

## 5. TAX EXPENDITURES

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

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

Because of potential interactions among provisions, this chapter does not present a grand total revenue loss estimate for tax expenditures. Moreover, past tax

changes entailing broad elimination of tax expenditures were generally accompanied by changes in tax rates or other basic provisions, so that the net effects on Federal revenues were considerably (if not totally) offset. Nevertheless, in aggregate, tax expenditures have revenue impacts of hundreds of billions of dollars, and are some of the most important ways in which the Federal Government affects economic decisions and social welfare.

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

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

### TAX EXPENDITURES IN THE INCOME TAX

#### Tax Expenditure Estimates

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

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

estimates and discussion of general features of the tax expenditure concept.

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

Table 5–2 reports the respective portions of the total revenue losses that arise under the individual and corporate income taxes. Listing revenue loss estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these break-

downs show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be stockholders, employees, customers, or others, depending on economic forces.

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

### Interpreting Tax Expenditure Estimates

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

- Eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the formerly subsidized activity or of other tax preferences or Government programs. For example, if deductibility of mortgage interest were limited, some taxpayers would hold smaller mortgages, with a concomitantly smaller effect on the budget than if no such limits were in force.
- Tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the revenue losses associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue losses from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue loss from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, since each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 5-1 are the totals of individual and corporate income tax revenue losses reported in Table 5-2 and do not reflect any possible interactions between the individual and corporate income tax receipts. For this reason, the figures in Table 5-1 (as well as those in Table 5-5, which are also based on summing individual and corporate estimates) should be regarded as approximations.
- Revenues raised by changes to tax expenditures are sensitive to timing effects and effective dates. Changes in some provisions would yield their full potential revenue gains relatively quickly, whereas

changes to other provisions would only gradually yield their full revenue potential, as certain deductions or exemptions would likely be grandfathered.

- The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 5-4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. While such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals do have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real cost to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful supplement to the cash-basis estimates for provisions involving deferrals, are discussed below.
- Repeal of some provisions could affect overall levels of income and rates of economic growth. In principle, repeal of major tax provisions may have some impact on the budget economic assumptions. In general, however, most changes in particular provisions are unlikely to have significant macroeconomic effects.

### Present-Value Estimates

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

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

**Table 5-1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX**  
(In millions of dollars)

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

**Table 5-1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued**  
(In millions of dollars)

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

**Table 5-1. TOTAL REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX—Continued**  
(In millions of dollars)

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

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

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

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

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

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

**Table 5-2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES**  
(In millions of dollars)

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

**Table 5-2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued**  
(In millions of dollars)

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

**Table 5-2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued**  
(In millions of dollars)

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

**Table 5-2. CORPORATE AND INDIVIDUAL INCOME TAX REVENUE LOSS ESTIMATES FOR TAX EXPENDITURES—Continued**  
(In millions of dollars)

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

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

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

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

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

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

**Table 5-3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS**  
(In millions of dollars)

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

**Table 5-3. MAJOR TAX EXPENDITURES IN THE INCOME TAX, RANKED BY TOTAL 2000 REVENUE LOSS—**  
**Continued**  
(In millions of dollars)

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

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

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

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

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

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

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

(In millions of dollars)

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

### Outlay Equivalents

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

The measure is larger than the revenue loss estimate when the tax expenditure is judged to function as a Government payment for service. This occurs because

an outlay program would increase the taxpayer's pre-tax income. For some tax expenditures, however, the revenue loss equals the outlay equivalent measure. This occurs when the tax expenditure is judged to function like a price reduction or tax deferral that does not directly enter the taxpayer's pre-tax income.<sup>1</sup>

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

**Table 5-5. OUTLAY EQUIVALENT ESTIMATES FOR TAX EXPENDITURES IN THE INCOME TAX**  
(In millions of dollars)

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

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

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

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

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

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

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

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

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

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

### Tax Expenditure Baselines

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

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

The reference tax law baseline is also patterned on a comprehensive income tax, but in practice is closer to existing law. Reference law tax expenditures are limited to special exceptions in the tax code that serve

programmatic functions. These functions correspond to specific budget categories such as national defense, agriculture, or health care. While tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, the reverse is not always true.

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

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

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

- *Tax rates.* The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first \$10 million of corporate income are thus regarded as a tax expenditure. Similarly, under the reference law baseline, preferential tax rates for capital gains generally do not yield a tax expenditure; only capital gains treatment of otherwise "ordinary income," such as that from coal and iron ore royalties and the sale of timber and certain agricultural products, is considered a tax expenditure. The alternative minimum tax is treated as part of the baseline rate structure under both the reference and normal tax methods.
- *Income subject to the tax.* Income subject to tax is defined as gross income less the costs of earning that income. The Federal income tax defines gross income to include: (1) consideration received in the exchange of goods and services, including labor

services or property; and (2) the taxpayer's share of gross or net income earned and/or reported by another entity (such as a partnership). Under the reference tax rules, therefore, gross income does not include gifts—defined as receipts of money or property that are not consideration in an exchange—or most transfer payments, which can be thought of as gifts from the Government.<sup>2</sup> 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.<sup>3</sup>

- *Capital recovery.* Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for machinery and equipment is determined using straight-line depreciation over tax lives equal to mid-values of the asset depreciation range (a depreciation system in effect from 1971 through 1980). The normal tax baseline for real property is computed using 40-year straight-line depreciation.
- *Treatment of foreign income.* Both the normal and reference tax baselines allow a tax credit for foreign income taxes paid (up to the amount of U.S. income taxes that would otherwise be due), which prevents double taxation of income earned abroad. Under the normal tax method, however, controlled foreign corporations (CFCs) are not regarded as entities separate from their controlling U.S. shareholders. Thus, the deferral of tax on income received by CFCs is regarded as a tax expenditure under this method. In contrast, except for tax haven activities, the reference law baseline follows current law in treating CFCs as separate taxable entities whose income is not subject to U.S. tax until distributed to U.S. taxpayers. Under this baseline, deferral of tax on CFC income is not a tax expenditure because U.S. taxpayers generally are not taxed on accrued, but unrealized, income.

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

<sup>2</sup>Gross income does, however, include transfer payments associated with past employment, such as social security benefits.

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

### **Performance Measures and the Economic Effects of Tax Expenditures**

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

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

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

***Comparisons of tax expenditure, spending, and regulatory policies.*** Tax expenditures by definition work through the tax system and, particularly, the in-

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

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

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

<sup>4</sup>Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103-58, 1993).

<sup>5</sup>Director of the Office of Management and Budget, "The Government Performance and Results Act," Report to the President and the Congress, May 1997.

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

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

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

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

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

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

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

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

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

and estimated ranges of effects, in many cases, as opposed to point estimates.

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

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

**General science, space and technology; energy; natural resources and the environment; agriculture; and commerce and housing.**—A series of tax expenditures reduces the cost of investment, both in specific activities—such as research and experimentation, extractive industries, and certain financial activities—and more generally, through accelerated depreciation for plant and equipment. These provisions can be evaluated along a number of dimensions. For example, it could be useful to consider the strength of the incentives by measuring their effects on the cost of capital (the interest rate which investments must yield to cover their costs) and effective tax rates. The impact of these provisions on the amounts of corresponding forms of investment—such as research spending, exploration activity, or equipment—could also be estimated. In some cases, such as research, there is evidence that the investment can provide significant positive externalities—that is, economic benefits that are not reflected in the market transactions between private parties. It could be useful to quantify these externalities and compare them with the degree of tax subsidy provided. Measures could also indicate the provisions' effects on production from these investments—such as numbers or values of patents, energy production and reserves, and industrial production. Issues to be considered include the extent to which the preferences in-

crease production (as opposed to benefitting existing output) and their cost-effectiveness relative to other policies. Analysis could also consider objectives that are more difficult to measure but still are ultimate goals, such as promoting the Nation's technological base, energy security, environmental quality, or economic growth. Such an assessment is likely to involve tax analysis as well as consideration of non-tax matters such as market structure, scientific, and other information (such as the effects of increased domestic fuel production on imports from various regions, or the effects of various energy sources on the environment).

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

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

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

**Education, training, employment, and social services.**—Major provisions in this function are intended to promote post-secondary education, to offset costs of raising children, and to promote a variety of

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

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

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

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

**General purpose fiscal assistance and interest.**—The tax-exemption for public purpose State and local bonds reduces the costs of borrowing for a variety of purposes; borrowing for non-public purposes is reflected under other budget functions. The deductibility of certain State and local taxes reflected under this function

primarily relates to personal income taxes; property tax deductibility is reflected under the commerce and housing function. Tax preferences for Puerto Rico and other U.S. possessions are also included here. These provisions can be compared with other tax and spending policies as means of benefitting fiscal and economic conditions in the States, localities, and possessions. Finally, the tax deferral for interest on U.S. savings bonds benefits savers who invest in these instruments; the extent of these benefits and any effects on Federal borrowing costs could be evaluated.

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

### Other Considerations

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

### Descriptions of Income Tax Provisions

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

#### National Defense

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

#### International Affairs

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

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

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

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

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

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

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

**5. *Income of U.S.-controlled foreign corporations.***—The income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source

pre-tax income from such a controlling interest is subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not distributed to a U.S. shareholder as tax-deferred income.

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

### General Science, Space, and Technology

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

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

### Energy

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

<sup>8</sup> Section 911 was also the subject of a January 1993 Treasury report to Congress, "Taxation of Americans Working Overseas."

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

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

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

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

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

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

15. **Enhanced oil recovery credit.**—A credit is provided equal to 15 percent of the taxpayer's costs for tertiary oil recovery on U.S. projects. Qualifying costs

include tertiary injectant expenses, intangible drilling and development costs on a qualified enhanced oil recovery project, and amounts incurred for tangible depreciable property.

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

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

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

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

### Natural Resources and Environment

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

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

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

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

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

costs are capitalized under the uniform capitalization rules.

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

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

### Agriculture

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

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

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

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

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

extension, the provision generally would have expired on December 31, 2000.

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

### Commerce and Housing

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

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

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

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

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

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

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

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

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

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

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

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

43. **Installment sales.**—Dealers in real and personal property (i.e., sellers that regularly hold property for sale or resale) cannot defer taxable income from installment sales until the receipt of the loan repayment. Nondealers (i.e., sellers of real property used in their business) are required to pay interest on deferred taxes attributable to their total installment obligations in excess of \$5 million. Only properties with sales prices

exceeding \$150,000 are includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for nondealers with total installment obligations of less than \$5,000,000 is, therefore, a tax expenditure.

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

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

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

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

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

49. **Imputed interest rules.**—Holders (issuers) of debt instruments are generally required to report interest earned (paid) in the period it accrues, not when paid. In addition, the amount of interest accrued is determined by the actual price paid, not by the stated principal and interest stipulated in the instrument.<sup>10</sup> 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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### Transportation

61. **Deferral of tax on U.S. shipping companies.**—Certain companies that operate U.S. flag vessels can defer income taxes on that portion of their income used for shipping purposes, primarily construction, modernization and major repairs to ships, and repayment of loans to finance these investments. Once indefinite, the deferral has been limited to 25 years since January 1, 1987.<sup>62</sup> **Exclusion of reimbursed employee parking expenses.**—Parking at or near an employer's business premises that is paid for by the employer is excludable from the income of the employee. In 1998, the maximum amount of the parking exclusion is \$175 (indexed, except in 1999) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

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

### Community and Regional Development

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

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

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

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

68. **Expensing of environmental remediation costs.**—Taxpayers who clean up hazardous substances at a qualified site may expense the clean-up costs, rather than capitalize the costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property.

he expensing only applies to clean-up costs incurred after August 5, 1997 and before January 1, 2001.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

contributions generally may not exceed 10 percent of pre-tax income.

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

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

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

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

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

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

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

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

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

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

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

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

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

## Health

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

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

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

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

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

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

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

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

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

## Income Security

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

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

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

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

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

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

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

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

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

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

An employed taxpayer can make a non-deductible contribution of up to \$2,000 (a non-employed spouse can also contribute up to \$2,000 if a joint return is filed) to a Roth IRA. Investment income of a Roth IRA is not taxed when earned. Withdrawals from a Roth

IRA are tax free if (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 59½, (b) dies, (c) is disabled, or (d) purchases a first-time house. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between \$150,000 and \$160,000 (\$95,000 and \$110,000 for singles). Total annual contributions to a taxpayer's deductible, non-deductible, and Roth IRAs cannot exceed \$2,000 (\$4,000 for joints).

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

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

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

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

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

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

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

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

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

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

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

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

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

### Social Security

120. **Social Security benefits for retired workers.**—Social security benefits that exceed the beneficiary's contributions out of taxed income are deferred employee compensation and the deferral of tax on that compensation is a tax expenditure. These additional retirement benefits are paid for partly by employers' contributions that were not included in employees' taxable compensation. Portions (reaching as much as 85 percent) of recipients' social security and tier 1 railroad

retirement benefits are included in the income tax base, however, if the recipient's provisional income exceeds certain base amounts. Provisional income is equal to adjusted gross income plus foreign or U.S. possession income and tax-exempt interest, and one half of social security and tier 1 railroad retirement benefits. The tax expenditure is limited to the portion of the benefits received by taxpayers who are below the base amounts at which 85 percent of the benefits are taxable.

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

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

Veterans Benefits and Services

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

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

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

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

### General Government

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

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

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

### Interest

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

## TAX EXPENDITURES IN THE UNIFIED TRANSFER TAX

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

### Unified Transfer Tax Reference Rules

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

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

within nine months after the decedent's death. The Internal Revenue Service may grant an extension of up to 10 years for a reasonable cause. Interest is charged on the unpaid tax liability at a rate equal to the cost of Federal short-term borrowing, plus three percentage points.

### Tax Expenditures by Function

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

#### Natural Resources and Environment

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

#### Agriculture

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

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

#### Commerce and Housing

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

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

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

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

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

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

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

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

### Health

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

### General Government

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

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

(In millions of dollars)

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