120	120	120	870	40	40	20	10	10	10	10	60
13	Exception from passive loss limitation for working interests in oil and gas properties	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	....	....	....	....	....	....	....	....	100	100	110	120	120	130	140	620
15	Exclusion of interest on energy facility bonds	20	20	20	30	30	30	30	140	70	70	80	90	100	110	120	500
16	Enhanced oil recovery credit	280	330	400	480	580	690	830	2,980	30	30	40	50	60	70	80	300
17	New technology credit	60	80	100	100	100	90	90	480	....	....	....	....	....	....	....	....
18	Alcohol fuel credits [1]	20	20	20	20	20	20	20	100	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	30	30	20	0	–20	–40	–40	–80	20	20	30	20	10	–10	–10	40
20	Exclusion from income of conservation subsidies provided by public utilities	....	....	....	....	....	....	....	....	70	70	70	70	70	70	60	340
	Natural resources and environment:																
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
22	Excess of percentage over cost depletion, nonfuel minerals	240	250	260	270	280	280	290	1,380	10	10	10	20	20	20	20	90
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	100	110	110	110	110	120	120	570	300	310	330	370	420	460	510	2,090
24	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	100	100	110	120	120	130	140	620
25	Expensing of multiperiod timber growing costs	240	240	250	260	260	270	280	1,320	120	120	120	120	130	130	130	630
26	Tax incentives for preservation of historic structures	170	180	190	200	210	220	230	1,050	10	20	20	20	20	20	20	100
	Agriculture:																
27	Expensing of certain capital outlays	20	20	20	20	20	20	20	100	150	150	150	150	150	150	150	750
28	Expensing of certain multiperiod production costs	10	20	20	20	20	20	20	100	110	110	110	110	100	100	100	520
29	Treatment of loans forgiven for solvent farmers	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	....	....	....	....	....	....	....	....	990	1,040	1,100	1,160	1,220	1,290	1,360	6,130
31	Income averaging for farmers	....	....	....	....	....	....	....	....	70	70	70	70	80	80	80	380
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	Commerce and housing:																
	Financial institutions and insurance:																
33	Exemption of credit union income	1,000	1,070	1,150	1,230	1,320	1,420	1,530	6,650	....	....	....	....	....	....	....	....
34	Excess bad debt reserves of financial institutions	60	50	30	20	10	0	0	60	....	....	....	....	....	....	....	....
35	Exclusion of interest on life insurance savings	1,650	1,770	1,890	2,020	2,160	2,280	2,490	10,840	14,640	15,940	17,360	18,920	20,620	22,510	24,440	103,850
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	220	230	250	260	280	290	300	1,380	....	....	....	....	....	....	....	....
38	Small life insurance company deduction	100	100	100	100	100	100	100	500	....	....	....	....	....	....	....	....
	Housing:																
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	210	210	220	230	230	240	1,130	600	620	660	740	820	910	1,000	4,130
40	Exclusion of interest on rental housing bonds	40	40	40	50	50	50	50	240	120	130	140	150	170	190	210	860
41	Deductibility of mortgage interest on owner-occupied homes	....	....	....	....	....	....	....	....	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	....	....	....	....	....	....	....	....	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	270	270	280	290	290	300	300	1,460	770	780	800	810	830	840	860	4,140
44	Capital gains exclusion on home sales	....	....	....	....	....	....	....	....	19,090	19,670	20,260	20,860	21,490	22,140	22,800	107,550
45	Exception from passive loss rules for $25,000 of rental loss	....	....	....	....	....	....	....	....	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	2,420	2,500	2,600	2,730	2,860	2,990	3,100	14,280	800	830	860	900	950	990	1,030	4,730
47	Accelerated depreciation on rental housing (normal tax method)	390	410	440	450	460	470	480	2,300	4,800	5,030	5,270	5,340	5,340	5,250	5,320	26,520
	Commerce:																
48	Cancellation of indebtedness	....	....	....	....	....	....	....	....	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	....	....	....	....	....	....	....	....	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	....	....	....	....	....	....	....	....	67,800	61,810	60,200	56,990	56,180	50,670	49,880	273,920
51	Capital gains exclusion of small corporation stock	....	....	....	....	....	....	....	....	70	100	130	160	210	250	300	1,050
52	Step-up basis of capital gains at death	....	....	....	....	....	....	....	....	26,540	27,610	28,710	29,860	31,050	32,300	33,590	155,510
53	Carryover basis of capital gains on gifts	....	....	....	....	....	....	....	....	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	....	....	....	....	....	....	....	....	40	40	40	50	50	50	50	240
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	2,690	2,620	2,450	2,180	1,990	2,050	2,310	10,980	1,850	1,940	1,790	1,780	1,810	2,110	2,570	10,060
56	Accelerated depreciation of machinery and equipment (normal tax method)	30,750	30,220	29,750	30,200	30,860	31,970	34,070	156,850	7,110	6,910	6,730	6,590	6,570	6,550	6,860	33,300
57	Expensing of certain small investments (normal tax method)	530	470	460	460	450	490	570	2,430	1,140	960	960	930	910	990	1,150	4,940
58	Amortization of start-up costs (normal tax method)	90	110	140	160	170	180	180	830	40	50	60	80	80	90	90	400
59	Graduated corporation income tax rate (normal tax method)	4,940	5,590	6,210	6,580	7,120	7,450	7,880	35,240	....	....	....	....	....	....	....	....
60	Exclusion of interest on small issue bonds	80	80	80	80	80	90	90	420	230	230	250	280	310	340	380	1,560
	Transportation:																
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100	....	....	....	....	....	....	....	....

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
62	Exclusion of reimbursed employee parking expenses	......	......	......	......	......	......	......	......	1,980	2,090	2,190	2,300	2,420	2,550	2,670	12,130
63	Exclusion for employer-provided transit passes	......	......	......	......	......	......	......	......	220	280	360	410	470	540	600	2,380
	Community and regional development:																
64	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
65	Exclusion of interest for airport, dock, and similar bonds	160	160	170	170	180	180	190	890	470	480	510	580	640	710	790	3,230
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330	......	......	......	......	......	......	......	......
67	Empowerment zones, Enterprise communities, and Renewal communities	100	220	300	300	320	350	390	1,660	280	510	830	870	960	1,060	1,190	4,910
68	New markets tax credit	0	20	50	70	110	150	210	590	10	70	140	220	320	460	620	1,760
69	Expensing of environmental remediation costs	70	80	80	20	–20	–10	–10	60	10	20	20	......	......	......	......	20
	Education, training, employment, and social services:																
	Education:																
70	Exclusion of scholarship and fellowship income (normal tax method)	......	......	......	......	......	......	......	......	1,210	1,200	1,210	1,240	1,330	1,380	1,390	6,550
71	HOPE tax credit	......	......	......	......	......	......	......	......	4,130	4,110	3,520	2,880	2,930	2,730	2,900	14,960
72	Lifetime Learning tax credit	......	......	......	......	......	......	......	......	2,370	2,290	2,360	3,140	2,980	2,740	2,960	14,180
73	Education Individual Retirement Accounts	......	......	......	......	......	......	......	......	30	50	80	130	220	330	470	1,230
74	Deductibility of student-loan interest	......	......	......	......	......	......	......	......	390	450	640	660	680	700	720	3,400
75	Deduction for higher education expenses	......	......	......	......	......	......	......	......	0	430	2,290	2,960	3,710	3,010	0	11,970
76	State prepaid tuition plans	......	......	......	......	......	......	......	......	190	270	340	400	460	530	590	2,320
77	Exclusion of interest on student-loan bonds	60	60	60	60	60	60	70	310	170	170	180	200	230	250	280	1,140
78	Exclusion of interest on bonds for private nonprofit educational facilities	140	140	140	150	150	150	160	750	400	410	440	490	550	610	670	2,760
79	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420	......	......	......	......	......	......	......	......
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	......	......	......	......	......	......	......	......	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	......	......	......	......	......	......	......	......	1,010	1,070	1,120	1,170	1,230	1,280	1,340	6,140
82	Deductibility of charitable contributions (education)	590	680	770	830	840	900	950	4,290	3,240	3,300	3,430	3,610	3,760	3,940	4,080	18,820
83	Exclusion of employer-provided educational assistance	......	......	......	......	......	......	......	......	260	410	500	530	560	590	620	2,800
	Training, employment, and social services:																
84	Work opportunity tax credit	260	190	120	50	20	10	0	200	40	40	20	10	10	0	0	40
85	Welfare-to-work tax credit	80	60	30	20	10	0	0	60	10	10	10	0	0	0	0	10
86	Employer provided child care exclusion	......	......	......	......	......	......	......	......	720	740	770	810	930	1,020	1,080	4,610
87	Employer-provided child care credit	0	40	90	130	150	150	160	680	......	......	......	......	......	......	......	......
88	Assistance for adopted foster children	......	......	......	......	......	......	......	......	190	220	250	260	270	280	290	1,350
89	Adoption credit and exclusion	......	......	......	......	......	......	......	......	130	140	220	450	500	540	560	2,270
90	Exclusion of employee meals and lodging (other than military)	......	......	......	......	......	......	......	......	710	740	780	810	850	890	930	4,260
91	Child credit [2]	......	......	......	......	......	......	......	......	19,840	19,760	19,680	19,550	20,550	21,530	21,240	102,550
92	Credit for child and dependent care expenses	......	......	......	......	......	......	......	......	2,670	2,610	2,670	2,960	2,700	2,150	1,920	12,400
93	Credit for disabled access expenditures	10	10	10	10	20	20	20	80	40	40	40	40	40	40	40	200
94	Deductibility of charitable contributions, other than education and health	730	850	950	1,040	1,040	1,110	1,180	5,320	29,420	29,960	31,130	32,790	34,150	35,780	37,110	170,960
95	Exclusion of certain foster care payments	......	......	......	......	......	......	......	......	500	510	520	530	540	570	610	2,770

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
96	Exclusion of parsonage allowances	....	....	....	....	....	....	....	....	350	370	400	420	450	470	490	2,230
	Health:																
97	Exclusion of employer contributions for medical insurance premiums and medical care	....	....	....	....	....	....	....	....	82,800	90,910	99,260	106,940	115,380	124,050	134,960	580,590
98	Self-employed medical insurance premiums	....	....	....	....	....	....	....	....	1,520	1,730	2,420	3,570	3,870	4,170	4,430	18,460
99	Workers' compensation insurance premiums	....	....	....	....	....	....	....	....	4,730	4,870	5,080	5,230	5,410	5,570	5,790	27,080
100	Medical Savings Accounts	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
101	Deductibility of medical expenses	....	....	....	....	....	....	....	....	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	280	290	290	300	310	320	320	1,540	820	840	900	1,010	1,130	1,250	1,380	5,670
103	Deductibility of charitable contributions (health)	710	820	920	1,010	1,010	1,080	1,150	5,170	3,300	3,360	3,500	3,680	3,840	4,020	4,170	19,210
104	Tax credit for orphan drug research	140	150	170	190	220	240	270	1,090	....	....	....	....	....	....	....	....
105	Special Blue Cross/Blue Shield deduction	270	300	340	310	300	270	300	1,520	....	....	....	....	....	....	....	....
	Income security:																
106	Exclusion of railroad retirement system benefits	....	....	....	....	....	....	....	....	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	....	....	....	....	....	....	....	....	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	....	....	....	....	....	....	....	....	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	....	....	....	....	....	....	....	....	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	....	....	....	....	....	....	....	....	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:																
111	Employer plans	....	....	....	....	....	....	....	....	42,070	48,070	53,080	54,500	55,630	58,980	63,320	285,510
112	401(k) plans	....	....	....	....	....	....	....	....	44,080	52,960	59,510	62,770	65,290	69,230	73,320	330,120
113	Individual Retirement Accounts	....	....	....	....	....	....	....	....	18,680	18,090	18,660	19,050	18,930	19,230	18,330	94,200
114	Low and moderate income savers credit	....	....	....	....	....	....	....	....	0	550	1,960	1,940	1,900	1,800	1,280	8,880
115	Keogh plans	....	....	....	....	....	....	....	....	6,160	6,520	6,770	7,040	7,250	7,490	7,730	36,280
	Exclusion of other employee benefits:																
116	Premiums on group term life insurance	....	....	....	....	....	....	....	....	1,750	1,780	1,800	1,830	1,860	1,890	1,920	9,300
117	Premiums on accident and disability insurance	....	....	....	....	....	....	....	....	210	220	230	240	250	260	270	1,250
118	Small business retirement plan credit	0	10	30	50	70	80	90	320	0	10	20	40	50	50	60	220
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150	....	....	....	....	....	....	....	....
120	Special ESOP rules	980	1,020	1,080	1,140	1,200	1,260	1,330	6,010	310	320	340	350	370	380	400	1,840
121	Additional deduction for the blind	....	....	....	....	....	....	....	....	40	40	40	40	40	40	40	200
122	Additional deduction for the elderly	....	....	....	....	....	....	....	....	1,970	1,890	1,950	2,060	2,100	2,150	2,050	10,310
123	Tax credit for the elderly and disabled	....	....	....	....	....	....	....	....	30	30	30	30	30	30	30	150
124	Deductibility of casualty losses	....	....	....	....	....	....	....	....	210	250	310	360	410	450	490	2,020
125	Earned income tax credit [3]	....	....	....	....	....	....	....	....	4,940	4,370	4,800	4,930	5,100	5,180	5,390	25,400
	Social Security:																
	Exclusion of social security benefits:																
126	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	....	....	....	....	....	....	....	....	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:																
129	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	30	30	30	30	40	40	50	190

Table 6–2. CORPORATE AND INDIVIDUAL INCOME TAX ESTIMATES OF TAX EXPENDITURES—Continued

(In millions of dollars)

		Corporations								Individuals							
		2001	2002	2003	2004	2005	2006	2007	2003–2007	2001	2002	2003	2004	2005	2006	2007	2003–2007
	General purpose fiscal assistance:																
133	Exclusion of interest on public purpose State and local bonds	5,860	6,010	6,160	6,310	6,470	6,630	6,800	32,370	17,240	17,670	18,110	18,570	19,030	19,510	20,000	95,220
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	2,190	2,240	2,240	2,240	2,200	1,300	0	7,980	....	....	....	....	....	....	....	....
	Interest:																
136	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	290	300	310	330	330	350	360	1,680
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
	Exclusion of interest on State and local bonds for:																
	Public purposes	5,860	6,010	6,160	6,310	6,470	6,630	6,800	32,370	17,240	17,670	18,110	18,570	19,030	19,510	20,000	95,220
	Energy facilities	20	20	20	30	30	30	30	140	70	70	80	90	100	110	120	500
	Water, sewage, and hazardous waste disposal facilities	100	110	110	110	110	120	120	570	300	310	330	370	420	460	510	2,090
	Small-issues	80	80	80	80	80	90	90	420	230	230	250	280	310	340	380	1,560
	Owner-occupied mortgage subsidies	200	210	210	220	230	230	240	1,130	600	620	660	740	820	910	1,000	4,130
	Rental housing	40	40	40	50	50	50	50	240	120	130	140	150	170	190	210	860
	Airports, docks, and similar facilities	160	160	170	170	180	180	190	890	470	480	510	580	640	710	790	3,230
	Student loans	60	60	60	60	60	60	70	310	170	170	180	200	230	250	280	1,140
	Private nonprofit educational facilities	140	140	140	150	150	150	160	750	400	410	440	490	550	610	670	2,760
	Hospital construction	280	290	290	300	310	320	320	1,540	820	840	900	1,010	1,130	1,250	1,380	5,670
	Veterans' housing	10	10	10	10	10	10	10	50	30	30	30	30	40	40	50	190
	Credit for holders of zone academy bonds	30	50	70	80	90	90	90	420	....	....	....	....	....	....	....	....

[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 tax reasons, 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: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.

[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: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.

[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: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130; and 2007 $34,090.

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 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2003 PROJECTED REVENUE EFFECT

(In millions of dollars)

Provision	2003	2003–2007
Exclusion of employer contributions for medical insurance premiums and medical care	99,260	580,590
Deductibility of mortgage interest on owner-occupied homes	66,110	355,480
Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	60,200	273,920
Net exclusion of pension contributions and earnings: 401(k) plans	59,510	330,120
Net exclusion of pension contributions and earnings: Employer plans	53,080	285,510
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	48,150	204,860
Accelerated depreciation of machinery and equipment (normal tax method)	36,480	190,150
Deductibility of charitable contributions, other than education and health	32,080	176,280
Step-up basis of capital gains at death	28,710	155,510
Exclusion of interest on public purpose State and local bonds	24,270	127,590
Deductibility of State and local property tax on owner-occupied homes	23,580	97,830
Capital gains exclusion on home sales	20,260	107,550
Child credit	19,680	102,550
Exclusion of interest on life insurance savings	19,250	114,690
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	18,660	94,200
Exclusion of Social Security benefits for retired workers	18,180	96,200
Deferral of income from controlled foreign corporations (normal tax method)	7,450	42,230
Net exclusion of pension contributions and earnings: Keogh plans	6,770	36,280
Graduated corporation income tax rate (normal tax method)	6,210	35,240
Exclusion of workers' compensation benefits	6,070	33,090
Accelerated depreciation on rental housing (normal tax method)	5,710	28,820
Deductibility of medical expenses	5,530	31,350
Extraterritorial income exclusion	5,150	29,570
Workers' compensation insurance premiums	5,080	27,080
Earned income tax credit	4,800	25,400
Credit for increasing research activities	4,590	12,350
Deductibility of charitable contributions (health)	4,420	24,380
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,240	21,040
Deductibility of charitable contributions (education)	4,200	23,110
Exception from passive loss rules for $25,000 of rental loss	4,070	17,760
Exclusion of Social Security benefits for dependents and survivors	4,060	22,930
HOPE tax credit	3,520	14,960
Credit for low-income housing investments	3,460	19,010
Exclusion of veterans death benefits and disability compensation	3,300	18,420
Exclusion of Social Security benefits for disabled	3,240	20,380
Credit for child and dependent care expenses	2,670	12,400
Exclusion of income earned abroad by U.S. citizens	2,660	14,090
Self-employed medical insurance premiums	2,420	18,460
Expensing of research and experimentation expenditures (normal tax method)	2,380	16,730
Lifetime Learning tax credit	2,360	14,180
Deduction for higher education expenses	2,290	11,970
Tax credit for corporations receiving income from doing business in U.S. possessions	2,240	7,980
Exclusion of benefits and allowances to armed forces personnel	2,210	11,310
Exclusion of reimbursed employee parking expenses	2,190	12,130
Net exclusion of pension contributions and earnings: Low and moderate income savers credit	1,960	8,880
Additional deduction for the elderly	1,950	10,310
Net exclusion of pension contributions and earnings: Premiums on group term life insurance	1,800	9,300
Inventory property sales source rules exception	1,540	8,530
Special ESOP rules	1,420	7,850
Expensing of certain small investments (normal tax method)	1,420	7,370
Exclusion of scholarship and fellowship income (normal tax method)	1,210	6,550
Exclusion of interest on hospital construction bonds	1,190	7,210
Exemption of credit union income	1,150	6,650
Empowerment zones, Enterprise communities, and Renewal communities	1,130	6,570
Parental personal exemption for students age 19 or over	1,120	6,140
Capital gains treatment of certain income	1,100	6,130
Deferral of income from post 1987 installment sales	1,080	5,600
Exclusion of interest on owner-occupied mortgage subsidy bonds	870	5,260
Exclusion of certain allowances for Federal employees abroad	840	4,620
Exclusion of employee meals and lodging (other than military)	780	4,260
Employer provided child care exclusion	770	4,610
Carryover basis of capital gains on gifts	680	4,550
Exclusion of interest for airport, dock, and similar bonds	680	4,120
Deductibility of student-loan interest	640	3,400
Exclusion of interest on bonds for private nonprofit educational facilities	580	3,510
Exclusion of certain foster care payments	520	2,770
Exclusion of employer-provided educational assistance	500	2,800
Enhanced oil recovery credit	440	3,280
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	440	2,660

Table 6–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2003 PROJECTED REVENUE EFFECT—Continued

(In millions of dollars)

Provision	2003	2003–2007
Alternative fuel production credit	410	930
Exclusion of parsonage allowances	400	2,230
Exclusion of public assistance benefits (normal tax method)	400	2,160
Exclusion of railroad retirement system benefits	400	2,000
Expensing of multiperiod timber growing costs	370	1,950
Exclusion for employer-provided transit passes	360	2,380
State prepaid tuition plans	340	2,320
Special Blue Cross/Blue Shield deduction	340	1,520
Exclusion of interest on small issue bonds	330	1,980
Deductibility of casualty losses	310	2,020
Deferral of interest on U.S. savings bonds	310	1,680
Excess of percentage over cost depletion, fuels	270	1,490
Excess of percentage over cost depletion, nonfuel minerals	270	1,470
Tax exemption of certain insurance companies owned by tax-exempt organizations	250	1,380
Assistance for adopted foster children	250	1,350
Exclusion of interest on student-loan bonds	240	1,450
Net exclusion of pension contributions and earnings: Premiums on accident and disability insurance	230	1,250
Adoption credit and exclusion	220	2,270
Tax incentives for preservation of historic structures	210	1,150
Amortization of start-up costs (normal tax method)	200	1,230
New markets tax credit	190	2,350
Exclusion of interest on rental housing bonds	180	1,100
Tax credit for orphan drug research	170	1,090
Expensing of certain capital outlays	170	850
Work opportunity tax credit	140	240
Capital gains exclusion of small corporation stock	130	1,050
Expensing of certain multiperiod production costs	130	620
Exclusion of military disability pensions	120	640
Capital gains treatment of royalties on coal	110	620
Capital gains treatment of certain timber income	110	620
Exclusion of interest on energy facility bonds	100	640
Small life insurance company deduction	100	500
New technology credit	100	480
Expensing of environmental remediation costs	100	80
Employer-provided child care credit	90	590
Exclusion of GI bill benefits	90	510
Education Individual Retirement Accounts	80	1,230
Exclusion of veterans pensions	80	440
Exceptions from imputed interest rules	80	400
Expensing of exploration and development costs, fuels	70	450
Credit for holders of zone academy bonds	70	420
Income averaging for farmers	70	380
Exclusion from income of conservation subsidies provided by public utilities	70	340
Exemption of certain mutuals' and cooperatives' income	60	330
Exclusion of special benefits for disabled coal miners	60	280
Small business retirement plan credit	50	540
Credit for disabled access expenditures	50	280
Tax credit and deduction for clean-fuel burning vehicles	50	–40
Ordinary income treatment of loss from small business corporation stock sale	40	240
Exclusion of interest on veterans housing bonds	40	240
Additional deduction for the blind	40	200
Welfare-to-work tax credit	40	70
Cancellation of indebtedness	30	190
Alcohol fuel credits	30	150
Investment credit for rehabilitation of structures (other than historic)	30	150
Income of trusts to finance supplementary unemployment benefits	30	150
Tax credit for the elderly and disabled	30	150
Excess bad debt reserves of financial institutions	30	60
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Deferral of tax on shipping companies	20	100
Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
Medical Savings Accounts	20	100
Expensing of exploration and development costs, nonfuel minerals	10	50
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
Deferred taxes for financial firms on certain income earned overseas	0	0

Table 6–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2001

(In millions of dollars)

	Provision	Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	6,760
2	Deferred taxes for financial firms on income earned overseas	1,170
3	Expensing of research and experimentation expenditures (normal tax method)	1,700
4	Expensing of exploration and development costs - fuels	130
5	Expensing of exploration and development costs - nonfuels	0
6	Expensing of multiperiod timber growing costs	220
7	Expensing of certain multiperiod production costs - agriculture	230
8	Expensing of certain capital outlays - agriculture	260
9	Deferral of income on life insurance and annuity contracts	22,920
10	Accelerated depreciation of rental housing (normal tax method)	4,750
11	Accelerated depreciation of buildings other than rental housing (normal tax method)	540
12	Accelerated depreciation of machinery and equipment (normal tax method)	31,210
13	Expensing of certain small investments (normal tax method)	990
14	Amortization of start-up costs (normal tax method)	20
15	Deferral of tax on shipping companies	20
16	Credit for holders of zone academy bonds	120
17	Credit for low-income housing investments	2,850
18	Deferral for state prepaid tuition plans	190
19	Exclusion of pension contributions - employer plans	97,290
20	Exclusion of 401(k) contributions	69,980
21	Exclusion of IRA contributions and earnings	6,090
22	Exclusion of contributions and earnings for Keogh plans	9,780
23	Exclusion of interest on public-purpose bonds	20,730
24	Exclusion of interest on non-public purpose bonds	5,560
25	Deferral of interest on U.S. savings bonds	330

Outlay Equivalents

The concept of "outlay equivalents" is another theoretical measure of the budget effect of tax expenditures. It is the amount of budget outlays 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 a tax expenditure to be compared with a direct Federal outlay on a more even footing. Outlay equivalents are reported in Table 6–5.

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX

(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,510	2,540	2,570	2,600	2,620	2,650	2,680	13,120
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	3,270	3,380	3,540	3,570	3,670	3,720	4,210	18,710
3	Exclusion of certain allowances for Federal employees abroad	1,020	1,060	1,130	1,170	1,230	1,270	1,350	6,150
4	Extraterritorial income exclusion	6,910	7,410	7,930	8,470	9,060	9,680	10,350	45,490
5	Inventory property sales source rules exception	2,150	2,260	2,370	2,490	2,620	2,750	2,890	13,120
6	Deferral of income from controlled foreign corporations (normal tax method)	6,600	7,000	7,450	7,900	8,400	8,930	9,550	42,230
7	Deferred taxes for financial firms on certain income earned overseas	1,300	550	....	....	....	....	....	0
	General science, space, and technology:								
8	Expensing of research and experimentation expenditures (normal tax method)	2,020	1,780	2,380	2,880	3,400	3,910	4,160	16,730
9	Credit for increasing research activities	8,270	9,240	7,060	6,190	3,580	1,530	640	18,990
	Energy:								
10	Expensing of exploration and development costs, fuels	80	80	100	120	120	130	130	600
11	Excess of percentage over cost depletion, fuels	290	300	310	320	340	340	360	1,670
12	Alternative fuel production credit	1,210	1,130	540	170	170	170	170	1,220
13	Exception from passive loss limitation for working interests in oil and gas properties	20	20	20	20	20	20	20	100
14	Capital gains treatment of royalties on coal	130	140	150	150	160	170	180	810
15	Exclusion of interest on energy facility bonds	130	130	150	170	180	200	210	1,170
16	Enhanced oil recovery credit	370	440	530	640	770	920	1,110	3,970
17	New technology credit	90	130	150	150	150	150	150	750
18	Alcohol fuel credits [1]	30	30	30	30	30	30	30	150
19	Tax credit and deduction for clean-fuel burning vehicles	70	70	70	30	-20	-60	-60	-40
20	Exclusion from income of conservation subsidies provided by public utilities	90	90	90	90	90	90	90	450

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued
(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
	Natural resources and environment:								
21	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
22	Excess of percentage over cost depletion, nonfuel minerals	340	360	370	380	380	400	410	1,940
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	570	600	630	690	760	840	910	3,830
24	Capital gains treatment of certain timber income	130	140	150	150	160	170	180	810
25	Expensing of multiperiod timber growing costs	460	470	480	500	510	520	540	2,550
26	Tax incentives for preservation of historic structures	190	200	210	220	230	240	250	1,150
	Agriculture:								
27	Expensing of certain capital outlays	210	210	210	210	210	210	210	1,050
28	Expensing of certain multiperiod production costs	150	160	160	150	150	140	140	740
29	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
30	Capital gains treatment of certain income	1,320	1,380	1,460	1,550	1,630	1,720	1,810	8,170
31	Income averaging for farmers	80	90	90	90	90	100	100	470
32	Deferral of gain on sale of farm refiners	10	10	10	10	10	10	10	50
	Commerce and housing:								
	Financial institutions and insurance:								
33	Exemption of credit union income	1,330	1,430	1,530	1,640	1,770	1,890	2,030	8,860
34	Excess bad debt reserves of financial institutions	80	70	40	30	10	0	0	80
35	Exclusion of interest on life insurance savings	16,290	17,710	19,250	20,940	22,780	24,790	26,930	114,690
36	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
37	Tax exemption of certain insurance companies owned by tax-exempt organizations	300	310	340	350	380	390	410	1,870
38	Small life insurance company deduction	130	130	130	130	130	130	130	650
	Housing:								
39	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,150	1,190	1,250	1,380	1,510	1,640	1,780	7,560
40	Exclusion of interest on rental housing bonds	230	250	260	290	320	350	370	1,590
41	Deductibility of mortgage interest on owner-occupied homes	64,510	64,190	66,110	68,070	70,870	73,560	76,870	355,480
42	Deductibility of State and local property tax on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
43	Deferral of income from post 1987 installment sales	1,020	1,040	1,060	1,080	1,100	1,120	1,140	5,500
44	Capital gains exclusion on home sales	23,870	24,580	25,320	26,080	26,860	27,670	28,500	134,430
45	Exception from passive loss rules for $25,000 of rental loss	4,800	4,400	4,070	3,780	3,530	3,290	3,090	17,760
46	Credit for low-income housing investments	4,360	4,510	4,700	4,930	5,170	5,400	5,610	25,810
47	Accelerated depreciation on rental housing (normal tax method)	5,190	5,440	5,710	5,790	5,800	5,720	5,800	28,820
	Commerce:								
48	Cancellation of indebtedness	30	30	30	40	40	40	40	190
49	Exceptions from imputed interest rules	80	80	80	80	80	80	80	400
50	Capital gains (except agriculture, timber, iron ore, and coal) (normal tax method)	90,400	82,420	80,260	75,980	74,910	67,560	66,510	365,220
51	Capital gains exclusion of small corporation stock	90	130	170	220	270	340	400	1,400
52	Step-up basis of capital gains at death	35,390	36,810	38,280	39,810	41,400	43,060	44,780	207,330
53	Carryover basis of capital gains on gifts	530	600	680	760	900	1,080	1,130	4,550
54	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	60	60	60	60	290
55	Accelerated depreciation of buildings other than rental housing (normal tax method)	4,540	4,560	4,240	3,960	3,800	4,160	4,880	21,040
56	Accelerated depreciation of machinery and equipment (normal tax method)	37,860	37,130	36,480	36,790	37,430	38,520	40,930	190,150
57	Expensing of certain small investments (normal tax method)	1,670	1,430	1,420	1,390	1,360	1,480	1,720	7,370
58	Amortization of start-up costs (normal tax method)	130	160	200	240	250	270	270	1,230
59	Graduated corporation income tax rate (normal tax method)	7,590	8,590	9,560	10,130	10,950	11,460	12,130	54,230
60	Exclusion of interest on small issue bonds	440	440	470	520	560	610	670	2,830
	Transportation:								
61	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
62	Exclusion of reimbursed employee parking expenses	2,560	2,690	2,830	2,970	3,130	3,280	3,450	15,660
63	Exclusion for employer-provided transit passes	310	390	500	570	660	750	840	3,320
	Community and regional development:								
64	Investment credit for rehabilitation of structures (other than historic)	20	30	30	30	30	30	30	150
65	Exclusion of interest for airport, dock, and similar bonds	900	920	980	1,080	1,180	1,280	1,400	5,920
66	Exemption of certain mutuals' and cooperatives' income	60	60	60	60	70	70	70	330
67	Empowerment zones and enterprise communities	380	730	1,120	1,170	1,280	1,410	1,580	6,560
68	New markets tax credit	20	90	190	300	420	610	830	2,350
69	Expensing of environmental remediation costs	110	120	130	40	-20	-20	-20	110
	Education, training, employment, and social services:								
	Education:								
70	Exclusion of scholarship and fellowship income (normal tax method)	1,330	1,320	1,330	1,360	1,460	1,520	1,530	7,200
71	HOPE tax credit	5,300	5,270	4,510	3,690	3,760	3,500	3,720	19,180
72	Lifetime Learning tax credit	3,030	2,940	3,030	4,020	3,830	3,520	3,800	18,200
73	Education Individual Retirement Accounts	40	60	90	150	260	390	550	1,440
74	Deductibility of student-loan interest	460	540	760	790	810	840	850	4,050
75	Deduction for higher education expenses	0	560	2,940	3,790	4,760	3,860	0	15,350
76	State prepaid tuition plans	250	340	430	510	590	680	760	2,970
77	Exclusion of interest on student-loan bonds	330	330	340	370	410	440	510	2,070
78	Exclusion of interest on bonds for private nonprofit educational facilities	770	780	830	920	1,010	1,090	1,190	5,040

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued

(In millions of dollars)

		Outlay Equivalents							
		2001	2002	2003	2004	2005	2006	2007	2003–2007
79	Credit for holders of zone academy bonds	40	70	100	120	120	120	120	580
80	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	20	20	20	20	20	20	100
81	Parental personal exemption for students age 19 or over	1,120	1,180	1,250	1,300	1,360	1,420	1,480	6,810
82	Deductibility of charitable contributions (education)	5,420	5,610	5,910	6,260	6,460	6,800	7,070	32,500
83	Exclusion of employer-provided educational assistance	320	510	620	660	690	730	770	3,470
	Training, employment, and social services:								
84	Work opportunity tax credit	300	230	140	60	30	10	0	240
85	Welfare-to-work tax credit	90	70	40	20	10	0	0	70
86	Exclusion of employer provided child care	950	990	1,020	1,080	1,240	1,360	1,450	6,150
87	Employer-provided child care	0	60	120	170	190	210	220	790
88	Assistance for adopted foster children	220	250	280	290	300	310	320	1,500
89	Adoption credit and exclusion	160	180	280	570	640	690	710	2,890
90	Exclusion of employee meals and lodging (other than military)	870	910	950	990	1,030	1,080	1,130	5,180
91	Child credit[2]	26,460	26,350	26,240	26,070	27,400	28,700	28,320	136,730
92	Credit for child and dependent care expenses	3,560	3,480	3,560	3,950	3,600	2,860	2,550	16,520
93	Credit for disabled access expenditures	60	70	70	70	80	80	80	380
94	Deductibility of charitable contributions, other than education and health	42,130	42,750	44,450	46,820	48,580	50,980	52,760	243,590
95	Exclusion of certain foster care payments	580	590	600	610	630	660	700	3,200
96	Exclusion of parsonage allowances	400	420	460	480	510	540	560	2,550
	Health:								
97	Exclusion of employer contributions for medical insurance premiums and medical care	106,750	117,750	128,760	138,400	149,240	160,370	173,450	750,220
98	Self-employed medical insurance premiums	1,900	2,140	3,000	4,420	4,790	5,160	5,470	22,840
99	Workers' compensation insurance premiums	5,900	6,070	6,330	6,510	6,730	6,920	7,190	33,680
100	Medical Savings Accounts	20	20	30	30	30	30	20	140
101	Deductibility of medical expenses	4,990	5,260	5,530	5,840	6,280	6,600	7,100	31,350
102	Exclusion of interest on hospital construction bonds	1,580	1,620	1,700	1,880	2,070	2,250	2,440	10,340
103	Deductibility of charitable contributions (health)	5,710	5,920	6,250	6,630	6,830	7,210	7,490	34,410
104	Tax credit for orphan drug research	200	230	260	290	320	360	400	1,630
105	Special Blue Cross/Blue Shield deduction	340	380	430	390	380	340	380	1,920
	Income security:								
106	Exclusion of railroad retirement system benefits	380	390	400	400	400	400	400	2,000
107	Exclusion of workers' compensation benefits	5,560	5,810	6,070	6,320	6,600	6,900	7,200	33,090
108	Exclusion of public assistance benefits (normal tax method)	370	380	400	410	430	450	470	2,160
109	Exclusion of special benefits for disabled coal miners	70	70	60	60	60	50	50	280
110	Exclusion of military disability pensions	110	120	120	120	130	130	140	640
	Net exclusion of pension contributions and earnings:								
111	Employer plans	52,590	59,350	65,130	66,460	67,840	71,930	77,220	348,580
112	401(k) plans	55,100	65,380	73,020	76,550	79,620	84,430	89,410	403,030
113	Individual Retirement Accounts	23,980	24,250	25,280	25,590	25,630	25,890	25,450	127,840
114	Low and moderate income savers credit	0	660	2,330	2,290	2,240	2,120	1,500	10,480
115	Keogh plans	7,880	8,330	8,620	8,930	9,150	9,410	9,680	45,790
	Exclusion of other employee benefits:								
116	Premiums on group term life insurance	2,330	2,370	2,400	2,440	2,480	2,520	2,560	12,400
117	Premiums on accident and disability insurance	280	290	310	320	330	350	360	1,670
118	Small business retirement plan credit	0	30	70	120	160	180	200	730
119	Income of trusts to finance supplementary unemployment benefits	20	20	30	30	30	30	30	150
120	Special ESOP rules	1,710	1,780	1,880	1,980	2,080	2,180	2,300	10,420
121	Additional deduction for the blind	50	50	50	50	50	50	50	250
122	Additional deduction for the elderly	2,390	2,280	2,360	2,490	2,550	2,600	2,480	12,480
123	Tax credit for the elderly and disabled	40	40	40	40	40	40	40	200
124	Deductibility of casualty losses	230	280	340	390	450	500	490	2,170
125	Earned income tax credit[3]	5,480	4,850	5,330	5,480	5,670	5,750	5,990	28,220
	Social Security:								
	Exclusion of social security benefits:								
126	Social Security benefits for retired workers	17,830	18,000	18,180	18,560	18,850	19,720	20,890	96,200
127	Social Security benefits for disabled	2,690	2,930	3,240	3,630	4,020	4,470	5,020	20,380
128	Social Security benefits for dependents and survivors	3,720	3,870	4,060	4,320	4,560	4,820	5,170	22,930
	Veterans benefits and services:								
129	Exclusion of veterans death benefits and disability compensation	3,150	3,190	3,300	3,490	3,680	3,870	4,080	18,420
130	Exclusion of veterans pensions	70	80	80	80	90	90	100	440
131	Exclusion of GI bill benefits	90	90	90	100	100	110	110	510
132	Exclusion of interest on veterans housing bonds	50	50	50	50	70	70	80	320
	General purpose fiscal assistance:								
133	Exclusion of interest on public purpose State and local bonds	33,100	33,930	34,780	35,660	36,540	37,460	38,410	182,850
134	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
135	Tax credit for corporations receiving income from doing business in U.S. possessions	3,130	3,190	3,190	3,190	3,140	1,860	0	11,380
	Interest:								
136	Deferral of interest on U.S. savings bonds	290	300	310	330	330	350	360	1,680

Table 6–5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued
(In millions of dollars)

	Outlay Equivalents							
	2001	2002	2003	2004	2005	2006	2007	2003–2007
Addendum: Aid to State and local governments:								
Deductibility of:								
Property taxes on owner-occupied homes	22,410	22,680	23,580	23,210	20,330	16,300	14,410	97,830
Nonbusiness State and local taxes other than on owner-occupied homes	45,520	46,160	48,150	47,730	43,270	34,820	30,890	204,860
Exclusion of interest on State and local bonds for:								
Public purposes	33,100	33,930	34,780	35,660	36,540	37,460	38,410	182,850
Energy facilities	130	130	150	170	180	200	210	1,170
Water, sewage, and hazardous waste disposal facilities	570	600	630	690	760	840	910	3,830
Small-issues	440	440	470	520	560	610	670	2,830
Owner-occupied mortgage subsidies	1,150	1,190	1,250	1,380	1,510	1,640	1,780	7,560
Rental housing	230	250	260	290	320	350	370	1,590
Airports, docks, and similar facilities	900	920	980	1,080	1,180	1,280	1,400	5,920
Student loans	330	330	340	370	410	440	510	2,070
Private nonprofit educational facilities	770	780	830	920	1,010	1,090	1,190	5,040
Hospital construction	1,580	1,620	1,700	1,880	2,070	2,250	2,440	10,340
Veterans' housing	50	50	50	50	70	70	80	320
Credit for holders of zone academy bonds	40	70	100	120	120	120	120	580

[1] In addition, the partial exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 2001 $990; 2002 $1,020; 2003 $1,050; 2004 $1,080; 2005 $1,080; 2006 $1,100; and 2007 $1,120.
[2] 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: 2001 $980; 2002 $7,390; 2003 $7,390; 2004 $7,210; 2005 $6,950; 2006 $9,380; and 2007 $9,200.
[3] 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: 2001 $26,120; 2002 $28,280; 2003 $30,630; 2004 $31,080; 2005 $31,720; 2006 $33,130 and 2007 $34,090.

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 baseline provisions of the tax structure. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, 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 it 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 measuring 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. [2] The normal tax baseline also excludes gifts between individuals from gross income. Under the normal tax baseline, however, all cash transfer payments from the Government to private individuals are counted in gross income, and exemptions of such transfers from tax are identified as tax expenditures. The costs of earning income are generally deductible in determining taxable income under both the reference and normal tax baselines. [3]

Capital recovery. Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.

Treatment of foreign income. Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

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. Tax expenditures, however, may also contribute to achieving these goals. The report of the Senate Governmental Affairs Committee on GPRA [4] 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 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 was 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 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. Because there is an existing public administrative and private compliance structure for the tax system, the

[2] Gross income does, however, include transfer paymnents associated with past employment, such as Social Security benefits.

[3] In the case of individuals who hold "passive" equity interests in businesses, however, the pro-rata shares of sales and expense deductions reportable in a year are limited. A passive business activity is defined to be one in which the holder of the interest, usually a partnership interst, 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.

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

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 activities to be addressed with specific 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 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 tax 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, which can impose further costs by diverting resources from their most efficient uses. 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 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 revenue effect. 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 combat service are intended to reduce tax burdens on military personnel undertaking hazardous service for the Nation. A portion of the tax expenditure associated with foreign earnings is targeted to benefit U.S. Government civilian personnel working abroad by offsetting the living costs that can be higher than those in the United States. These tax expenditures should be considered together with direct agency budget costs in making programmatic decisions.

International affairs.—Tax expenditures are also aimed at goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental 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 expenditures. 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 preferences increase production (as opposed to benefitting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel production on imports from various regions, or the effects of various energy sources on the environment).

Housing investment also benefits from tax expenditures. The mortgage interest deduction on personal residences is a tax expenditure because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. 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 value of benefits funded 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, omitting important details 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 as of December 31, 2001, 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 combat service, 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 2001 may exclude up to $78,000 in foreign earned income from U.S. taxes.

The exclusion increases to $80,000 in 2002 (and thereafter). 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 ($67,765 in 2001).

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. ***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 FSC Repeal and Extraterritorial Income Exclusion Act of 2000 created the extraterritorial income exclusion to replace the foreign sales corporation provisions, which the Act repealed. The exclusion is generally available for transactions entered into after September 30, 2000.

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

6. ***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.

7. ***Exceptions under subpart F for active financing income.***—Financial firms can defer taxes on income earned overseas in an active business. Taxes on income earned through December 31, 2001 can be deferred.

[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 extimates include, for example, estimtes 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.

General Science, Space, and Technology

8. ***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.

9. ***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

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

11. ***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.

12. ***Alternative fuel production credit.***—A nontaxable credit of $3 per oil-equivalent barrel of production (in 1979 dollars) 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.

13. ***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.

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

15. ***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.

16. ***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.

17. ***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.

18. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 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.

19. ***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.

20. ***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

21. ***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.

22. ***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.

23. ***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.

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

25. ***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.

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

Agriculture

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

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

29. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, 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.

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

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

32. ***Deferral of gain on sales of farm refiners.***—A taxpayer who sells stock in a farm refiner to a farmers' cooperative can defer recognition of gain if the taxpayer reinvests the proceeds in qualified replacement property.

Commerce and Housing

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

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

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

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

36. ***Small property and casualty insurance companies.***—Insurance companies that have annual net premium incomes of less than $350,000 are exempt from tax; those with $350,000 to $2.1 million of net premium incomes may elect to pay tax only on the income earned by their investment portfolio.

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

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

39. ***Mortgage housing bonds.***—Interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of State and local tax-exempt bonds that can be issued to finance 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 $62.50 per capita ($187.5 million minimum) per State 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 home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a State cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

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

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

42. ***Taxes on owner-occupied homes.***—Owner-occupants of homes may deduct property taxes on their primary and secondary residences even though they are

not required to report the value of owner-occupied housing services as gross income.

43. ***Installment sales.***—Dealers in real and personal property (i.e., sellers 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.

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

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

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

47. ***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.

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

49. ***Imputed interest rules.***—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument. 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.

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

For 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.

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

52. ***Step-up in basis of capital gains at death.***—Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. After repeal of the estate tax under EGTRRA for 2010, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

53. ***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. Even though the estate tax is repealed for 2010 under EGTRRA, the gift tax is retained with a lifetime exemption of $1 million.

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

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

56. ***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. Under the normal tax baseline, this tax depreciation allowance is measured relative to straight-line depreciation using Asset Depreciation Range (ADR) lives. Statutory depreciation of machinery and equipment is accelerated relative to this baseline, thereby creating a tax expenditure under the normal tax rules.

57. ***Expensing of certain small investments.***—In 2001, qualifying investments in tangible property up to $24,000 can be expensed rather than depreciated over time. The expensing limit increases 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 2001, the amount expensed is completely phased out when qualifying investments exceed $224,000.

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

59. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $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.

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

Transportation

61. ***Deferral of tax on U.S. shipping companies.***—Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.

62. ***Exclusion of 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 2001, the maximum amount of the parking exclusion is $180 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

63. ***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 2001, 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

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

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

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

67. ***Empowerment zones, 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. home-buyer credit from December 31, 2001 to December 31, 2003.

68. ***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.

69. ***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 will generally increase the value of the property significantly or appreciably prolong the life of the property. 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

70. ***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).

71. ***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) (indexed beginning in 2002).

72. ***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) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

73. ***Deduction for higher education expenses.***—EGTRRA provides a new above-the-line deduction for qualified higher education expenses. The maximum annual deduction is $3,000 beginning in 2002 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). The maximum deduction increases to $4,000 in 2004. Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2005.

74. ***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 in 2001 is $500 per beneficiary. In 2001, the maximum contribution is phased down ratably for taxpayers with modified AGI between $150,000 and $160,000 ($95,000 and $110,000 for singles). EGTRRA increases the maximum contribution to $2,000 and the phase-out range for joint filers to $190,000 through $220,000 of modified AGI, double the range of singles. EGTRRA also allows elementary and secondary school expenses to be paid tax-free from such accounts.

75. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2001, 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). EGTRRA increased the income thresholds for the phase down to $100,000 and $130,000 ($50,000 and $65,000 for singles) (indexed) and repealed the five year rule for interest payments made after December 21, 2001.

76. ***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. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses. These changes were the result of EGTRRA.

77. ***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.

78. ***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.

79. ***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.

80. ***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 $83,650 and $113,650 ($55,750 and $70,750 for singles) in 2001.

81. ***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.

82. ***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.

83. ***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. EGTRRA permanently extended this exclusion and extended the exclusion to also include graduate education (beginning in 2002).

84. ***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.

85. ***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.

86. ***Employer-provided child care exclusion.***—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.

87. ***Employer-provided child care credit.***—Employers can deduct expenses for supporting child care or child care resource and referral services. EGTRRA provides a tax credit to employers for qualified expenses beginning in 2002. The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

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) for 2001. The credit is phased-out ratably for taxpayers with modified AGI

between $75,000 and $115,000 in 2001. EGTRRA increased the maximum credit for non-special needs children to $10,000, set a flat credit amount of $10,000 for special needs children, and increased the start point of the phase-out to $150,000 beginning in 2002. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. 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 the credit and the exclusion were made permanent by EGTRRA.

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 $600 refundable per child credit. The maximum credit is increased to $700 in 2005, $800 in 2009, and $1,000 in 2010. 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).

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. EGTRRA increased the maximum expenditure limit to $3,000 for one dependent and $6,000 for two or more dependents beginning in 2003. The credit is equal to 30 percent of qualified expenditures (35 percent beginning in 2003) for taxpayers with incomes of $10,000 or less ($15,000 or less beginning in 2003). The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $10,000 ($15,000 beginning in 2003).

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 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.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2001, an employee could exclude up to $10,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. EGTRRA increases the exclusion amount to $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005 and $15,000 in 2006 (indexed thereafter). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

EGTRRA also allows employees to make after-tax contributions to 401(k) and 401(k)-type plans beginning in 2002. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

113. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. In 2001, employees can make annual contributions to an IRA up to $2,000 (or 100 percent of compensation, if less). The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. EGTRRA increases the IRA contribution limit to $3,000 in 2002, $4,000 in 2005, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000 (by 2006).

Taxpayers whose AGI is below $53,000 ($33,000 for non-joint filers) in 2001 can claim a deduction for IRA contributions. In 2001, the IRA deduction is phased out for taxpayers with AGI between $53,000 and $63,000 ($33,000 and $43,000 for non-joint). The phase-out range increases annually until it reaches $80,000 to $100,000 in 2007 ($50,000 to $60,000 in 2005 for non-joint filers). Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $150,000 ($90,000 for nonjoint filers) can make contributions to Roth IRAs. 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). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty free if: (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 59–1/2, (b) dies, (c) is disabled, or (d) purchases a first-time house.

Taxpayers can contribute to a non-deductible IRA regardless of their income and whether they are an active participant in an employer-provided retirement plan. The tax on investment income earned by non-deductible IRAs is deferred until the money is withdrawn.

114. ***Low and moderate income savers' credit.***—EGTRRA provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA contributions. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $50,000 for joint filers and $25,000 for single filers. This temporary credit is in effect from 2002 through 2006.

115. ***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 $35,000 in 2001. Total plan contributions are limited to 15 percent of a firm's total wages. EGTRRA increases the percent of pay limit to 100 percent of the income of the self-employed by 2005 and increases the dollar limit on contributions to $40,000 beginning in 2002. EGTRRA also increased the plan limit to 25 percent of a firm's total wages and excluded employee contributions from this limit beginning in 2002. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

116. ***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.

117. ***Small business retirement plan credit.***—EGTRRA provides businesses with 100 or fewer employees a credit for 50 percent of the qualified startup costs associated with a new qualified retirement plan. The credit is limited to $500 annually and may only be claimed for expenses incurred during the first three years from the start of the qualified plan. Qualified startup expenses include expenses related to the establishment and administration of the plan, and the retirement-related education of employees. The credit applies to costs incurred beginning in 2002.

118. ***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.

119. ***Employer-provided supplementary unemployment benefits.***—Employers may establish trusts to pay supplemental unemployment benefits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

120. ***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.

121. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,100 standard deduction if single, or $900 if married.

122. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,100 standard deduction if single, or $900 if married.

123. ***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.

124. ***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.

125. ***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 $7,140 of earned income in 2001. The credit is 40 percent of the first $10,020 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $13,090 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $28,281 ($32,121 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 2001, the credit is 7.65 percent of the first $4,760 of earned income. When the taxpayer's income exceeds $5,950, the credit is phased out at the rate of 7.65 percent. It is completely phased out at $10,710 of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, EGTRRA increases the base amount for the phase-out by $1,000 in 2002 through 2004, $2,000 in 2005 through 2007, and $3,000 in 2008 (indexed thereafter). 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

126. ***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.

127. ***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.

128. ***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

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

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

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

132. ***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

133. ***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.

134. ***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.

135. ***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

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