19. 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." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs.

Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared. The tax expenditure estimates presented in this chapter are 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.

An important assumption underlying each tax expenditure estimate reported below is that other parts of the Tax Code remain unchanged. The estimates would be different if 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.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2008–2014 using two methods of accounting: current revenue effects and present value effects. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

A discussion of performance measures and economic effects related to the assessment of the effect of tax expenditures on the achievement of program performance goals is presented in Appendix A. This section is a complement to the Government-wide performance plan required by the Government Performance and Results Act of 1993.

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, 2008. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2008. The estimates reflect preliminary 2010 Budget economic assumptions. Legislation enacted in 2009 is not reflected in the current exercise.

The total revenue effects for tax expenditures for fiscal years 2008–2014 are displayed according to the Budget's functional categories in Table 19–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the discussion of general features of the tax expenditure concept.

Two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify and estimate tax expenditures.[1] 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 19–2 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 19–3 ranks the major tax expenditures by the size of their 2010–2014 revenue effect. The first column provides the number of the provision in order to cross reference this table to Tables 19–1 and 19–2, as well as to the descriptions below. Outlay Equivalent Estimates of Income Tax Expenditures, which were included in the 2007 and prior volumes of *Analytical Perspectives*, are no longer included in this chapter.

In the 2005 *Analytical Perspectives*, the treatment of capital gains was changed to exclude the portion of capital gains derived from corporate equity from the estimate of the tax expenditure for preferential tax rates on capital gains under the normal tax baseline. In addition, the preferential rates on qualified dividend income that were enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 were not identified as a tax expenditure. The estimate of other tax expenditures related to saving and retirement plans were also affected by this change in methodology. The Administration plans a review of tax expenditures for future *Analytical Perspectives* volumes. In anticipation of that review, this chapter shows supple-

[1] These baseline concepts are thoroughly discussed in Special Analysis G of the 1985 Budget, where the former is referred to as the pre-1983 method and the latter the post-1982 method.

mental estimates in Table 19-4 of the full tax expenditure for capital gains and dividends under the pre-2005 methodology.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 19–1, 19–2, and 19–3 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.

First, 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 capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, resulting in lower tax receipts. Such behavioral effects are not reflected in the estimates.

Second, 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 19–1 are the totals of individual and corporate income tax revenue effects reported in Table 19–2 and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 19–1 should be regarded as approximations.

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 19–5. 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 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.

Discounted present-value estimates of revenue effects are presented in Table 19–5 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 2008 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2008 would cause a deferral of tax payments on wages in 2008 and on pension fund earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2008 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.

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. 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 judgment. As in prior years, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. An exception is provided for the lower tax rate on dividends and capital gains on corporate shares as discussed below. Tax expenditures may take the form of credits, deductions, special exceptions and allowances, and reduce tax liability below the level implied by the baseline tax system.

The normal tax baseline is patterned on a practical variant of 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 deduction of 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. Reference law tax expenditures are limited to special exceptions in the Tax Code that serve programmatic functions. Provisions 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

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES FOR FISCAL YEARS 2008-2014
(In millions of dollars)

		Total from corporations and individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14
National Defense									
1	Exclusion of benefits and allowances to armed forces personnel	11,190	11,710	10,210	10,550	10,900	11,270	11,660	54,590
International affairs:									
2	Exclusion of income earned abroad by U.S. citizens	5,070	5,320	5,590	5,870	6,160	6,470	6,790	30,880
3	Exclusion of certain allowances for Federal employees abroad	880	920	970	1,020	1,070	1,120	1,180	5,360
4	Inventory property sales source rules exception	2,200	2,440	2,640	2,860	3,100	3,360	3,640	15,600
5	Deferral of income from controlled foreign corporations (normal tax method)	31,580	30,960	32,720	33,870	34,490	33,930	34,130	169,140
6	Deferred taxes for financial firms on certain income earned overseas	5,570	5,460	5,770	5,980	6,090	5,990	6,020	29,850
General science, space, and technology:									
7	Expensing of research and experimentation expenditures (normal tax method)	5,180	3,820	3,500	4,560	5,720	6,690	6,930	27,400
8	Credit for increasing research activities	7,440	8,010	5,880	3,850	3,080	2,460	1,960	17,230
Energy:									
9	Expensing of exploration and development costs, fuels	1,650	2,480	2,390	1,850	1,580	1,260	940	8,020
10	Excess of percentage over cost depletion, fuels	920	1,360	1,350	1,370	1,380	1,390	1,400	6,890
11	Alternative fuel production credit	590	70	80	10	10	0	0	100
12	Exception from passive loss limitation for working interests in oil and gas properties	10	10	10	10	10	10	10	50
13	Capital gains treatment of royalties on coal	110	110	140	110	110	130	140	630
14	Exclusion of interest on energy facility bonds	10	20	20	30	30	30	30	140
15	New technology credit	920	1,130	1,180	1,180	1,150	1,140	1,120	5,770
16	Energy investment credit	50	50	50	50	50	50	50	250
17	Alcohol fuel credits[1]	50	60	90	190	390	230	0	900
18	Bio-Diesel and small agri-biodiesel producer tax credits[2]	40	30	20	0	0	0	0	20
19	Tax credit and deduction for clean-fuel burning vehicles	170	90	80	40	10	60	100	290
20	Exclusion of utility conservation subsidies	120	120	110	110	110	110	110	550
21	Credit for holding clean renewable energy bonds	40	70	70	70	70	70	70	350
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	–30	–50	–120	–320	–400	–480	–490	–1,810
23	Credit for investment in clean coal facilities	30	200	290	260	240	230	210	1,230
24	Temporary 50% expensing for equipment used in the refining of liquid fuels	350	750	890	900	800	700	630	3,920
25	Natural gas distribution pipelines treated as 15-year property	80	90	110	120	110	100	90	530
26	Amortize all geological and geophysical expenditures over 2 years	20	90	130	120	90	60	40	440
27	Allowance of deduction for certain energy efficient commercial building property	170	200	210	190	200	20	60	680
28	Credit for construction of new energy efficient homes	30	20	10	0	0	0	0	10
29	Credit for energy efficiency improvements to existing homes	230	380	150	0	0	0	0	150
30	Credit for energy efficient appliances	120	130	130	50	0	0	0	180
31	Credit for residential purchases/installations of solar and fuel cells	20	30	20	0	0	0	0	20
32	Partial expensing for advanced mine safety equipment	20	0	0	0	0	0	0	0
33	Qualified energy conservation bonds	0	0	10	30	40	40	40	160
Natural resources and environment:									
34	Expensing of exploration and development costs, nonfuel minerals	210	220	230	230	240	250	250	1,200
35	Excess of percentage over cost depletion, nonfuel minerals	720	740	770	790	810	850	860	4,080
36	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	170	370	390	410	450	460	470	2,180
37	Capital gains treatment of certain timber income	110	110	140	110	110	130	140	630
38	Expensing of multiperiod timber growing costs	290	290	310	310	320	340	340	1,620
39	Tax incentives for preservation of historic structures	480	500	520	550	580	610	640	2,900
40	Expensing of capital costs with respect to complying with EPA sulfur regulations	30	50	30	–10	0	0	0	20
41	Exclusion of gain or loss on sale or exchange of certain brownfield sites	30	40	40	40	30	30	30	170
42	Industrial CO_2 capture and sequestration tax credit	0	0	0	40	130	240	290	700
43	Deduction for endangered species recovery expenditures	0	10	20	20	30	30	30	130
Agriculture:									
44	Expensing of certain capital outlays	110	110	110	120	120	120	120	590
45	Expensing of certain multiperiod production costs	80	80	80	80	90	90	90	430
46	Treatment of loans forgiven for solvent farmers	10	10	10	20	20	20	20	90
47	Capital gains treatment of certain income	1,160	1,130	1,390	1,190	1,140	1,300	1,460	6,480
48	Income averaging for farmers	80	80	80	80	80	80	80	400
49	Deferral of gain on sale of farm refiners	20	20	20	20	20	20	20	100

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES FOR FISCAL YEARS 2008-2014—Continued
(In millions of dollars)

		Total from corporations and individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14
Commerce and housing:									
	Financial institutions and insurance:								
50	Exemption of credit union income	1140	1190	1230	1280	1330	1380	1430	6,650
51	Exclusion of interest on life insurance savings	21,190	22,790	24,450	26,770	29,830	32,580	34,860	148,490
52	Special alternative tax on small property and casualty insurance companies	40	40	40	40	50	50	60	240
53	Tax exemption of certain insurance companies owned by tax-exempt organizations	190	190	200	200	210	210	220	1,040
54	Small life insurance company deduction	50	50	50	50	50	50	50	250
55	Exclusion of interest spread of financial institutions	270	220	240	280	290	310	320	1,930
	Housing:								
56	Exclusion of interest on owner-occupied mortgage subsidy bonds	460	990	1,030	1,110	1,180	1,220	1,270	5,810
57	Exclusion of interest on rental housing bonds	410	890	930	1,000	1,060	1,090	1,120	5,200
58	Deductibility of mortgage interest on owner-occupied homes	88,500	97,280	107,980	119,750	131,230	139,990	147,130	646,080
59	Deductibility of State and local property tax on owner-occupied homes	29,130	20,850	14,980	24,550	30,630	31,870	32,540	134,570
60	Deferral of income from installment sales	1,230	1,250	1,370	1,500	1,650	1,810	1,950	8,280
61	Capital gains exclusion on home sales	30,090	27,980	30,460	39,530	49,550	54,720	60,440	234,700
62	Exclusion of net imputed rental income	–1,720	–5,850	–2,200	2,230	3,680	4,390	5,720	13,820
63	Exception from passive loss rules for $25,000 of rental loss	8,430	8,840	9,160	9,580	10,090	10,240	10,620	49,690
64	Credit for low-income housing investments	3,210	3,750	4,340	4,920	5,520	6,130	6,730	27,640
65	Accelerated depreciation on rental housing (normal tax method)	9,690	10,150	10,770	13,620	14,610	15,770	17,090	71,860
66	Discharge of mortgage indebtedness	310	330	260	190	140	80	0	670
67	Credit for first-time homebuyer	9,530	1,230	–1,350	–1,400	–1,400	–1,060	–910	–6,120
	Commerce:								
68	Cancellation of indebtedness	60	30	20	40	50	40	30	180
69	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
70	Capital gains (except agriculture, timber, and coal)[3]	24,240	23,640	28,920	24,840	23,890	27,270	30,480	135,400
71	Capital gains exclusion of small corporation stock	60	60	60	200	340	350	370	1,320
72	Step-up basis of capital gains at death	21,590	19,530	20,830	25,210	31,720	34,100	36,650	148,510
73	Carryover basis of capital gains on gifts	670	730	710	2,370	1,030	1,370	1,470	6,950
74	Ordinary income treatment of loss from small business corporation stock sale	50	50	60	60	60	60	60	300
75	Accelerated depreciation of buildings other than rental housing (normal tax method)	–6,640	–6,640	–6,560	–7,370	–7,360	–7,360	–7,340	–35,990
76	Accelerated depreciation of machinery and equipment (normal tax method)	55,890	–11,140	–3,820	–1,190	6,010	10,940	15,130	27,070
77	Expensing of certain small investments (normal tax method)	930	90	910	–3,400	–1,680	–850	–260	–5,280
78	Graduated corporation income tax rate (normal tax method)	2,460	2,460	2,880	3,090	3,120	3,300	3,310	15,700
79	Exclusion of interest on small issue bonds	140	320	330	350	380	390	400	1,850
80	Deduction for U.S. production activities	10,660	10,820	14,140	16,890	17,910	19,010	20,010	87,960
81	Special rules for certain film and TV production	70	60	–50	–100	–80	–50	–40	–320
Transportation:									
82	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
83	Exclusion of reimbursed employee parking expenses	2,920	3,000	3,120	3,270	3,400	3,520	3,630	16,940
84	Exclusion for employer-provided transit passes	480	500	530	570	600	630	660	2,990
85	Tax credit for certain expenditures for maintaining railroad tracks	180	180	70	20	10	10	0	110
86	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	80	90	100	100	90	60	60	410
Community and regional development:									
87	Investment credit for rehabilitation of structures (other than historic)	40	40	40	40	40	50	50	220
88	Exclusion of interest for airport, dock, and similar bonds	380	820	850	920	990	1,020	1,050	4,830
89	Exemption of certain mutuals' and cooperatives' income	70	70	70	70	70	80	80	370
90	Empowerment zones and renewal communities	–1,650	–1,960	–1,150	–420	–680	–830	–940	–4,020
91	New markets tax credit	990	1,110	1,050	920	810	580	300	3,660
92	Expensing of environmental remediation costs	590	290	20	–140	–140	–140	–130	–530
93	Credit to holders of Gulf Tax Credit Bonds	10	30	80	80	70	50	50	330
Education, training, employment, and social services:									
	Education:								
94	Exclusion of scholarship and fellowship income (normal tax method)	2,000	2,080	2,160	2,250	2,340	2,440	2,540	11,730
95	HOPE tax credit	3,770	3,800	3,890	4,650	5,100	5,340	5,580	24,560
96	Lifetime Learning tax credit	2,470	2,460	2,510	2,980	3,260	3,410	3,570	15,730
97	Education Individual Retirement Accounts	30	40	60	70	80	80	90	380
98	Deductibility of student-loan interest	1,250	1,260	1,270	1,220	970	980	990	5,430

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES FOR FISCAL YEARS 2008-2014—Continued
(In millions of dollars)

		Total from corporations and individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14
99	Deduction for higher education expenses	1,550	1,680	1,430	0	0	0	0	1,430
100	State prepaid tuition plans	1,030	1,250	1,480	1,700	1,900	2,030	2,140	9,250
101	Exclusion of interest on student-loan bonds	210	470	490	530	560	590	600	2,770
102	Exclusion of interest on bonds for private nonprofit educational facilities	860	1,870	1,960	2,110	2,260	2,320	2,390	11,040
103	Credit for holders of zone academy bonds	160	170	170	170	160	140	130	770
104	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	20	20	20	20	20	20	100
105	Parental personal exemption for students age 19 or over	4,690	2,670	1,660	2,680	3,060	2,860	2,640	12,900
106	Deductibility of charitable contributions (education)	4,330	4,880	5,270	5,670	6,110	6,600	7,010	30,660
107	Exclusion of employer-provided educational assistance	650	680	710	40	0	0	0	750
108	Special deduction for teacher expenses	180	180	160	0	0	0	0	160
109	Discharge of student loan indebtedness	20	20	20	20	20	20	20	100
	Training, employment, and social services:								
110	Work opportunity tax credit	490	740	790	700	520	260	110	2,380
111	Welfare-to-work tax credit	80	50	20	10	10	0	0	40
112	Employer provided child care exclusion	940	1,240	1,480	1,490	1,550	1,620	1,700	7,840
113	Employer-provided child care credit	20	20	30	10	0	0	0	40
114	Assistance for adopted foster children	430	450	480	510	550	580	620	2,740
115	Adoption credit and exclusion	470	480	500	470	90	100	100	1,260
116	Exclusion of employee meals and lodging (other than military)	970	1,010	1,060	1,110	1,170	1,230	1,300	5,870
117	Child credit [4]	28,420	27,250	27,032	20,250	10,072	9,580	9,120	76,054
118	Credit for child and dependent care expenses	3,020	3,670	2,070	1,920	1,710	1,600	1,520	8,820
119	Credit for disabled access expenditures	30	30	30	30	30	30	30	150
120	Deductibility of charitable contributions, other than education and health	38,200	43,370	46,980	50,550	54,600	59,070	62,790	273,990
121	Exclusion of certain foster care payments	480	480	480	480	480	480	480	2,400
122	Exclusion of parsonage allowances	550	580	620	660	700	740	790	3,510
123	Employee retention credit for employers in certain Federal disaster areas	30	140	40	0	0	0	0	40
124	Exclusion for benefits provided to volunteer EMS and firefighters	20	80	80	60	0	0	0	140
125	Temporary income exclusion for employer provided lodging in Midwestern disaster area								
Health:									
126	Exclusion of employer contributions for medical insurance premiums and medical care [5]	131,080	142,010	155,050	169,190	184,860	199,900	214,740	923,740
127	Self-employed medical insurance premiums	5,080	5,470	6,020	6,680	7,490	8,250	9,100	37,540
128	Medical Savings Accounts / Health Savings Accounts	1,830	1,930	2,030	2,130	2,240	2,350	2,470	11,220
129	Deductibility of medical expenses	9,320	9,660	10,760	12,540	14,750	16,850	19,260	74,160
130	Exclusion of interest on hospital construction bonds	1,350	2,940	3,070	3,310	3,530	3,640	3,750	17,300
131	Deductibility of charitable contributions (health)	4,310	4,890	5,300	5,700	6,160	6,660	7,080	30,900
132	Tax credit for orphan drug research	290	320	360	410	460	510	570	2,310
133	Special Blue Cross/Blue Shield deduction	620	600	650	660	670	680	690	3,350
134	Tax credit for health insurance purchased by certain displaced and retired individuals [6]	0	10	10	10	10	10	10	50
135	Distributions from retirement plans for premiums for health and long-term care insurance	240	280	310	340	380	420	460	1,910
Income security:									
136	Exclusion of railroad retirement system benefits	390	390	370	370	370	360	350	1,820
137	Exclusion of workers' compensation benefits	5,830	5,920	6,010	6,110	6,200	6,300	6,400	31,020
138	Exclusion of public assistance benefits (normal tax method)	560	590	620	650	690	740	780	3,480
139	Exclusion of special benefits for disabled coal miners	40	40	40	40	40	40	40	200
140	Exclusion of military disability pensions	110	130	150	180	220	260	320	1,130
	Net exclusion of pension contributions and earnings:								
141	Employer plans	46,120	45,670	44,370	42,420	42,230	41,620	43,600	214,240
142	401(k) plans	47,000	50,000	53,000	66,000	72,000	75,000	77,000	343,000
143	Individual Retirement Accounts	11,700	12,700	13,500	14,800	16,500	17,000	17,200	79,000
144	Low and moderate income savers credit	890	980	1,050	1,050	1,010	940	920	4,970
145	Keogh plans	12,000	13,000	14,000	15,000	17,000	20,000	21,000	87,000
	Exclusion of other employee benefits:								
146	Premiums on group term life insurance	2,230	2,250	2,320	2,460	2,480	2,490	2,510	12,260
147	Premiums on accident and disability insurance	310	320	330	340	350	360	360	1,740
148	Income of trusts to finance supplementary unemployment benefits	30	30	40	40	50	50	50	230
149	Special ESOP rules	1,600	1,700	1,800	1,900	1,900	2,000	2,100	10,600
150	Additional deduction for the blind	40	30	30	40	50	50	50	220
151	Additional deduction for the elderly	2,250	1,940	1,940	2,730	3,290	3,470	3,570	15,000
152	Tax credit for the elderly and disabled	10	10	10	10	10	10	10	50

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES FOR FISCAL YEARS 2008-2014—Continued
(In millions of dollars)

		Total from corporations and individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14
153	Deductibility of casualty losses	540	580	620	690	740	780	810	3,640
154	Earned income tax credit [7]	5,380	5,740	6,130	6,390	8,530	8,790	9,140	38,980
155	Additional exemption for housing Hurricane Katrina displaced individuals	20	10	0	0	0	0	0	0
	Social Security:								
	Exclusion of social security benefits:								
156	Social Security benefits for retired workers	19,700	20,610	19,330	20,420	23,130	25,350	25,750	113,980
157	Social Security benefits for disabled	5,420	5,770	5,840	6,230	6,750	7,090	7,140	33,050
158	Social Security benefits for dependents and survivors	3,570	3,610	3,280	3,350	3,670	3,880	3,800	17,980
	Veterans benefits and services:								
159	Exclusion of veterans death benefits and disability compensation	3,870	3,950	4,140	4,480	4,850	5,260	5,690	24,420
160	Exclusion of veterans pensions	180	180	180	190	220	220	220	1,030
161	Exclusion of GI bill benefits	280	280	290	300	330	330	340	1,590
162	Exclusion of interest on veterans housing bonds	10	20	30	30	30	30	30	150
	General purpose fiscal assistance:								
163	Exclusion of interest on public purpose State and local bonds	11,110	24,610	25,730	27,820	29,810	30,700	31,620	145,680
164	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	49,140	36,270	30,290	48,750	60,350	63,330	65,390	268,110
	Interest:								
165	Deferral of interest on U.S. savings bonds	1,310	1,320	1,330	1,380	1,470	1,490	1,500	7,170
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	29,130	20,850	14,980	24,550	30,630	31,870	32,540	134,570
	Nonbusiness State and local taxes other than on owner-occupied homes	49,140	36,270	30,290	48,750	60,350	63,330	65,390	268,110
	Exclusion of interest on State and local bonds for:								
	Public purposes	11,110	24,610	25,730	27,820	29,810	30,700	31,620	145,680
	Energy facilities	10	20	20	30	30	30	30	140
	Water, sewage, and hazardous waste disposal facilities	170	370	390	410	450	460	470	2,180
	Small-issues	140	320	330	350	380	390	400	1,850
	Owner-occupied mortgage subsidies	460	990	1,030	1,110	1,180	1,220	1,270	5,810
	Rental housing	410	890	930	1,000	1,060	1,090	1,120	5,200
	Airports, docks, and similar facilities	380	820	850	920	990	1,020	1,050	4,830
	Student loans	210	470	490	530	560	590	600	2,770
	Private nonprofit educational facilities	860	1,870	1,960	2,110	2,260	2,320	2,390	11,040
	Hospital construction	1,350	2,940	3,070	3,310	3,530	3,640	3,750	17,300
	Veterans' housing	10	20	30	30	30	30	30	150
	GO Zone and GO Zone mortgage	0	10	10	10	10	10	20	60
	Credit for holders of zone academy bonds	160	170	170	170	160	140	130	770

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.

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2008 $4,410; 2009 $4,730; 2010 $5,230; 2011 $1,630; 2012 $0; 2013 $0; 2014 $0.

[2] In addition, the bio-diesel producer tax credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2008 $940; 2009 $780; 2010 $70; 2011 $60; 2012 $40; 2013 $40; 2014 $10.

[3] An alternative calculation for this tax expenditure based on pre-2005 methodology is shown in Table 19-4.

[4] 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: 2008 $34,020 2009 $26,940; 2010 $17,230; 2011 $16,740; 2012 $1,510; 2013 $1,490; and 2014 $1,480.

[5] The figures in the table indicate the effect on income taxes of the employer contributions for health. In addition, the effect on payroll tax receipts (in millions of dollars) is as follows: 2008 $83,150; 2009 $86,490; 2010 $91,460; 2011 $97,820; 2012 $104,660; 2013 $111,000; and 2014 $117,560.

[6] The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2007 $100; 2008 $110; 2009 $120; 2010 $130; 2011 $140; 2012 $150; and 2013 $160.

[7] 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: 2008 $45,282; 2009 $42,271; 2010 $49,733; 2011 $50,954; 2012 $45,837; 2013 $46,667; and 2014 $47,974.

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES FOR FISCAL YEARS 2008-2014

(In millions of dollars)

		Corporations								Individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14	2008	2009	2010	2011	2012	2013	2014	2010–14
National Defense																	
1	Exclusion of benefits and allowances to Armed Forces personnel									11,190	11,710	10,210	10,550	10,900	11,270	11,660	54,590
International affairs:																	
2	Exclusion of income earned abroad by U.S. citizens									5,070	5,320	5,590	5,870	6,160	6,470	6,790	30,880
3	Exclusion of certain allowances for Federal employees abroad									880	920	970	1020	1070	1120	1180	5,360
4	Inventory property sales source rules exception	2,200	2,440	2,640	2,860	3,100	3,360	3,640	15,600								
5	Deferral of income from controlled foreign corporations (normal tax method)	31,580	30,960	32,720	33,870	34,490	33,930	34,130	169,140								
6	Deferred taxes for financial firms on certain income earned overseas	5,570	5,460	5,770	5,980	6,090	5,990	6,020	29,850								
General science, space, and technology:																	
7	Expensing of research and experimentation expenditures (normal tax method)	4,930	3,560	3,220	4,250	5,390	6,330	6,550	25,740	250	260	280	310	330	360	380	1,660
8	Credit for increasing research activities	7,080	7,620	5,760	3,850	3,080	2,460	1,960	17,110	360	390	120	0	0	0	0	120
Energy:																	
9	Expensing of exploration and development costs, fuels	1,380	2,070	1,990	1,540	1,320	1,050	780	6,680	270	410	400	310	260	210	160	1,340
10	Excess of percentage over cost depletion, fuels	830	1,230	1,220	1,240	1,250	1,260	1,270	6,240	90	130	130	130	130	130	130	650
11	Alternative fuel production credit	570	70	80	10	10	0	0	100	20	0	0	0	0	0	0	0
12	Exception from passive loss limitation for working interests in oil and gas properties									10	10	10	10	10	10	10	50
13	Capital gains treatment of royalties on coal									110	110	140	110	110	130	140	630
14	Exclusion of interest on energy facility bonds	0	10	10	10	10	10	10	50	10	10	10	20	20	20	20	90
15	Energy production credit	840	1,030	1,070	1,070	1,050	1,040	1,020	5,250	80	100	110	110	100	100	100	520
16	Energy investment credit	30	30	30	30	30	30	30	150	20	20	20	20	20	20	20	100
17	Alcohol fuel credits [1]	40	50	70	160	320	160	0	710	10	10	20	30	70	70	0	190
18	Bio-Diesel and small agri-biodiesel producer tax credits [2]	30	20	20	0	0	0	0	20	10	10	0	0	0	0	0	0
19	Tax credit and deduction for clean-fuel burning vehicles	60	30	50	10	–20	10	40	90	110	60	30	30	30	50	60	200
20	Exclusion of utility conservation subsidies	0	0	0	0	0	0	0	0	120	120	110	110	110	110	110	550
21	Credit for holding clean renewable energy bonds	10	20	20	20	20	20	20	100	30	50	50	50	50	50	50	250
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	–30	–50	–120	–320	–400	–480	–490	–1,810								
23	Credit for investment in clean coal facilities	30	200	290	260	240	230	210	1,230								
24	Temporary 50% expensing for equipment used in the refining of liquid fuels	350	750	890	900	800	700	630	3,920								
25	Natural gas distribution pipelines treated as 15-year property	80	90	110	120	110	100	90	530								
26	Amortize all geological and geophysical expenditures over 2 years	20	70	100	100	70	50	30	350	0	20	30	20	20	10	10	90
27	Allowance of deduction for certain energy efficient commercial building property	130	150	160	130	130	10	40	470	40	50	50	60	70	10	20	210
28	Credit for construction of new energy efficient homes	20	20	10	0	0	0	0	10	10	0	0	0	0	0	0	0
29	Credit for energy efficiency improvements to existing homes									230	380	150	0	0	0	0	150
30	Credit for energy efficient appliances	120	130	130	50	0	0	0	180								0
31	Credit for residential energy efficient property									20	30	20	0	0	0	0	20
32	Partial expensing for advanced mine safety equipment	20	0	0	0	0	0	0	0								
33	Qualified energy conservation bonds	0	0	0	10	10	10	10	40	0	0	10	20	30	30	30	120
Natural resources and environment:																	
34	Expensing of exploration and development costs, nonfuel minerals	210	220	230	230	240	250	250	1,200								0
35	Excess of percentage over cost depletion, nonfuel minerals	700	720	750	770	790	820	830	3,960	20	20	20	20	20	30	30	120
36	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	70	120	130	130	140	140	140	680	100	250	260	280	310	320	330	1,500
37	Capital gains treatment of certain timber income									110	110	140	110	110	130	140	630
38	Expensing of multiperiod timber growing costs	180	180	190	190	200	210	210	1,000	110	110	120	120	120	130	130	620
39	Tax incentives for preservation of historic structures	380	390	410	430	460	480	500	2,280	100	110	110	120	120	130	140	620
40	Expensing of capital costs with respect to complying with EPA sulfur regulations	30	50	30	–10	0	0	0	20	0	0	0	0	0	0	0	0
41	Exclusion of gain or loss on sale or exchange of certain brownfield sites	20	30	30	30	20	20	20	120	10	10	10	10	10	10	10	50
42	Industrial CO_2 capture and sequestration tax credit	0	0	0	40	130	240	290	700								
43	Deduction for endangered species recovery expenditures	0	10	20	20	30	30	30	130								
Agriculture:																	
44	Expensing of certain capital outlays	10	10	10	10	10	10	10	50	100	100	100	110	110	110	110	540
45	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	50	70	70	70	70	80	80	80	380
46	Treatment of loans forgiven for solvent farmers									10	10	10	20	20	20	20	90
47	Capital gains treatment of certain income									1,160	1,130	1,390	1,190	1,140	1,300	1,460	6,480
48	Income averaging for farmers									80	80	80	80	80	80	80	400
49	Deferral of gain on sale of farm refiners	20	20	20	20	20	20	20	100								

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES FOR FISCAL YEARS 2008-2014—Continued

(In millions of dollars)

		Corporations								Individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14	2008	2009	2010	2011	2012	2013	2014	2010–14
	Commerce and housing:																
	Financial institutions and insurance:																
50	Exemption of credit union income	1140	1190	1230	1280	1330	1380	1430	6,650								
51	Exclusion of interest on life insurance savings	2660	2830	3010	3160	3380	3630	3880	17,060	18530	19960	21440	23610	26450	28950	30980	131,430
52	Special alternative tax on small property and casualty insurance companies	40	40	40	40	50	50	60	240								
53	Tax exemption of certain insurance companies owned by tax-exempt organizations	190	190	200	200	210	210	220	1,040								
54	Small life insurance company deduction	50	50	50	50	50	50	50	250								
55	Exclusion of interest spread of financial institutions									270	220	240	280	290	310	320	1,930
	Housing:																
56	Exclusion of interest on owner-occupied mortgage subsidy bonds	200	330	340	350	360	370	390	1,810	260	660	690	760	820	850	880	4,000
57	Exclusion of interest on rental housing bonds	180	300	310	320	320	330	340	1,620	230	590	620	680	740	760	780	3,580
58	Deductibility of mortgage interest on owner-occupied homes									88,500	97,280	107,980	119,750	131,230	139,990	147,130	646,080
59	Deductibility of State and local property tax on owner-occupied homes									29,130	20,850	14,980	24,550	30,630	31,870	32,540	134,570
60	Deferral of income from installment sales	310	320	320	320	330	330	330	1,630	920	930	1,050	1,180	1,320	1,480	1,620	6,650
61	Capital gains exclusion on home sales									30,090	27,980	30,460	39,530	49,550	54,720	60,440	234,700
62	Exclusion of net imputed rental income									–1,720	–5,850	–2,200	2,230	3,680	4,390	5,720	13,820
63	Exception from passive loss rules for $25,000 of rental loss									8,430	8,840	9,160	9,580	10,090	10,240	10,620	49,690
64	Credit for low-income housing investments	2,960	3,480	4,050	4,620	5,210	5,800	6,390	26,070	250	270	290	300	310	330	340	1,570
65	Accelerated depreciation on rental housing (normal tax method)	600	620	640	730	770	820	880	3,840	9,090	9,530	10,130	12,890	13,840	14,950	16,210	68,020
66	Discharge of mortgage indebtedness									310	330	260	190	140	80	0	670
67	Credit for first-time homebuyer									9,530	1,230	–1,350	–1,400	–1,400	–1,060	–910	–6,120
	Commerce:																
68	Cancellation of indebtedness									60	30	20	40	50	40	30	180
69	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
70	Capital gains (except agriculture, timber, and coal) [3]									24,240	23,640	28,920	24,840	23,890	27,270	30,480	135,400
71	Capital gains exclusion of small corporation stock									60	60	60	200	340	350	370	1,320
72	Step-up basis of capital gains at death									21,590	19,530	20,830	25,210	31,720	34,100	36,650	148,510
73	Carryover basis of capital gains on gifts									670	730	710	2,370	1,030	1,370	1,470	6,950
74	Ordinary income treatment of loss from small business corporation stock sale									50	50	60	60	60	60	60	300
75	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,390	–2,380	–2,330	–2,430	–2,430	–2,440	–2,440	–12,070	–4,250	–4,260	–4,230	–4,940	–4,930	–4,920	–4,900	–23,920
76	Accelerated depreciation of machinery and equipment (normal tax method)	39,090	–14,300	–8,170	–3,610	610	3,970	6,930	–270	16,800	3,160	4,350	2,420	5,400	6,970	8,200	27,340
77	Expensing of certain small investments (normal tax method)	200	60	180	–800	–440	–250	–120	–1,430	730	30	730	–2600	–1240	–600	–140	–3,850
78	Graduated corporation income tax rate (normal tax method)	2,460	2,460	2,880	3,090	3,120	3,300	3,310	15,700								
79	Exclusion of interest on small issue bonds	60	110	110	110	120	120	120	580	80	210	220	240	260	270	280	1,270
80	Deduction for U.S. production activities	8,630	8,760	11,380	13,560	14,380	15,260	16,070	70,650	2,030	2,060	2,760	3,330	3,530	3,750	3,940	17,310
81	Special rules for certain film and TV production	60	50	–40	–80	–60	–40	–30	–250	10	10	–10	–20	–20	–10	–10	–70
	Transportation:																
82	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
83	Exclusion of reimbursed employee parking expenses									2,920	3,000	3,120	3,270	3,400	3,520	3,630	16,940
84	Exclusion for employer-provided transit passes									480	500	530	570	600	630	660	2,990
85	Tax credit for certain expenditures for maintaining railroad tracks	160	160	60	20	10	10	0	100	20	20	10	0	0	0	0	10
86	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	20	20	30	30	20	10	10	100	60	70	70	70	70	50	50	310
	Community and regional development:																
87	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	30	30	120
88	Exclusion of interest for airport, dock, and similar bonds	160	280	280	290	300	310	320	1,500	220	540	570	630	690	710	730	3,330
89	Exemption of certain mutuals' and cooperatives' income	70	70	70	70	70	80	80	370								
90	Empowerment zones and renewal communities	–400	–470	–200	–50	–120	–150	–180	–700	–1,250	–1,490	–950	–370	–560	–680	–760	–3,320
91	New markets tax credit	250	280	260	230	200	140	70	900	740	830	790	690	610	440	230	2,760
92	Expensing of environmental remediation costs	490	240	20	–120	–120	–120	–110	–450	100	50	0	–20	–20	–20	–20	–80
93	Credit to holders of Gulf Tax Credit Bonds	0	0	20	20	20	10	10	80	10	30	60	60	50	40	40	250
	Education, training, employment, and social services:																
	Education:																
94	Exclusion of scholarship and fellowship income (normal tax method)									2,000	2,080	2,160	2,250	2,340	2,440	2,540	11,730
95	HOPE tax credit									3,770	3,800	3,890	4,650	5,100	5,340	5,580	24,560
96	Lifetime Learning tax credit									2,470	2,460	2,510	2,980	3,260	3,410	3,570	15,730
97	Education Individual Retirement Accounts									30	40	60	70	80	80	90	380

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES FOR FISCAL YEARS 2008-2014—Continued

(In millions of dollars)

		Corporations								Individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14	2008	2009	2010	2011	2012	2013	2014	2010–14
98	Deductibility of student-loan interest									1,250	1,260	1,270	1,220	970	980	990	5,430
99	Deduction for higher education expenses									1,550	1,680	1,430	0	0	0	0	1,430
100	State prepaid tuition plans									1,030	1,250	1,480	1,700	1,900	2,030	2,140	9,250
101	Exclusion of interest on student-loan bonds	90	160	160	170	170	180	180	860	120	310	330	360	390	410	420	1,910
102	Exclusion of interest on bonds for private nonprofit educational facilities	370	630	650	670	690	710	730	3,450	490	1240	1310	1440	1570	1610	1660	7,590
103	Credit for holders of zone academy bonds	160	170	170	170	160	140	130	770								
104	Exclusion of interest on savings bonds redeemed to finance educational expenses									20	20	20	20	20	20	20	100
105	Parental personal exemption for students age 19 or over									4,690	2,670	1,660	2,680	3,060	2,860	2,640	12,900
106	Deductibility of charitable contributions (education)	600	630	670	710	750	790	830	3,750	3,730	4,250	4,600	4,960	5,360	5,810	6,180	26,910
107	Exclusion of employer-provided educational assistance									650	680	710	40	0	0	0	750
108	Special deduction for teacher expenses									180	180	160	0	0	0	0	160
109	Discharge of student loan indebtedness									20	20	20	20	20	20	20	100
	Training, employment, and social services:																
110	Work opportunity tax credit	440	610	620	570	420	220	100	1,930	50	130	170	130	100	40	10	450
111	Welfare-to-work tax credit	60	40	20	10	10			40	20	10						0
112	Employer provided child care exclusion									940	1240	1480	1490	1550	1620	1700	7,840
113	Employer-provided child care credit	20	20	30	10	0	0	0	40								0
114	Assistance for adopted foster children									430	450	480	510	550	580	620	2,740
115	Adoption credit and exclusion									470	480	500	470	90	100	100	1,260
116	Exclusion of employee meals and lodging (other than military)									970	1,010	1,060	1,110	1,170	1,230	1,300	5,870
117	Child credit [4]									28,420	27,250	27,032	20,250	10,072	9,580	9,120	76,054
118	Credit for child and dependent care expenses									3,020	3,670	2,070	1,920	1,710	1,600	1,520	8,820
119	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
120	Deductibility of charitable contributions, other than education and health	1,370	1,440	1,510	1,580	1,650	1,720	1790	8,250	36,830	41,930	45,470	48,970	52,950	57,350	61,000	265,740
121	Exclusion of certain foster care payments									480	480	480	480	480	480	480	2,400
122	Exclusion of parsonage allowances									550	580	620	660	700	740	790	3,510
123	Employee retention credit for employers in certain Federal disaster areas	10	70	20	0	0	0	0	20	20	70	20	0	0	0	0	20
124	Exclusion for benefits provided to volunteer EMS and firefighters									20	80	80	60	0	0	0	140
125	Temporary income exclusion for employer provided lodging in Midwestern disaster area									0	20	0	0	0	0	0	0
Health:																	
126	Exclusion of employer contributions for medical insurance premiums and medical care [5]									131,080	142,010	155,050	169,190	184,860	199,900	214,740	923,740
127	Self-employed medical insurance premiums									5,080	5,470	6,020	6,680	7,490	8,250	9,100	37,540
128	Medical Savings Accounts / Health Savings Accounts									1,830	1,930	2,030	2,130	2,240	2,350	2,470	11,220
129	Deductibility of medical expenses									9,320	9,660	10,760	12,540	14,750	16,850	19,260	74,160
130	Exclusion of interest on hospital construction bonds	580	990	1,020	1,050	1,080	1,110	1,150	5,410	770	1,950	2,050	2,260	2,450	2,530	2,600	11,890
131	Deductibility of charitable contributions (health)	180	190	200	210	220	230	240	1,100	4,130	4,700	5,100	5,490	5,940	6,430	6,840	29,800
132	Tax credit for orphan drug research	290	320	360	410	460	510	570	2,310								
133	Special Blue Cross/Blue Shield deduction	620	600	650	660	670	680	690	3,350								
134	Tax credit for health insurance purchased by certain displaced and retired individuals [6]									0	10	10	10	10	10	10	50
135	Distributions from retirement plans for premiums for health and long-term care insurance									240	280	310	340	380	420	460	1,910
Income security:																	
136	Exclusion of railroad retirement system benefits									390	390	370	370	370	360	350	1,820
137	Exclusion of workers' compensation benefits									5,830	5,920	6,010	6,110	6,200	6,300	6,400	31,020
138	Exclusion of public assistance benefits (normal tax method)									560	590	620	650	690	740	780	3,480
139	Exclusion of special benefits for disabled coal miners									40	40	40	40	40	40	40	200
140	Exclusion of military disability pensions									110	130	150	180	220	260	320	1,130
	Net exclusion of pension contributions and earnings:																
141	Employer plans									46,120	45,670	44,370	42,420	42,230	41,620	43,600	214,240
142	401(k) plans									47,000	50,000	53,000	66,000	72,000	75,000	77,000	343,000
143	Individual Retirement Accounts									11,700	12,700	13,500	14,800	16,500	17,000	17,200	79,000
144	Low and moderate income savers credit									890	980	1,050	1,050	1,010	940	920	4,970
145	Keogh plans									12,000	13,000	14,000	15,000	17,000	20,000	21,000	87,000
	Exclusion of other employee benefits:																
146	Premiums on group term life insurance									2,230	2,250	2,320	2,460	2,480	2,490	2,510	12,260
147	Premiums on accident and disability insurance									310	320	330	340	350	360	360	1,740
148	Income of trusts to finance supplementary unemployment benefits									30	30	40	40	50	50	50	230
149	Special ESOP rules	1,200	1,200	1,300	1,400	1,400	1,400	1,500	7,000	400	500	500	500	500	600	600	3,600
150	Additional deduction for the blind									40	30	30	40	50	50	50	220
151	Additional deduction for the elderly									2,250	1,940	1,940	2,730	3,290	3,470	3,570	15,000
152	Tax credit for the elderly and disabled									10	10	10	10	10	10	10	50

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES FOR FISCAL YEARS 2008-2014—Continued

(In millions of dollars)

		Corporations								Individuals							
		2008	2009	2010	2011	2012	2013	2014	2010–14	2008	2009	2010	2011	2012	2013	2014	2010–14
153	Deductibility of casualty losses									540	580	620	690	740	780	810	3,640
154	Earned income tax credit [7]									5,380	5,740	6,130	6,390	8,530	8,790	9,140	38,980
155	Additional exemption for housing disaster related displaced individuals									20	10	0	0	0	0	0	0
	Social Security:																
	Exclusion of social security benefits:																
156	Social Security benefits for retired workers									19,700	20,610	19,330	20,420	23,130	25,350	25,750	113,980
157	Social Security benefits for disabled									5,420	5,770	5,840	6,230	6,750	7,090	7,140	33,050
158	Social Security benefits for dependents and survivors									3,570	3,610	3,280	3,350	3,670	3,880	3,800	17,980
	Veterans benefits and services:																
159	Exclusion of veterans death benefits and disability compensation									3,870	3,950	4,140	4,480	4,850	5,260	5,690	24,420
160	Exclusion of veterans pensions									180	180	180	190	220	220	220	1,030
161	Exclusion of GI bill benefits									280	280	290	300	330	330	340	1,590
162	Exclusion of interest on veterans housing bonds	0	10	10	10	10	10	10	50	10	10	20	20	20	20	20	100
	General purpose fiscal assistance:																
163	Exclusion of interest on public purpose State and local bonds	4,190	7,100	7,320	7,540	7,760	7,990	8,230	38,840	6,920	17,510	18,410	20,280	22,050	22,710	23,390	106,840
164	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes									49,140	36,270	30,290	48,750	60,350	63,330	65,390	268,110
	Interest:																
165	Deferral of interest on U.S. savings bonds									1,310	1,320	1,330	1,380	1,470	1,490	1,500	7,170
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes									29,130	20,850	14,980	24,550	30,630	31,870	32,540	134,570
	Nonbusiness State and local taxes other than on owner-occupied homes									49,140	36,270	30,290	48,750	60,350	63,330	65,390	268,110
	Exclusion of interest on State and local bonds for:																
	Public purposes	4,190	7,100	7,320	7,540	7,760	7,990	8,230	38,840	6,920	17,510	18,410	20,280	22,050	22,710	23,390	106,840
	Energy facilities	0	10	10	10	10	10	10	50	10	10	10	20	20	20	20	90
	Water, sewage, and hazardous waste disposal facilities	70	120	130	130	140	140	140	680	100	250	260	280	310	320	330	1,500
	Small-issues	60	110	110	110	120	120	120	580	80	210	220	240	260	270	280	1,270
	Owner-occupied mortgage subsidies	200	330	340	350	360	370	390	1,810	260	660	690	760	820	850	880	4,000
	Rental housing	180	300	310	320	320	330	340	1,620	230	590	620	680	740	760	780	3,580
	Airports, docks, and similar facilities	160	280	280	290	300	310	320	1,500	220	540	570	630	690	710	730	3,330
	Student loans	90	160	160	170	170	180	180	860	120	310	330	360	390	410	420	1,910
	Private nonprofit educational facilities	370	630	650	670	690	710	730	3,450	490	1,240	1,310	1,440	1,570	1,610	1,660	7,590
	Hospital construction	580	990	1020	1050	1080	1110	1150	5,410	770	1,950	2,050	2,260	2,450	2,530	2,600	11,890
	Veterans' housing	0	10	10	10	10	10	10	50	10	10	20	20	20	20	20	100
	GO Zone and GO Zone mortgage	0	0	0	0	0	0	10	10	0	10	10	10	10	10	10	50
	Credit for holders of zone academy bonds	160	170	170	170	160	140	130	770								

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.

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2008 $4,410; 2009 $4,730; 2010 $5,230; 2011 $1,630; 2012 $0; 2013 $0; 2014 $0.

[2] In addition, the bio-diesel producer tax credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2008 $940; 2009 $780; 2010 $70; 2011 $60; 2012 $40; 2013 $40; 2014 $10.

[3] An alternative calculation for this tax expenditure based on pre-2005 methodology is shown in Table 19-4.

[4] 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: 2008 $34,020 2009 $26,940; 2010 $17,230; 2011 $16,740; 2012 $1,510; 2013 $1,490; and 2014 $1,480.

[5] The figures in the table indicate the effect on income taxes of the employer contributions for health. In addition, the effect on payroll tax receipts (in millions of dollars) is as follows: 2008 $83,150; 2009 $86,490; 2010 $91,460; 2011 $97,820; 2012 $104,660; 2013 $111,000; and 2014 $117,560.

[6] The figures in the table indicate the effect of the health insurance tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2008 $100; 2009 $100; 2010 $110; 2011 $110; 2012 $120; 2013 $140; and 2014 $150.

[7] 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: 2008 $45,280; 2009 $42,270; 2010 $49,730; 2011 $50,950; 2012 $45,840; 2013 $46,670; and 2014 $47,970.

tax. For example, under the normal and reference tax baselines:

- Income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as a tax expenditure. Accrued income would be taxed under a comprehensive income tax.
- There is a separate corporate 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.
- Noncorporate tax rates vary by level of income.
- Individual tax rates, including brackets, standard deduction, and personal exemptions, are allowed to vary with marital status.
- Values of assets and debt are not generally adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the general price level. 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, by convention, 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 under the normal tax. By convention, 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. Under the reference tax rules, gross income does not include gifts defined as receipts of money or property that are not consideration in an exchange nor does gross income include most transfer payments 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 property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law first made in the 2004 Budget.

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.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported on in this chapter follow. These descriptions relate to current law as of December 31, 2008, and do not reflect proposals made elsewhere in the Budget. Legislation enacted in 2008, such as the Energy Improvement and Extension Act of 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, the Emergency Economic Stabilization Act of 2008, the Emergency Economic Stabilization Act of 2008, the Economic Stimulus Act of 2008, the Heroes Earnings Assistance and Relief Tax Act of 2008, the Food, Conservation, and Energy Act of 2008, and the Housing and Economic Recovery Act of 2008 introduced many changes which for the most part expanded the scope of a number of existing provisions in the Tax Code.

National Defense

1. ***Benefits and allowances to Armed Forces personnel.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. As an example, a rental voucher of $100 is (approximately) equal in value to $100 of cash income. In contrast to this treatment, certain housing

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

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

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL FISCAL YEAR 2010–2014 PROJECTED REVENUE EFFECT
(In millions of dollars)

	Provision	2010	2010–14
126	Exclusion of employer contributions for medical insurance premiums and medical care	155,050	923,740
58	Deductibility of mortgage interest on owner-occupied homes	107,980	646,080
142	401(k) plans	53,000	343,000
120	Deductibility of charitable contributions, other than education and health	46,980	273,990
164	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	30,290	268,110
61	Capital gains exclusion on home sales	30,460	234,700
141	Employer plans	44,370	214,240
5	Deferral of income from controlled foreign corporations (normal tax method)	32,720	169,140
72	Step-up basis of capital gains at death	20,830	148,510
51	Exclusion of interest on life insurance savings	24,450	148,490
163	Exclusion of interest on public purpose State and local bonds	25,730	145,680
70	Capital gains (except agriculture, timber, and coal)	28,920	135,400
59	Deductibility of State and local property tax on owner-occupied homes	14,980	134,570
156	Social Security benefits for retired workers	19,330	113,980
80	Deduction for U.S. production activities	14,140	87,960
145	Keogh plans	14,000	87,000
143	Individual Retirement Accounts	13,500	79,000
117	Child credit	27,032	76,054
129	Deductibility of medical expenses	10,760	74,160
65	Accelerated depreciation on rental housing (normal tax method)	10,770	71,860
1	Exclusion of benefits and allowances to Armed Forces personnel	10,210	54,590
63	Exception from passive loss rules for $25,000 of rental loss	9,160	49,690
154	Earned income tax credit	6,130	38,980
127	Self-employed medical insurance premiums	6,020	37,540
157	Social Security benefits for disabled	5,840	33,050
137	Exclusion of workers' compensation benefits	6,010	31,020
131	Deductibility of charitable contributions (health)	5,300	30,900
2	Exclusion of income earned abroad by U.S. citizens	5,590	30,880
106	Deductibility of charitable contributions (education)	5,270	30,660
6	Deferred taxes for financial firms on certain income earned overseas	5,770	29,850
64	Credit for low-income housing investments	4,340	27,640
7	Expensing of research and experimentation expenditures (normal tax method)	3,500	27,400
76	Accelerated depreciation of machinery and equipment (normal tax method)	–3,820	27,070
95	HOPE tax credit	3,890	24,560
159	Exclusion of veterans death benefits and disability compensation	4,140	24,420
158	Social Security benefits for dependents and survivors	3,280	17,980
130	Exclusion of interest on hospital construction bonds	3,070	17,300
8	Credit for increasing research activities	5,880	17,230
83	Exclusion of reimbursed employee parking expenses	3,120	16,940
96	Lifetime Learning tax credit	2,510	15,730
78	Graduated corporation income tax rate (normal tax method)	2,880	15,700
4	Inventory property sales source rules exception	2,640	15,600
151	Additional deduction for the elderly	1,940	15,000
62	Exclusion of net imputed rental income	–2,200	13,820
105	Parental personal exemption for students age 19 or over	1,660	12,900
146	Premiums on group term life insurance	2,320	12,260
94	Exclusion of scholarship and fellowship income (normal tax method)	2,160	11,730
128	Medical Savings Accounts / Health Savings Accounts	2,030	11,220
102	Exclusion of interest on bonds for private nonprofit educational facilities	1,960	11,040
149	Special ESOP rules	1,800	10,600
100	State prepaid tuition plans	1,480	9,250
118	Credit for child and dependent care expenses	2,070	8,820
60	Deferral of income from installment sales	1,370	8,280
9	Expensing of exploration and development costs, fuels	2,390	8,020
112	Employer provided child care exclusion	1,480	7,840
165	Deferral of interest on U.S. savings bonds	1,330	7,170
73	Carryover basis of capital gains on gifts	710	6,950
10	Excess of percentage over cost depletion, fuels	1,350	6,890
50	Exemption of credit union income	1,230	6,650
47	Capital gains treatment of certain income	1,390	6,480
116	Exclusion of employee meals and lodging (other than military)	1,060	5,870
56	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,030	5,810
15	New technology credit	1,180	5,770
98	Deductibility of student-loan interest	1,270	5,430

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL FISCAL YEAR 2010–2014 PROJECTED REVENUE EFFECT—Continued
(In millions of dollars)

	Provision	2010	2010–14
3	Exclusion of certain allowances for Federal employees abroad	970	5,360
57	Exclusion of interest on rental housing bonds	930	5,200
144	Low and moderate income savers credit	1,050	4,970
88	Exclusion of interest for airport, dock, and similar bonds	850	4,830
35	Excess of percentage over cost depletion, nonfuel minerals	770	4,080
24	Temporary 50% expensing for equipment used in the refining of liquid fuels	890	3,920
91	New markets tax credit	1,050	3,660
153	Deductibility of casualty losses	620	3,640
122	Exclusion of parsonage allowances	620	3,510
138	Exclusion of public assistance benefits (normal tax method)	620	3,480
133	Special Blue Cross/Blue Shield deduction	650	3,350
84	Exclusion for employer-provided transit passes	530	2,990
39	Tax incentives for preservation of historic structures	520	2,900
101	Exclusion of interest on student-loan bonds	490	2,770
114	Assistance for adopted foster children	480	2,740
121	Exclusion of certain foster care payments	480	2,400
110	Work opportunity tax credit	790	2,380
132	Tax credit for orphan drug research	360	2,310
36	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	390	2,180
55	Exclusion of interest spread of financial institutions	240	1,930
135	Distributions from retirement plans for premiums for health and long-term care insurance	310	1,910
79	Exclusion of interest on small issue bonds	330	1,850
136	Exclusion of railroad retirement system benefits	370	1,820
147	Premiums on accident and disability insurance	330	1,740
38	Expensing of multiperiod timber growing costs	310	1,620
161	Exclusion of GI bill benefits	290	1,590
99	Deduction for higher education expenses	1,430	1,430
71	Capital gains exclusion of small corporation stock	60	1,320
115	Adoption credit and exclusion	500	1,260
23	Credit for investment in clean coal facilities	290	1,230
34	Expensing of exploration and development costs, nonfuel minerals	230	1,200
140	Exclusion of military disability pensions	150	1,130
53	Tax exemption of certain insurance companies owned by tax-exempt organizations	200	1,040
160	Exclusion of veterans pensions	180	1,030
17	Alcohol fuel credits	90	900
103	Credit for holders of zone academy bonds	170	770
107	Exclusion of employer-provided educational assistance	710	750
42	Industrial CO_2 capture and sequestration tax credit	0	700
27	Allowance of deduction for certain energy efficient commercial building property	210	680
66	Discharge of mortgage indebtedness	260	670
13	Capital gains treatment of royalties on coal	140	630
37	Capital gains treatment of certain timber income	140	630
44	Expensing of certain capital outlays	110	590
20	Exclusion of utility conservation subsidies	110	550
25	Natural gas distribution pipelines treated as 15-year property	110	530
26	Amortize all geological and geophysical expenditures over 2 years	130	440
45	Expensing of certain multiperiod production costs	80	430
86	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	100	410
48	Income averaging for farmers	80	400
97	Education Individual Retirement Accounts	60	380
89	Exemption of certain mutuals' and cooperatives' income	70	370
21	Credit for holding clean renewable energy bonds	70	350
93	Credit to holders of Gulf Tax Credit Bonds	80	330
74	Ordinary income treatment of loss from small business corporation stock sale	60	300
19	Tax credit and deduction for clean-fuel burning vehicles	80	290
16	Energy investment credit	50	250
54	Small life insurance company deduction	50	250
69	Exceptions from imputed interest rules	50	250
52	Special alternative tax on small property and casualty insurance companies	40	240
148	Income of trusts to finance supplementary unemployment benefits	40	230
87	Investment credit for rehabilitation of structures (other than historic)	40	220
150	Additional deduction for the blind	30	220
139	Exclusion of special benefits for disabled coal miners	40	200
30	Credit for energy efficient appliances	130	180

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL FISCAL YEAR 2010–2014 PROJECTED REVENUE EFFECT—Continued
(In millions of dollars)

	Provision	2010	2010–14
68	Cancellation of indebtedness	20	180
41	Exclusion of gain or loss on sale or exchange of certain brownfield sites	40	170
33	Qualified energy conservation bonds	10	160
108	Special deduction for teacher expenses	160	160
29	Credit for energy efficiency improvements to existing homes	150	150
119	Credit for disabled access expenditures	30	150
162	Exclusion of interest on veterans housing bonds	30	150
14	Exclusion of interest on energy facility bonds	20	140
124	Exclusion for benefits provided to volunteer EMS and firefighters	80	140
43	Deduction for endangered species recovery expenditures	20	130
85	Tax credit for certain expenditures for maintaining railroad tracks	70	110
11	Alternative fuel production credit	80	100
49	Deferral of gain on sale of farm refiners	20	100
82	Deferral of tax on shipping companies	20	100
104	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
109	Discharge of student loan indebtedness	20	100
46	Treatment of loans forgiven for solvent farmers	10	90
12	Exception from passive loss limitation for working interests in oil and gas properties	10	50
134	Tax credit for health insurance purchased by certain displaced and retired individuals	10	50
152	Tax credit for the elderly and disabled	10	50
111	Welfare-to-work tax credit	20	40
113	Employer-provided child care credit	30	40
123	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	40	40
18	Bio-Diesel and small agri-biodiesel producer tax credits	20	20
31	30% credit for residential purchases/installations of solar and fuel cells	20	20
40	Expensing of capital costs with respect to complying with EPA sulfur regulations	30	20
28	Credit for construction of new energy efficient homes	10	10
32	Partial expensing for advanced mine safety equipment	0	0
125	Temporary income exclusion for employer provided lodging in Midwestern disaster area	0	0
155	Additional exemption for housing Hurricane Katrina displaced individuals	0	0
81	Special rules for certain film and TV production	–50	–320
92	Expensing of environmental remediation costs	20	–530
22	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	–120	–1,810
90	Empowerment zones, Enterprise communities, and Renewal communities	–1,150	–4,020
77	Expensing of certain small investments (normal tax method)	910	–5,280
67	Credit for first-time homebuyer	–1,350	–6,120
75	Accelerated depreciation of buildings other than rental housing (normal tax method)	–6,560	–35,990

Table 19–4. ALTERNATIVE ESTIMATES FOR CAPITAL GAINS AND DIVIDENDS, PRE-2005 METHODOLOGY
(In millions of dollars)

	2008	2009	2010	2011	2012	2013	2014	2010-14
Capital Gains *	59,230	57,760	70,640	60,690	58,380	66,600	74,450	330,760
Qualified Dividends	21,400	23,110	45,390	18,750	......	......	......	64,140

* This is an alternative estimate for tax expenditure provision number 70. It does not include tax expenditures for capital gains from agriculture, timber, and coal. These are listed separately in tables 19–1 and 19–2.

Table 19-5. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2008
(In millions of dollars)

	Provision	2008 Present Value of Revenue Loss
5	Deferral of income from controlled foreign corporations (normal tax method)	19,100
6	Deferred taxes for financial firms on income earned overseas	3,370
7	Expensing of research and experimentation expenditures (normal tax method)	2,750
21	Credit for holding clean renewable energy bonds	360
9	Expensing of exploration and development costs - fuels	510
34	Expensing of exploration and development costs - nonfuels	40
38	Expensing of multiperiod timber growing costs	190
45	Expensing of certain multiperiod production costs - agriculture	150
44	Expensing of certain capital outlays - agriculture	200
51	Deferral of income on life insurance and annuity contracts	19,310
65	Accelerated depreciation on rental housing	7,290
75	Accelerated depreciation of buildings other than rental	-3,720
76	Accelerated depreciation of machinery and equipment	18,600
77	Expensing of certain small investments (normal tax method)	504
82	Deferral of tax on shipping companies	20
103	Credit for holders of zone academy bonds	160
64	Credit for low-income housing investments	5,020
100	Deferral for State prepaid tuition plans	7,400
141	Exclusion of pension contributions - employer plans	71,270
142	Exclusion of 401(k) contributions	132,000
143	Exclusion of IRA contributions and earnings	4,900
143	Exclusion of Roth earnings and distributions	500
143	Exclusion of non-deductible IRA earnings	9,200
145	Exclusion of contributions and earnings for Keogh plans	8,290
163	Exclusion of interest on public-purpose bonds	24,920
	Exclusion of interest on non-public purpose bonds	8,930
165	Deferral of interest on U.S. savings bonds	330

and meals, in addition to other benefits 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.***—Under the baseline tax system, all compensation received by U.S. citizens is properly included in their taxable income. It makes no difference whether the compensation is a result of working abroad or whether it is labeled as a housing allowance. In contrast to this treatment, U.S. tax law allows U.S. citizens who live abroad, work in the private sector, and satisfy a foreign residency requirement to exclude up to $80,000 in foreign earned income from U.S. taxes. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, then 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 ($81,093 in 2008).

3. ***Exclusion of certain allowances for Federal employees abroad.***—In general, all compensation received by U.S. citizens is properly included in their taxable income. It makes no difference whether the compensation is a result of working abroad or whether it is labeled as an allowance for the high cost of living abroad. In contrast to this treatment, 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 such as rent, education, and the cost of travel to and from the United States.

4. ***Sales source rule exceptions.***—The United States generally taxes the worldwide income of U.S. persons, with taxpayers receiving a credit for foreign taxes paid, limited to the pre-credit U.S. tax on the foreign source income. In contrast, the sales source rules for inventory property allow U.S. exporters to use more foreign tax credits by allowing the exporters to attribute a larger portion of their earnings abroad than would be the case if the allocation of earnings was based on actual economic activity.

5. ***Income of U.S.-controlled foreign corporations.*** — The United States generally taxes the worldwide income of U.S. persons and business entities. In contrast, certain active income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation when it is earned. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. The reference law tax baseline reflects this tax treatment where only realized income is taxed. Under the normal tax method, however, 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 yet distributed to a U.S. shareholder as tax-deferred income.

6. ***Exceptions under subpart F for active financing income.***—The United States generally taxes the worldwide income of U.S. persons and business entities. It would not allow the deferral of tax or other relief targeted at particular industries or activities. In contrast, under current law, financial firms may defer taxes on income earned overseas in an active business.

General Science, Space, and Technology

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

8. ***R&E credit.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code allows an R&E credit of 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 can elect the alternative simplified credit regime, which is equal to 14 percent (12 percent prior to 2009) of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. Prior to January 1, 2009, taxpayers could also elect an alternative incremental credit regime. Under the alternative incremental credit regime the taxpayer was assigned a three-tiered fixed base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate was reduced. The rates for the alternative incremental credit ranged from 3 percent to 5 percent. The research credit expires on December 31, 2009.

Energy

9. ***Exploration and development costs.***—Under the baseline tax system, the costs of exploring and developing oil and gas wells would be capitalized and then amortized (or depreciated) over an estimate of the economic life of the well. This insures that the net income from the well is measured appropriately each year.

In contrast to this treatment, current law allows intangible drilling costs for successful investments in domestic oil and gas wells (such as wages, the cost of using machinery for grading and drilling, and the cost of unsalvageable materials used in constructing wells) to be deducted immediately, i.e., expensed. Because it allows recovery of costs sooner, expensing is more generous for the taxpayer than would be amortization. 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.

10. ***Percentage depletion.***—The baseline tax system would allow recovery of the costs of developing certain oil and mineral properties using cost depletion. Cost depletion is similar in concept to depreciation, in that the costs of developing or acquiring the asset are capitalized and then gradually reduced over an estimate of the asset's productive life, as is appropriate for measuring net income.

In contrast, the Tax Code generally allows independent fuel and mineral producers and royalty owners to take percentage depletion deductions rather than cost depletion on limited quantities of output. Under percentage depletion, taxpayers deduct a percentage of gross income from mineral production. In certain cases the deduction is limited to a fraction of the asset's net income. Over the life of an investment, percentage depletion deductions can exceed the cost of the investment. Consequently, percentage depletion offers more generous tax treatment than would cost depletion, which would limit deductions to an investment's cost.

11. ***Alternative fuel production credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides a credit of $3 per oil-equivalent barrel of production (in 2004 dollars) for coke or coke gas during a four-year period for qualified facilities placed in service before January 1, 2010.

12. ***Oil and gas exception to passive loss limitation.***—The baseline tax system accepts current law's general rule limiting taxpayers' ability to deduct losses from passive activities against nonpassive income (e.g., wages, interest, and dividends). Passive activities generally are defined as those in which the taxpayer does not materially participate and there are numerous additional considerations brought to bear on the determination of which activities are passive for a given taxpayer. Losses are limited in an attempt to limit tax sheltering activities. Passive losses that are unused may be carried forward and applied against future passive income.

In contrast to the general restrictions on passive losses, the Tax Code exempts owners of working interests in oil and gas properties from "passive income" limitations, such that the working interest-holder who manages the development of wells and incurs all operating costs on behalf of himself and all other owners may aggregate negative taxable income (i.e., losses) from such interests with his other income. Thus, these taxpayers are able to fully deduct passive losses against nonpassive income, in contradiction to the general prohibition against such deductions.

13. ***Capital gains treatment of royalties on coal.***—For individuals in 2008, tax rates on regular income vary from 10 percent to 35 percent, depending on the taxpayer's income. The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, current law allows capital gains to be taxed at a preferentially low rate that is no higher than 15 percent. Certain sales of coal under royalty contracts qualify for taxation as capital gains rather than ordinary income, and so benefit from the preferentially low 15 percent maximum tax rate on capital gains.

14. ***Energy facility bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance construction of certain energy facilities to be exempt from tax. These bonds are generally subject to the State private-activity-bond annual volume cap.

15. ***Energy production credit***.—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides a credit for certain electricity produced from wind energy, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. In addition to the electricity production credit, an income tax credit is allowed for the production of refined coal and Indian coal at qualified facilities.

16. ***Energy investment credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code provides credits for investments in solar and geothermal energy property, qualified fuel cell power plants, stationary microturbine power plants, geothermal heat pumps, small wind property and combined heat and power property.

17. ***Alcohol fuel credits.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides an income tax credit for ethanol derived from renewable sources and used as fuel. In lieu of the alcohol mixture credit, the taxpayer may claim a refundable excise tax credit. In addition, small ethanol producers are eligible for a separate income tax credit for ethanol production and a separate income tax credit is available for qualified cellulosic biofuel production.

18. ***Bio-Diesel tax credit.***—The baseline tax system would not allow credits for particular activities, invest-

ments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code allows an income tax credit for bio-diesel used or sold and for bio-diesel derived from virgin sources. In lieu of the bio-diesel credit, the taxpayer may claim a refundable excise tax credit. In addition, small agri-biodiesel producers are eligible for a separate income tax credit for ethanol production and a separate credit is available for qualified renewable diesel fuel mixtures.

19. ***Credit and deduction for clean-fuel vehicles and property and alternative motor vehicle credits.***—The baseline tax system would not allow credits or deductions for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows a number of credits and deductions for certain types of vehicles. These are available for the purchase of hybrid vehicles, fuel cell vehicles, alternative fuel vehicles and advanced lean burn vehicles and the installing of refueling property.

20. ***Exclusion of utility conservation subsidies.***—The baseline tax system generally takes a comprehensive view of taxable income that includes a wide variety of (measurable) accretions to wealth. In certain circumstances, public utilities offer rate subsidies to non-business customers who invest in energy conservation measures. These rate subsidies are equivalent to payments from the utility to its customer, and so represent accretions to wealth, income, that would be taxable to the customer under the baseline tax system. In contrast, the Tax Code exempts these subsidies from the non-business customer's gross income.

21. ***Credit to holders of clean renewable energy bonds.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides for the issuance of Clean Renewable Energy Bonds which entitles the bond holder to a Federal income tax credit in lieu of interest.

22. ***Deferral of gain from dispositions of transmission property to implement FERC restructuring policy.***—The baseline tax system generally would tax gains from sale when realized. However, the Tax Code allows utilities to defer gains from the sale of their transmission assets to a FERC-approved independent transmission company.

23. ***Credit for investment in clean coal facilities.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides investment tax credits for clean coal facilities producing electricity and for industrial gasification combined cycle projects.

24. ***Temporary 50 percent expensing for equipment used in the refining of liquid fuels.***—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. However, the Tax Code provides for an accelerated recovery of the cost of certain investments in refineries by allowing partial expensing of the cost, thereby giving such investments a tax advantage.

25. ***Natural gas distribution pipelines treated as 15-year property.***—The baseline tax system allows taxpayers to deduct the decline in the economic value of an investment over time. However, the Tax Code allows depreciation of natural gas distribution pipelines (placed in service between 2005 and 2011) over a 15 year period. These deductions are accelerated relative to deductions based on economic depreciation.

26. ***Amortize all geological and geophysical expenditures over two years.***—The baseline tax system allows taxpayers to deduct the decline in the economic value of an investment over time. However, the Tax Code allows geological and geophysical expenditures incurred in connection with oil and gas exploration in the United States to be amortized over two years for non-integrated oil companies.

27. ***Allowance of deduction for certain energy efficient commercial building property.*** —The baseline tax system would not allow deductions in addition to normal depreciation allowances for particular investments in particular industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows a deduction, per square foot, for certain energy efficient commercial buildings.

28. ***Credit for construction of new energy efficient homes.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. However, the Tax Code allows contractors a tax credit of $2,000 for the construction of a qualified new energy-efficient home that has an annual level of heating and cooling energy consumption at least 50 percent below the annual consumption of a comparable dwelling unit. The credit equals $1,000 in the case of a new manufactured home that meets a 30 percent standard.

29. ***Credit for energy efficiency improvements to existing homes.***—The baseline tax system would not allow credits for particular activities, investments, or industries. However, the Tax Code provides an investment tax credit for expenditures made on insulation, exterior windows, and doors that improve the energy efficiency of homes and meet certain standards. The Tax Code also provides a credit for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property.

30. ***Credit for energy efficient appliances.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides tax credits for the manufacture of efficient dishwashers, clothes washers, and refrigerators. The size of the credit depends on the efficiency of the appliance.

31. ***Credit for residential energy efficient property.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, the Tax Code

provides a credit for the purchase of a qualified photovoltaic property and solar water heating property, as well as for fuel cell power plants, geothermal heat pumps and small wind property.

32. ***Expensing for advanced mine safety equipment.***—The baseline tax system generally allows depreciation deductions based on estimates of the decline in the value of an asset as it ages. It would not allow faster write-offs for a particular class of assets or industries. In contrast, the Tax Code allows qualified mine safety equipment placed in service before 2009 to be expensed (deducted immediately) rather than depreciated over time.

33. ***Credit for qualified energy conservation bonds.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, the Tax Code provides for the issuance of energy conservation bonds which entitle the bond holder to a Federal income tax credit in lieu of interest.

Natural Resources and Environment

34. ***Exploration and development costs.***—The baseline tax system allows the taxpayer to deduct the depreciation of an asset according to the decline in its economic value over time. However, certain capital outlays associated with exploration and development of nonfuel minerals may be expensed rather than depreciated over the life of the asset.

35. ***Percentage depletion.***—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. Under current law, however, most nonfuel mineral extractors may use percentage depletion (whereby the deduction is fixed as a percentage of revenue and can exceed total costs) rather than cost depletion, with percentage depletion rates ranging from 22 percent for sulfur to 5 percent for sand and gravel. Over the life of an investment, percentage depletion deductions can exceed the cost of the investment. Consequently, percentage depletion offers more generous tax treatment than would cost depletion, which would limit deductions to an investment's cost.

36. ***Sewage, water, solid and hazardous waste facility bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance construction of sewage, water, or hazardous waste facilities to be exempt from tax. These bonds are generally subject to the State private-activity-bond annual volume cap.

37. ***Capital gains treatment of certain timber.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. However, under current law certain timber sales can be treated as a capital gain rather than ordinary income and therefore subject to the lower capital-gains tax rate. For individuals in 2008, tax rates on regular income vary from 10 percent to 35 percent, depending on the taxpayer's income. In contrast, current law allows capital gains to be taxed at a preferentially low rate that is no higher than 15 percent.

38. ***Expensing multi-period timber growing costs.***—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. However, most of the production costs of growing timber may be expensed under current law rather than capitalized and deducted when the timber is sold, thereby accelerating cost recovery.

39. ***Historic preservation.***—The baseline tax system would not allow credits for particular activities, investments, or industries. However, expenditures to preserve and restore certified historic structures qualify for an investment tax credit of 20 percent under current law for certified rehabilitation activities.

40. ***Expensing of capital costs with respect to complying with EPA sulfur regulations.***—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. However, the Tax Code allows small refiners to deduct 75 percent of qualified capital costs incurred during the taxable year, thereby accelerating cost recovery relative to economic depreciation.

41. ***Exclusion of gain or loss on sale or exchange of certain brownfield sites.***—In general, a tax-exempt organization must pay taxes on income from activities unrelated to its nonprofit status. The Tax Code, however, provides a special exclusion from unrelated business taxable income of the gain or loss from the sale or exchange of certain qualifying brownfield properties.

42. ***Industrial CO_2 capture and sequestration tax credit.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. In contrast, the Tax Code allows a credit of $20 per metric ton for qualified carbon dioxide captured at a qualified facility and disposed of in secure geological storage. In addition, the provision allows a credit of $10 per metric ton of qualified carbon dioxide that is captured at a qualified facility and as a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

43. ***Deduction for endangered species recovery expenditures.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, under current law farmers can deduct up to 25 percent of their gross income for expenses incurred as a result of site and habitat improvement activities that will benefit endangered species on their farm land, in accordance with site specific management actions included in species recovery plans approved pursuant to the Endangered Species Act of 1973.

Agriculture

44. ***Expensing certain capital outlays.***—The baseline tax system allows the taxpayer to deduct the de-

cline in the economic value of an investment over time. However, farmers may expense certain expenditures for feed and fertilizer as well as for soil and water conservation measures as well as other capital improvements under current law.

45. ***Expensing multi-period livestock and crop production costs.***—The baseline tax system allows the taxpayer to deduct the decline in the economic value of an investment over time. However, the production of livestock and crops with a production period greater than two years (e.g., establishing orchards or constructing barns) is exempt from the uniform cost capitalization rules, thereby accelerating cost recovery.

46. ***Loans forgiven solvent farmers.***—The baseline tax system requires debtors to include the amount of loan forgiveness as income or else reduce their recoverable basis in the property related to the loan. If the amount of forgiveness exceeds the basis, the excess forgiveness is taxable. However, for bankrupt debtors, the amount of loan forgiveness reduces carryover losses, unused credits, and then basis, with the remainder of the forgiven debt excluded from taxation.

47. ***Capital gains treatment of certain income.***—For individuals in 2008, tax rates on regular income vary from 10 percent to 35 percent, depending on the taxpayer's income. The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, current law allows capital gains to be taxed at a preferentially low rate that is no higher than 15 percent. Certain agricultural income, such as unharvested crops, qualify for taxation as capital gains rather than ordinary income, and so benefit from the preferentially low 15 percent maximum tax rate on capital gains.

48. ***Income averaging for farmers.***—The baseline tax system generally taxes all earned income each year at the rate determined by the income tax. However, taxpayers may average their taxable income from farming and fishing over the previous three years.

49. ***Deferral of gain on sales of farm refiners.***—The baseline tax system generally subjects capital gains to taxes the year that they are realized. However, the Tax Code allows a taxpayer who sells stock in a farm refiner to a farmers' cooperative to defer recognition of the gain if the proceeds are re-invested in a 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.

50. ***Credit union income.***—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. However, in the Tax Code the earnings of credit unions not distributed to members as interest or dividends are exempt from the income tax.

51. ***Deferral of income on life insurance and annuity contracts.***—Under the baseline tax system, individuals and corporations pay taxes on their income when it is (actually or constructively) received or accrued, depending on their method of accounting. Nevertheless, the Tax Code provides favorable tax treatment for investment income earned within qualified life insurance and annuity contracts. In general, 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 generally tax-deferred. Investment income earned on annuities benefits from tax deferral.

52. ***Small property and casualty insurance companies.***—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Under current law, however, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed $600,000 and more than 50 percent of such gross receipts consists of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed $150,000 and more than 35 percent of gross receipts consist of premiums. Also, non-life insurance companies with no more than $1.2 million of annual net premiums may elect to pay tax only on their taxable investment income.

53. ***Insurance companies owned by exempt organizations.***—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. 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, voluntary employee benefit associations, and others, however, are exempt from tax.

54. ***Small life insurance company deduction.***—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. However, under current law small life insurance companies (with 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.

55. ***Exclusion of interest spread of financial institutions.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Consumers and nonprofit organizations pay for some deposit-linked services, such as check cashing, by accepting a below-market interest rate on their demand deposits. If they received a

market rate of interest on those deposits and paid explicit fees for the associated services, they would pay taxes on the full market rate and (unlike businesses) could not deduct the fees. The Government thus foregoes tax on the difference between the risk-free market interest rate and below-market interest rates on demand deposits, which under competitive conditions should equal the value added of deposit services.

56. ***Mortgage housing bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers to be exempt. These bonds are generally subject to the State private-activity-bond annual volume cap.

57. ***Rental housing bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on State and local government bonds used to finance multifamily rental housing projects to be tax-exempt.

58. ***Interest on owner-occupied homes.***—The baseline tax system would allow the write-off of expenses incurred in earning income. It would not allow the deductibility of expenses when income or the return on investments are not taxed. In contrast, the Tax Code provides that owner-occupants of homes may deduct mortgage interest on their primary and secondary residences as itemized nonbusiness deductions even though the value of owner-occupied housing services is not included in a taxpayer's taxable income. In general, the mortgage interest deduction is limited to interest on debt no greater than the owner's basis in the residence, and is also limited to interest on debt of 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.

59. ***Taxes on owner-occupied homes.***—The Tax Code allows owner-occupants of homes to 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.

60. ***Installment sales.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates, or deferral of tax, to apply to certain types or sources of income. 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.

61. ***Capital gains exclusion on home sales.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law, 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.

62. ***Imputed net rental income on owner-occupied housing.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Under current law, the implicit rental value of home ownership, net of expenses such as mortgage interest and depreciation, is excluded from income.

63. ***Passive loss real estate exemption.***—The baseline tax system accepts current law's general rule limiting taxpayers' ability to deduct losses from passive activities against nonpassive income (e.g., wages, interest, and dividends). Passive activities generally are defined as those in which the taxpayer does not materially participate and there are numerous additional considerations brought to bear on the determination of which activities are passive for a given taxpayer. Losses are limited in an attempt to limit tax sheltering activities. Passive losses that are unused may be carried forward and applied against future passive income.

In contrast to the general restrictions on passive losses, the Tax Code exempts owners of working interests in rental real estate activities are exempt from "passive income" limitations. The exemption is limited to $25,000 in losses.

64. ***Low-income housing credit.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, under current law 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 can exceed these levels in certain statutorily defined and State designated areas where project development costs are higher. The credit is allowed in equal amounts over 10 years and is generally subject to a volume cap.

65. ***Accelerated depreciation of rental property.***—Under an economic income tax, the costs of acquiring a building are capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolescence. This insures that the net income from the rental property is measured appropriately each year. However, the depreciation provisions of the Tax Code are part of the reference law rules, and thus do not give rise to tax expenditures under refer-

ence law. Under normal law, however, depreciation allowances reflect estimates of economic depreciation.

66. ***Discharge of mortgage indebtedness***.—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows an exclusion from the income of a taxpayer any discharge of indebtedness of a qualified principal residence. The provision sunsets on December 31, 2009.

67. ***Credit for first-time homebuyer.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code allows a tax credit of $7,500 for first time home buyers on purchases on or after April 9, 2008 and before July 1, 2009. The credit will be repaid by the homeowner over time.

68. ***Cancellation of indebtedness.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law 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.

69. ***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.

70. ***Capital gains (other than agriculture, timber, and coal)***.— For individuals in 2008, tax rates on regular income vary from 10 percent to 35 percent, depending on the taxpayer's income. The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low tax rates to apply to certain types or sources of income. In contrast, current law allows capital gains on assets held for more than one year to be taxed at a preferentially low rate that is no higher than 15 percent. Table 19-4 shows the full tax expenditure from taxing capital gains (other than capital gains from agriculture, timber, and coal) at a preferential rate. Tables 19-1 to 19-3 show the tax expenditure limited only to capital gains that have not been previously taxed under the corporate income tax.

71. ***Capital gains exclusion for small business stock.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code provides an exclusion of 50 percent (from a 28 percent tax rate) for capital gains from qualified small business stock held by individuals for more than 5 years; 75 percent for stock issued in 2009 and 2010. A qualified small business is a corporation whose gross assets do not exceed $50 million as of the date of issuance of the stock.

72. ***Step-up in basis of capital gains at death.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, capital gains on assets held at the owner's death are not subject to capital gains tax under current law. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death.

73. ***Carryover basis of capital gains on gifts.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates or tax deferral to apply to certain types or sources of income. In contrast, when a gift of appreciated asset is made under current law, 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.

74. ***Ordinary income treatment of losses from sale of small business corporate stock shares.***—The baseline tax system limits to $3,000 the write-off of losses from capital assets, with carryover of the excess to future years. In contrast, the Tax Code allows up to $100,000 in losses from the sale of small business corporate stock (capitalization less than $1 million) to be treated as ordinary losses and fully deducted.

75. ***Accelerated depreciation of non-rental-housing buildings.***—Under an economic income tax, the costs of acquiring a building are capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolescence. This insures that the net income from the rental property is measured appropriately each year. However, the depreciation provisions of the Tax Code are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, depreciation allowances reflect estimates of economic depreciation.

76. ***Accelerated depreciation of machinery and equipment.***—Under an economic income tax, the costs of acquiring machinery and equipment are capitalized and depreciated over time in accordance with the decline in the property's economic value due to wear and tear or obsolescence. This insures that the net income from the rental property is measured appropriately each year. However, the depreciation provisions of the Tax Code are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, depreciation allowances reflect estimates of economic depreciation.

77. ***Expensing of certain small investments.***—Under the reference law baseline, the costs of acquiring tangible property and computer software would be depreciated using the Tax Code's depreciation provisions. Under the normal tax baseline, depreciation allowances are estimates of economic depreciation. However, the Tax Code allows qualifying investments by small businesses in tangible property and certain computer software to be expensed rather than depreciated over time.

78. ***Graduated corporation income tax rate schedule.***—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 rate is considered a tax expenditure under this concept.

79. ***Small issue industrial development bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows interest earned on small issue industrial development bonds (IDBs) issued by State and local governments to finance manufacturing facilities to be 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.

80. ***Deduction for U.S. production activities.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows for a deduction equal to a portion of taxable income attributable to domestic production.

81. ***Special rules for certain film and TV production.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law taxpayers may deduct up to $15 million per production ($20 million in certain distressed areas) in non-capital expenditures incurred during the year.

Transportation

82. ***Deferral of tax on U.S. shipping companies.***—The baseline tax system generally would tax all profits and income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows certain companies that operate U.S. flag vessels to 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.

83. ***Exclusion of employee parking expenses.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. In contrast, under current law 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 2008, the maximum amount of the parking exclusion is $220 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

84. ***Exclusion of employee transit pass expenses.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. In contrast, under current law 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 2008, the maximum amount of the exclusion is $115 (indexed) per month.

85. ***Tax credit for certain expenditures for maintaining railroad tracks.***—The baseline tax system would not allow credits for particular activities, investments, or industries. However, under current law eligible taxpayers may claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of $3,500 and the number of miles of track owned or leased.

86. ***Exclusion of interest on bonds for financing of highway projects and rail-truck transfer facilities.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code provides for $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities. The authority to issue these bonds expires on December 31, 2015.

Community and Regional Development

87. ***Rehabilitation of structures.***—The baseline tax system would uniformly tax all returns to investments and not allow credits for particular activities, investments, or industries. However, the Tax Code allows a 10-percent investment tax credit 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.

88. ***Airport, dock, and similar facility bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, the Tax Code allows 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 to be tax-exempt. These bonds are not subject to a volume cap.

89. ***Exemption of income of mutuals and cooperatives.***—Under the baseline tax system, corporations pay taxes on their profits under the regular tax rate schedule. In contrast, the Tax Code provides for the incomes of mutual and cooperative telephone and electric companies to be exempt from tax if at least 85 percent of their revenues are derived from patron service charges.

90. ***Empowerment zones and renewal communities.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income, tax credits, and write-offs faster than economic depreciation. In contrast, under current law 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.

91. ***New markets tax credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. However, under current law taxpayers who make qualified equity investments in a community development entity (CDE), which then makes qualified investments in low-income communities, are eligible for a tax credit received over 7 years. The total equity investment available for the credit across all CDEs is $3.5 billion in 2008.

92. ***Expensing of environmental remediation costs.***—Under the baseline tax system, the costs would be amortized (or depreciated) over an estimate of the economic life of the building. This insures that the net income from the buildings is measured appropriately each year. However, the Tax Code allows taxpayers who clean up certain hazardous substances at a qualified site to expense the clean-up costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property.

93. ***Credit to holders of Gulf and Midwest Tax Credit Bonds.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, under current law taxpayers that own Gulf and Midwest Tax Credit bonds receive a non-refundable tax credit rather than interest. The credit is included in gross income.

Education, Training, Employment, and Social Services

94. ***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 baseline tax system of 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).

95. ***HOPE tax credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Under current law, however, the non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,100 of tuition and fees and 50 percent of the next $1,200 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. In 2008, the credit is phased out ratably for taxpayers with modified AGI between $96,000 and $116,000 ($48,000 and $58,000 for singles), indexed.

96. ***Lifetime Learning tax credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Under current law, however, the non-refundable Lifetime Learning tax credit allows a credit for 20 percent of an eligible student's tuition and fees, up to a maximum credit per return of $2,000. The credit is phased out ratably for taxpayers with modified AGI between $96,000 and $116,000 ($48,000 and $58,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

97. ***Education Individual Retirement Accounts (IRA).***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Contributions to an education IRA are not tax-deductible. However, 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 2008 is $2,000 per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $190,000 and $220,000 ($95,000 and $110,000 for singles).

98. ***Student-loan interest.***—The baseline tax system accepts current law's general rule limiting taxpayers' ability to deduct non-business interest expenses. In contrast, 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 2008, the maximum deduction is phased down ratably for taxpayers with modified AGI between $110,000 and $140,000 ($55,000 and $70,000 for singles), indexed.

99. ***Deduction for higher education expenses.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides a maximum annual deduction of $4,000 in 2008 for qualified higher education expenses for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000. No deduction is allowed for expenses paid after December 31, 2008.

100. ***State prepaid tuition plans.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. 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. Under current law, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses.

101. ***Student-loan bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, interest earned on State and local bonds issued to finance student loans is tax-exempt under current law. The volume of all such private activity bonds that each State may issue annually is limited.

102. ***Bonds for private nonprofit educational institutions.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law interest earned on State and local Government bonds issued to finance the construction of facilities used by private nonprofit educational institutions is not taxed.

103. ***Credit for holders of zone academy bonds.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Under current law, however, financial institutions that own zone academy bonds receive a non-refundable tax credit rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be 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 $400 million in each year.

104. ***U.S. savings bonds for education.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Under current law, however, 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 $100,650 and $130,650 ($67,100 and $81,100 for singles) in 2008.

105. ***Dependent students age 19 or older.***—The tax rate schedule, including personal exemptions and the standard deduction, are part of the baseline tax system. Additional exemptions to targeted groups are not allowed. In contrast, the Tax Code provides taxpayers personal exemptions for dependent children who are over the age of 18 or under the age of 24 and who (1) reside with the taxpayer for over half the year (with exceptions for temporary absences from home, such as for school attendance), (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns. However, under current law, the dependent/student is not eligible to claim a personal exemption on his or her own tax return.

106. ***Charitable contributions to educational institutions.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides taxpayers a deduction for contributions to nonprofit educational institutions. Moreover, taxpayers who donate capital assets to educational institutions can deduct the asset's 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.

107. ***Employer-provided educational assistance.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, 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.

108. ***Special deduction for teacher expenses.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, under current law educators in both public and private elementary and secondary schools, who work at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, may subtract up to $250 of qualified expenses when figuring their adjusted gross income (AGI). This provision expired at end of December 31, 2008.

109. ***Discharge of student loan indebtedness.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, the Tax Code allows certain professionals who perform in underserved areas, and as a consequence get their student loans discharged, not to recognize such discharge as income.

110. ***Work opportunity tax credit (WOTC).***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would seek to tax uniformly all returns from investment-like activities. In contrast, the Tax Code provides employers with a tax credit for qualified wages paid to individuals. The credit applies to employees who begin work on or before August 31, 2011 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent of qualified wages for employment less than 400 hours and 40 percent for employment of 400 hours or more. Generally, 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. However, the credit for long-term welfare recipients can be claimed on second year wages as well and has a $9,000 maximum. Employees must work at least 120 hours to be eligible for the credit. Employers must reduce their deduction for wages paid by the amount of the credit claimed.

111. ***Welfare-to-work tax credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, it generally would

seek to tax uniformly all returns from investment-like activities. In contrast, under current law 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 welfare-to-work credit expired on December 31, 2006. After this date, long-term welfare recipients became a WOTC target group.

112. ***Employer-provided child care exclusion.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law up to $5,000 of 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.

113. ***Employer-provided child care credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. Instead, current law provides a credit 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.

114. ***Assistance for adopted foster children.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. 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 under current law.

115. ***Adoption credit and exclusion.***—The baseline tax system would not allow credits for particular activities. Instead, taxpayers can receive a nonrefundable tax credit for qualified adoption expenses under current law. The maximum credit is $11,650 per child for 2008, and is phased-out ratably for taxpayers with modified AGI between $174,730 and $214,630. The credit amounts and the phase-out thresholds are indexed for inflation. 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.

116. ***Employer-provided meals and lodging.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law 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.

117. ***Child credit.***—The baseline tax system would not allow credits for particular activities or targeted at specific groups. Under current law, however, taxpayers with children under age 17 can qualify for a $1,000 partially refundable per child credit. The maximum credit declines to $500 in 2011 and later years. 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).

118. ***Child and dependent care expenses.***—The baseline tax system would not allow credits for particular activities or targeted at specific groups. In contrast, the Tax Code provides married couples with child and dependent care expenses 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. In 2008, expenditures up to a maximum $3,000 for one dependent and $6,000 for two or more dependents are eligible for the credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of $15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $15,000.

119. ***Disabled access expenditure credit.***—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides small businesses (less than $1 million in gross receipts or fewer than 31 full-time employees) a 50-percent credit for expenditures in excess of $250 to remove access barriers for disabled persons. The credit is limited to $5,000.

120. ***Charitable contributions, other than education and health.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides taxpayers a deduction for 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.

121. ***Foster care payments.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. Foster parents provide a home and care for children who are wards of the State, under contract with the State. However, compensation received for this service is excluded from the gross incomes of foster parents; the expenses they incur are nondeductible.

122. ***Parsonage allowances.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, the value of a clergyman's housing allowance and the rental value of parsonages are not included in a minister's taxable income under current law.

123. ***Provide an employee retention credit to employers affected by hurricanes Katrina, Rita, Wilma, and Ike.***—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, the Tax Code provides tax credits against the wages paid to eligible employees in areas affected by nat-

ural disasters such as hurricanes Katrina, Rita, Wilma, and Ike.

124. ***Exclusion for benefits provided to volunteer EMS and firefighters.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, the Tax Code provides that certain benefits received by volunteer EMS and firefighters excluded from income.

125. ***Temporary income exclusion for employer provided lodging in Midwestern disaster area.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law employer-provided meals and lodging in disaster areas are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

Health

126. ***Employer-paid medical insurance and expenses.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law, 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.

127. ***Self-employed medical insurance premiums.***—Under the baseline tax system, all compensation and remuneration, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, under current law 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.

128. ***Medical and health savings accounts.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. Also, the baseline tax system would not allow a deduction for personal expenditures. In contrast, individual contributions to Archer Medical Savings Accounts (Archer MSAs) and Health Savings Accounts (HSAs) are allowed as a deduction in determining adjusted gross income whether or not the individual itemizes deductions. Employer contributions to Archer MSAs and HSAs are excluded from income and employment taxes. Archer MSAs and HSAs require that the individual have coverage by a qualifying high deductible health plan. Earnings from the accounts are excluded from taxable income. Distributions from the accounts used for medical expenses are not taxable. The rules for HSAs are generally more flexible than for Archer MSAs and the deductible contribution amounts are greater (in 2008, $2900 for taxpayers with individual coverage and $5,800 for taxpayers with family coverage). Thus, HSAs have largely replaced MSAs.

129. ***Medical care expenses.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, under current law personal expenditures for medical care (including the costs of prescription drugs) exceeding 7.5 percent of the taxpayer's adjusted gross income are deductible.

130. ***Hospital construction bonds.*** —The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

131. ***Charitable contributions to health institutions.***—The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides individuals and corporations a deduction for 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.

132. ***Orphan drugs.***—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, under current law 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.

133. ***Blue Cross and Blue Shield.***—The baseline tax system generally would tax all profits under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, 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.

134. ***Tax credit for health insurance purchased by certain displaced and retired individuals.***—The baseline tax system would not allow credits for particular activities, investments, or industries. In contrast, the Trade Act of 2002 provides a refundable tax credit of 65 percent for the purchase of health insurance coverage by individuals eligible for Trade Adjustment Assistance and certain Pension Benefit Guarantee Corporation pension recipients.

135. ***Distributions for premiums for health and long-term care insurance.***—Under the baseline tax system, all compensation, including dedicated and deferred payments, should be included in taxable income. In contrast, the Tax Code provides for tax-free distributions of up to $3,000 from governmental retirement plans for premiums for health and long term care premiums of public safety officers.

Income Security

136. ***Railroad retirement benefits.***—Under the baseline tax system, all compensation, including dedicated and deferred payments, should be included in taxable income. In contrast, railroad retirement benefits are not generally subject to the income tax unless the recipient's gross income reaches a certain threshold under current law. The threshold is discussed more fully under the Social Security function.

137. ***Workers' compensation benefits.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. However, workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax under current law.

138. ***Public assistance benefits.***—Under the reference law baseline tax system, gifts and transfers are not treated as income to the recipients. In contrast, the normal tax method considers cash transfers from the Government as part of the recipients' income, and thus, treats the exclusion for public assistance benefits under current law as tax expenditure.

139. ***Special benefits for disabled coal miners.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. However, 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.

140. ***Military disability pensions.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

141. ***Employer-provided pension contributions and earnings.***—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law 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.

142. ***401(k) plans.***—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law 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 2008, an employee could exclude up to $15,500 (indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. Employees age 50 or over could exclude an additional $5,000 "catch-up" contribution (indexed). The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

143. ***Individual Retirement Accounts (IRAs).***—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law individual taxpayers can take advantage of several different IRAs to defer or otherwise reduce the tax on the return to their retirement savings. These arrangements include deductible IRAs, nondeductible IRAs and Roth IRAs. The IRA contribution limit is $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000. Taxpayers can make a deductible IRA contribution only up to certain levels of AGI. Above those AGI limits, the amount that may be deducted is reduced and eventually phased out. There is no income limit for nondeductible IRA contributions, which still benefit from deferral of tax on earnings. Roth IRA contributions are not deductible, but earnings and withdrawals are exempt from taxation under certain conditions. AGI limits also apply to Roth IRA contributions.

144. ***Low and moderate-income savers' credit.***—The baseline tax system would not allow credits for particular activities or targeted at specific group. In contrast, the Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to $2,000. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $52,000 for joint filers and $26,000 for single filers.

145. ***Keogh plans.***—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law 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 $46,000 in 2008. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

146. ***Employer-provided life insurance benefits.***—Under the baseline tax system, all compensation, including deferred and dedicated payments, should be included in taxable income. In contrast, under current law 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, but only to the extent that the employer's share of the total costs does not exceed the cost of $50,000 of such insurance.

147. ***Employer-provided accident and disability benefits.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, 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.

148. ***Employer-provided supplementary unemployment benefits.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. Employers may establish trusts to pay supplemental unemployment ben-

efits to employees separated from employment. Interest payments to such trusts are exempt from taxation.

149. ***Employer Stock Ownership Plan (ESOP) provisions.***—ESOPs are a special type of tax-exempt employee benefit plan. Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income. In contrast, 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.

150. ***Additional deduction for the blind.***—The tax rate schedule, including personal exemptions and the standard deduction, are part of the baseline tax system. Additional exemptions to targeted groups are not allowed. In contrast, the Tax Code provides taxpayers who are blind an additional $1,350 standard deduction if single, or $1,050 if married in 2008.

151. ***Additional deduction for the elderly.***—The tax rate schedule, including personal exemptions and the standard deduction, are part of the baseline tax system. Additional exemptions to targeted groups are not allowed. In contrast, the Tax Code provides taxpayers who are 65 years or older an additional $1,350 standard deduction if single, or $1,050 if married in 2008.

152. ***Tax credit for the elderly and disabled.***—The baseline tax system would not allow credits for particular activities or targeted at specific group. Under current law, however, 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.

153. ***Casualty losses.***—Under the baseline tax system, 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 and uninsured losses not deductible. In contrast, the Tax Code provides a deduction for 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.

154. ***Earned income tax credit (EITC)***.— The baseline tax system would not allow credits for particular activities or targeted at specific group. In contrast, the Tax Code provides an EITC to low-income workers at a maximum rate of 40 percent of income. For a family with one qualifying child, the credit is 34 percent of the first $8,580 of earned income in 2008. The credit is 40 percent of the first $12,060 of income for a family with two or more qualifying children. The credit is phased out at income levels and rates which depend upon how many qualifying children are eligible and marital status. Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals.

155. ***Additional exemption for housing natural disaster displaced individuals.***—The tax rate schedule, including personal exemptions and the standard deduction, are part of the baseline tax system. Additional exemptions to targeted groups are not allowed. In contrast, the Tax Code provides additional exemption to persons displaced by natural disasters such as hurricane Katrina.

Social Security

156. ***Social Security benefits for retired workers.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. In contrast, the Tax Code may not tax all of the Social Security benefits that exceed the beneficiary's contributions out of taxed income. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation and partly by earnings on employee and employer contributions. Portions of benefits (reaching as much as 85 percent) of recipients' Social Security and tier 1 railroad retirement benefits are included in (phased-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 income amounts at which 85 percent of the benefits are taxable.

157. ***Social Security benefits for the disabled.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, benefit payments from the Social Security Trust Fund for disability are fully or partially excluded from a beneficiary's gross incomes. (See provision number 156, Social Security benefits for retired workers.)

158. ***Social Security benefits for dependents and survivors.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they

represent accretions to wealth that do not materially differ from cash wages. Under current law, however, benefit payments from the Social Security Trust Fund for dependents and survivors are fully or partially excluded from a beneficiary's gross income.

Veterans Benefits and Services

159. ***Veterans death benefits and disability compensation.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. In contrast, all compensation due to death or disability paid by the Veterans Administration is excluded from taxable income under current law.

160. ***Veterans pension payments.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, pension payments made by the Veterans Administration are excluded from gross income.

161. ***G.I. Bill benefits.***—Under the baseline tax system, all compensation, including dedicated payments and in-kind benefits, should be included in taxable income because they represent accretions to wealth that do not materially differ from cash wages. Under current law, however, G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

162. ***Tax-exempt mortgage bonds for veterans.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law, interest earned on general obligation bonds issued by State and local governments to finance housing for veterans is excluded from taxable income.

General Government

163. ***Public purpose State and local bonds.***—The baseline tax system generally would tax all income under the regular tax rate schedule. It would not allow preferentially low (or zero) tax rates to apply to certain types or sources of income. In contrast, under current law 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.

164. ***Deductibility of certain nonbusiness State and local taxes.***— The baseline tax system would not allow a deduction for personal expenditures. In contrast, the Tax Code provides taxpayers who itemize a deduction for State and local income taxes and property taxes (or at the taxpayer's election state and local sales taxes) even though these taxes primarily pay for services that, if purchased directly by taxpayers, would not be deductible.

Interest

165. ***U.S. savings bonds.***—The baseline tax system would uniformly tax all returns to investments and not allow an exemption or deferral for particular activities, investments, or industries. In contrast, taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

APPENDIX A
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 are achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. This Appendix responds to the report of the Senate Governmental Affairs Committee on GPRA[4] calling 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.

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.[5] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the operation of 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; and these can be dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range of policy instruments means that tax expenditures can be flexible and can have very different economic effects.

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

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

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, personal exemptions, deductions, credits, and phase-outs can complicate filing and decision-making. 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 socioeconomic disparity. 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.

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. 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 often be changed as needed by the Executive Branch without legislation. Like tax expenditures, regulations often rely largely on 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 degree of scrutiny that outlay programs receive. However, major regulations are subjected to a formal regulatory 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. When measured against a comprehensive income tax, for example, 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 benefiting 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 imputed net rental income from owner-occupied housing is excluded from the tax base. The mortgage interest deduction and property tax deduction on personal residences also are reported as tax expenditures 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. 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 benefiting 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.