FEDERAL RECEIPTS AND COLLECTIONS

17. FEDERAL RECEIPTS

Receipts (budget and off-budget) are taxes and other collections from the public that result from the exercise of the Federal Government's sovereign or governmental powers. The difference between receipts and outlays is the surplus or deficit.

The Federal Government also collects income from the public from market-oriented activities. Collections from these activities, which are subtracted from gross outlays, rather than added to taxes and other governmental receipts, are discussed in the next Chapter.

Total receipts in 2009 are estimated to be $2,699.9 billion, an increase of $178.8 billion or 7.1 percent relative to 2008. Receipts are projected to grow at an average annual rate of 6.2 percent between 2009 and 2013, rising to $3,428.2 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of Gross Domestic Product (GDP), receipts are projected to increase from 17.6 percent in 2008 to 18.0 percent in 2009, and to rise to 18.8 percent in 2013.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

	2007 Actual	Estimate					
		2008	2009	2010	2011	2012	2013
Individual income taxes	1,163.5	1,219.7	1,259.0	1,417.3	1,499.0	1,599.9	1,709.1
Corporation income taxes	370.2	345.3	339.2	338.9	356.8	391.3	379.8
Social insurance and retirement receipts	869.6	910.1	949.4	1,004.0	1,059.7	1,111.4	1,168.5
(On-budget)	(234.5)	(247.9)	(253.8)	(263.9)	(278.3)	(292.9)	(309.4)
(Off-budget)	(635.1)	(662.2)	(695.6)	(740.2)	(781.4)	(818.6)	(859.1)
Excise taxes	65.1	68.8	68.9	60.7	65.9	68.5	69.7
Estate and gift taxes	26.0	26.8	26.3	19.5	1.5	0.4	0.5
Customs duties	26.0	29.2	29.1	30.8	32.5	35.0	37.0
Miscellaneous receipts	47.8	46.3	47.9	50.0	53.2	57.4	59.5
Economic growth package	....	–125.0	–20.0	10.0	8.0	6.0	4.0
Total receipts	2,568.2	2,521.2	2,699.9	2,931.3	3,076.4	3,269.9	3,428.2
(On-budget)	(1,933.2)	(1,859.0)	(2,004.4)	(2,191.2)	(2,295.1)	(2,451.3)	(2,569.1)
(Off-budget)	(635.1)	(662.2)	(695.6)	(740.2)	(781.4)	(818.6)	(859.1)
Total receipts as a percentage of GDP	18.8	17.6	18.0	18.6	18.6	18.8	18.8

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2009	2010	2011	2012	2013
Social security (OASDI) taxable earnings base increases:					
$102,000 to $106,800 on Jan. 1, 2009	2.4	6.4	7.2	8.0	8.8
$106,800 to $111,600 on Jan. 1, 2010	....	2.4	6.5	7.2	8.0
$111,600 to $116,100 on Jan. 1, 2011	....	....	2.3	6.2	6.8
$116,100 to $121,500 on Jan. 1, 2012	....	....	....	2.8	7.4
$121,500 to $126,900 on Jan. 1, 2013	....	....	....	....	2.9

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates revert to 39.6, 36, 31, and 28 percent
10 Percent Bracket	Top of bracket increased to $7,000/$14,000 for single/joint filers and inflation-indexed								Bracket eliminated, lowest bracket reverts to 15 percent
15 Percent Bracket for Joint Filers	Top of bracket for joint filers increased to 200 percent of top of bracket for single filers								Top of bracket for joint filers reverts to 167 percent of top of bracket for single filers
Standard Deduction for Joint Filers	Standard deduction for joint filers increased to 200 percent of standard deduction for single filers								Standard deduction for joint filers reverts to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000 and refundability extended to families with 1 or 2 children								Tax credit for each qualifying child under age 17 reverts to $500 and refundability restricted to taxpayers with 3 or more children
Estate Taxes	Top rate reduced to 49 percent	Top rate reduced to 48 percent Exempt amount increased to $1.5 million	Top Rate reduced to 47 percent	Top rate reduced to 46 percent Exempt amount increased to $2 million	Top rate reduced to 45 percent		Exempt amount increased to $3.5 million	Estate tax repealed	Top rate reverts to 60 percent Exempt amount reverts to $1 million
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Includes software				Deduction increased to $125,000, reduced by amount qualifying property exceeds $500,000, and both amounts inflation-indexed Includes software				Deduction reverts to $25,000, reduced by amount qualifying property exceeds $200,000 and amounts not inflation-indexed Does not apply to software

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Capital Gains	Tax rate on capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets			Tax rate on capital gains reverts to 10/20 percent (8/18 percent on assets held over 5 years)
Dividends	Tax rate on dividends reduced to 5/15 percent					Tax on dividends eliminated for taxpayers in 10/15 percent tax brackets			Dividends taxed at standard income tax rates
Bonus Depreciation	Bonus depreciation increased to 50 percent of qualified property aquired after 5/5/03		Bonus depreciation expires						
Alternative Minimum Tax	AMT exemption amount increased to $40,250/$58,000 for single/joint filers			AMT exemption amount increased to $42,500/$62,550 for single /joint filers	AMT exemption amount increased to $44,350/ $66,250 for single /joint filers	AMT exemption amount reverts to $33,750/ $45,000 for single /joint filers			

ENACTED LEGISLATION

Several laws were enacted in 2007 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

U.S. TROOP READINESS, VETERANS' CARE, KATRINA RECOVERY, AND IRAQ ACCOUNTABILITY APPROPRIATIONS ACT, 2007

The U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 was signed by President Bush on May 25, 2007. In addition to increasing the minimum wage and providing funding for the Global War on Terror, hurricane disaster relief and other purposes, this Act provided tax relief to small businesses that was in large part offset by other tax changes. The major provisions of this Act that affected governmental receipts are described below.

Tax Incentives for Small Business

Extend and increase expensing for small businesses.—Under prior law, business taxpayers were allowed to expense up to $100,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning after 2002 and before 2010. The maximum amount that could be expensed was reduced by the amount by which the taxpayer's cost of qualifying property exceeded $400,000. Both the deduction and annual investment limit were indexed annually for inflation, effective for taxable years beginning after 2003 and before 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, taxpayers were permitted to make or revoke expensing elections on amended returns without the consent of the Internal Revenue Service (IRS) Commissioner. This Act extended for one year, through 2010, the prior law rules applicable to small business expensing in taxable years beginning after 2002 and before 2010. This Act also increased the deduction and annual investment limit to $125,000 and $500,000, respectively, effective for taxable years beginning after 2006 and before 2011. Both the deduction and annual investment limit were indexed annually for inflation, effective for taxable years beginning after 2007 and before 2011.

Extend and modify the work opportunity tax credit (WOTC).—The WOTC provides incentives to employers for hiring individuals from certain targeted groups. Under prior law, the credit expired with respect to wages paid to qualified individuals who began work after December 31, 2007. This Act extended the credit to apply to qualified wages paid to workers hired before September 1, 2011 and expanded the eligibility criteria for certain targeted groups.

Modify tax credit for tips.—Businesses are allowed to pay a tip-earning employee wages that are below the minimum wage if the combined value of the employee's tips and reduced wage exceeds the minimum wage.

Businesses are also required to pay social security and Medicare payroll taxes on both the wages and tip income of their employees; however, a "tip credit" may be claimed for the payroll taxes paid on tips in excess of the minimum wage. This Act increased the minimum wage in three stages over 24 months, from $5.15 per hour to $7.25 per hour. To prevent a reduction in the "tip credit" that would occur as a result of this increase in the minimum wage, this Act allowed employers to continue to calculate the tip credit using the minimum wage in effect on January 1, 2007 ($5.15 per hour).

Allow "tip credit" and WOTC against the alternative minimum tax (AMT).—Taxpayers generally are not allowed to offset AMT liability with business tax credits. Effective for taxable years beginning after December 31, 2006, this Act waived this limitation with respect to the WOTC and the "tip credit," thereby allowing taxpayers (both individuals and corporations) to offset AMT liability with these two credits.

Simplify the taxation of a family business owned by a husband and wife.—Under current law, each member of a partnership pays the taxes on his or her distributive share of the earnings of the partnership. A partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and that is not a trust or estate or a corporation. Under this Act, effective for taxable years beginning after December 31, 2006, a qualified joint venture whose only members are a husband and wife filing a joint return is permitted to elect not to be treated as a partnership for Federal income and self-employment tax purposes if each spouse materially participates in the venture's trade or business. All items of income, gain, loss, deduction and credit from the trade or business must be divided between the spouses in accordance with their respective interest in the venture and each spouse must take into account his or her respective share of those items as if he or she were a sole proprietor.

Taxation of S Corporations

Modify taxation of S corporations.—In general, S corporations do not pay Federal income tax. Instead, an S corporation passes through its items of income and loss to its shareholders. Each shareholder separately accounts for his or her share of these items on his or her individual income tax return. This Act included provisions that modified the taxation of S corporations, with the following major changes that: (1) excluded gains from the sale of stock or securities from treatment as an item of passive investment income; (2) excluded restricted stock in a bank held by bank directors from treatment as S corporation stock; (3) modified the treatment of banks that become S corporations and change from the reserve method of accounting for bad debts; (4) modified the treatment of sales of stock of qualified subsidiaries of S corporations; (5) modified the treatment of pre-1983 accumulated earnings and profits of certain S corporations; and (6) permitted electing small business trusts to deduct interest expenses incurred on funds borrowed to purchase S corporation stock.

Hurricane-Related Tax Relief

Extend and modify certain tax relief provided to individuals and businesses affected by hurricanes along the Gulf coast in 2005.—Several laws were enacted in 2005 that provided tax relief to individuals and businesses affected by hurricanes Katrina, Rita and Wilma. This Act extended and/or modified several of the tax incentives enacted in 2005; the specific changes included the following: (1) a one-year extension of the enhanced small business expensing provided to qualified Gulf Opportunity Zone (GO Zone) property; (2) a two-year extension of the enhanced low-income housing tax credit for property in the GO Zone, the Rita GO Zone and the Wilma GO Zone, and expansion of the credit; and (3) the expansion of special tax-exempt bond financing rules to apply to the repair and reconstruction of residential property in the GO Zone, the Rita GO Zone and the Wilma GO Zone.

Pension-Related Provisions

Modify several provisions of the Pension Protection Act of 2006.—This Act modified several provisions of the Pension Protection Act of 2006, which was the most sweeping reform of America's pension system enacted in 30 years. Major changes included the following: (1) modification of the ability to revoke the election relating to treatment as a multiemployer plan; (2) modification of the requirements for qualified transfers under section 420; (3) extension of alternative deficit reduction contribution rules for commercial passenger airlines; and (4) modification of the interest rate used by plans maintained by commercial passenger airlines and airline catering companies to calculate pension liability.

Offsets

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15, and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 114.25 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

Modify taxation of unearned income of minors.—An unmarried individual eligible to be claimed as a dependent on another taxpayer's individual income tax return generally must file an individual income tax return if he or she has: (1) earned income only over $5,350 (for 2007); (2) unearned income only over the minimum standard deduction amount for dependents ($850 in 2007); or (3) both earned income and unearned income totaling more than the smaller of (a) $5,350 (for 2007) or (b) the larger of (i) $850 (for 2007) or (ii) earned income plus $300. Under prior law, unearned income of a child was taxed under special rules if: (1) the child had not reached the age of 18 by the close of the taxable year, (2) the child's unearned income (income other than wages, salaries, professional fees, or other amounts received as compensation for personal services actually rendered) was more than $1,700 (for 2007), and (3) the child was required to file a return for the year. These special rules (referred to as the "kiddie tax") applied if the child could have been claimed as a dependent on the parent's return, regardless of whether the parent actually claimed the child as a dependent. Under the kiddie tax, the child's net unearned income over $1,700 (for 2007) was taxed at the parent's tax rate if that rate was higher than the child's rate. The remainder of a child's taxable income was taxed at the child's tax rate, regardless of whether the kiddie tax applied. Effective for taxable years beginning after May 25, 2007, this Act increased the age to which the kiddie tax applies from under 18 years of age to under 19 years of age (under 24 years of age for full-time students, provided their earned income does not exceed one-half of the amount of their support).

Modify period of suspension of penalties and interest on unpaid taxes.—In general, interest and penalties accrue during periods for which taxes are unpaid, without regard to whether the taxpayer was aware that there was tax due. However, under prior law, if an individual taxpayer filed a timely return and the IRS did not send the taxpayer a notice of the unpaid liability and the basis for that liability, interest and penalties generally were suspended starting 18 months after the filing of the return. The suspension did not apply to underpayments attributable to fraud, listed transactions, and undisclosed reportable transactions, or to criminal or failure-to-pay penalties. Interest and penalties resumed 21 days after the IRS sent the required notice. This Act extended the period before which accrual of interest and certain penalties are suspended to 36 months after the filing of the return, effective for IRS notices issued after November 25, 2007.

Modify collection due process procedures for employment tax liabilities.—Employers are required to withhold and pay Federal Insurance Contribution Act (FICA) taxes and income taxes, and are required to pay Federal Unemployment Tax Act (FUTA) taxes (collectively "Federal employment taxes") with respect to wages paid to their employees. In order to ensure the payment and collection of Federal employment taxes, the IRS is authorized to take various collection actions, including the issuance of a levy. A levy is the IRS's administrative authority to seize a taxpayer's property to pay the taxpayer's liability if a Federal tax lien has been attached to such property. Before a tax levy could be issued under prior law, the IRS generally was required to provide the taxpayer with notice and an opportunity for an administrative collection due process (CDP) hearing, and for judicial review. This pre-levy CDP hearing requirement did not apply to levies issued to collect Federal tax liability from a State tax refund; instead, such taxpayers were provided a CDP hearing within a reasonable period of time after the levy. This Act expanded the exception to the requirement for a pre-levy CDP hearing to include levies issued on or after September 27, 2007 to collect Federal employment taxes for any taxable period if the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy was served.

Permanently extend IRS user fees.—The IRS has authority to charge fees for written responses to questions from individuals, corporations, and organizations related to their tax status or the effects of particular transactions for tax purposes. This Act permanently extended authority for these fees, which had been scheduled to expire effective with requests made after September 30, 2014.

Increase penalty for bad checks and money orders.—The IRS has authority to impose a penalty on taxpayers who issue a bad check or money order. Under prior law, the penalty was two percent of the amount of the bad check or money order, with a minimum penalty of $15 or, if less, the amount of the check or money order, on checks and money orders less than $750. Effective with respect to checks or money orders issued after May 25, 2007, this Act increased the minimum penalty to $25 or if less, the amount of the check or money order, on checks and money orders less than $1,250.

Expand penalties on tax return preparers.—Under prior law, an income tax return preparer who prepared a return with respect to which there was an understatement of tax due to an undisclosed position for which there was not a realistic possibility of being sustained on its merits, or a frivolous position, was liable for a first-tier penalty of $250, provided the preparer knew or reasonably should have known of the position. An income tax return preparer who engaged in specified willful or reckless conduct with respect to preparing a return was liable for a second-tier penalty of $1,000. Effective for tax returns prepared after May 25, 2007, this Act: (1) broadened the scope of tax return preparer penalties to include preparers of estate and gift, employment, and excise tax returns, and returns of exempt organizations; (2) increased the first-tier penalty to the greater of $1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer from the preparation of the return or claim with respect to which the penalty was imposed; (3) increased the second-tier penalty to the greater of $5,000 or 50 percent of the income derived (or to be derived) by the tax return preparer; and (4) altered the standards of conduct that must be met to avoid imposition of the penalties for preparing a return with respect to which there is an understatement of tax.

Levy a penalty on erroneous refund claims.—Effective for returns filed on or after May 25, 2007, this Act imposed a penalty of 20 percent on the disallowed portion of a claim for refund or credit for which there was no reasonable basis for the claimed tax treatment or for which the taxpayer did not have reasonable cause. The penalty does not apply to any portion of the disallowed portion of the claim for refund or credit: (1) relating to the earned income credit, or (2) subject to accuracy-related or fraud penalties.

AN ACT TO EXTEND THE AUTHORITIES OF THE ANDEAN TRADE PREFERENCE ACT (ATPA) UNTIL FEBRUARY 29, 2008

The ATPA, which was scheduled to expire after June 30, 2007, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking. This Act, which was signed by President Bush on June 30, 2007, extended the provisions of the ATPA for eight months, through February 29, 2008. This Act also increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 114.5 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

APPROVING THE RENEWAL OF IMPORT RESTRICTIONS CONTAINED IN THE BURMESE FREEDOM AND DEMOCRACY ACT OF 2003

The Act, which was signed by President Bush on August 1, 2007, extended for one year, through July 28, 2008, the ban on all imports from Burma. This Act also increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 114.75 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

AN ACT TO EXTEND THE TRADE ADJUSTMENT ASSISTANCE PROGRAM UNDER THE TRADE ACT OF 1974 FOR 3 MONTHS

This Act extended the trade adjustment assistance program for farmers, which was scheduled to expire September 31, 2007, for three months through December 31, 2007. This Act, which was signed by President Bush on September 28, 2007, also affected governmental receipts by increasing the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 115 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

UNITED STATES-PERU TRADE PROMOTION AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on December 14, 2007, approved and provided for tariff reductions and other changes in law related to U.S. implementation of the United States-Peru Free Trade Agreement, as signed by the United States and Peru on April 12, 2006 and amended through a Protocol signed in Washington, D.C. on June 24, 2007 and in Lima on June 25, 2007. When this Agreement enters into force, it will level the playing field for American exporters and investors, expand an important market in this hemisphere for U.S. goods and services, allow Peru to lock in access to the largest market in the world, and signal America's firm support for those who share the Nation's values of freedom and democracy and expanding opportunity for all.

This Act also affected governmental receipts by increasing the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 115.75 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

ENERGY INDEPENDENCE AND SECURITY ACT OF 2007

This Act, which was signed by President Bush on December 19, 2007, represented a major step forward in expanding the production of renewable fuels, reducing the Nation's dependence on oil, and making America stronger, safer, and cleaner for future generations. The major provisions of this Act that affected governmental receipts are described below:

Modify Corporate Average Fuel Economy (CAFE) standards.—Under prior law, passenger cars and non-passenger cars (light trucks and SUVs) were required to meet CAFE standards of 27.5 miles per gallon and 22.2 miles per gallon, respectively. These standards were written into law in 1975. Beginning with model year 2011, this Act required the Department of Transportation (DOT) to prescribe separate, attribute-based CAFE standards for passenger cars and non-passenger cars that would reach a combined fleet average of at least 35 miles per gallon by model year 2020. This Act also required DOT, after consultation with the Department of Energy and the Environmental Protection Agency, to prescribe separate CAFE standards for work trucks (vehicles weighing between 8,500 and 10,000 pounds) and commercial medium- and heavy-duty vehicles (weighing over 10,000 pounds).

Modify Renewable Fuel Standard (RFS).—Under prior law, 7.5 billion gallons of renewable fuels were required to be blended with conventional fuel sold in the United States by 2012. Beginning in 2008, this Act required the blending of specified minimum volumes of renewable fuels each year, rising from 9 billion gallons in 2008 to 36 billion gallons by 2022.

Modify amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. Under the Energy Policy Act of 2005, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, could be amortized over two years. The Tax Increase Prevention and Reconciliation Act of 2006 increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applied only to integrated oil companies that had an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, had gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and were either a crude oil refiner or related to a crude oil refiner. This Act increased the amortization period for G&G costs paid or incurred by these major integrated oil companies from five to seven years, effective for amounts paid or incurred in taxable years beginning after December 19, 2007.

Extend unemployment insurance surtax.—Under prior law the Federal unemployment tax on employers was scheduled to drop from 0.8 percent to 0.6 percent with respect to wages paid after December 31, 2007. This Act extended the 0.8 percent rate for one year, through December 31, 2008.

TAX RELIEF FOR RECIPIENTS OF DISBURSEMENTS FROM THE HOKIE SPIRIT MEMORIAL FUND

The Virginia Tech Foundation was established in 1948 to receive, manage, and disburse private gifts in support of programs of Virginia Polytechnic Institute and State University (Virginia Tech). The Hokie Spirit Memorial Fund was established by the Virginia Tech Foundation as a vehicle to receive financial donations from donors to assist families and victims of the April 16, 2007 shootings at Virginia Tech. This Act, which was signed by President Bush on December 19, 2007, excluded from gross income amounts received from this fund as payments in connection with the April 16, 2007 shootings at Virginia Tech. In addition, effective for taxable years beginning in 2008, this Act increased the penalty for failure to file a partnership return from $50 to $51 per partner for each month that the failure continues, up to a maximum of five months.

MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007

This Act, which was signed by President Bush on December 20, 2007, provided housing-related tax relief to financially-troubled homeowners, provided tax relief for volunteer firefighters and emergency medical responders, modified several tax penalties, and modified the timing of estimated tax payments by corporations. The major provisions of this Act that affected governmental receipts are described below.

Housing-Related Tax Relief

Exclude discharges of indebtedness on principal residences from gross income—Gross income generally includes income realized by a debtor from the discharge of indebtedness, subject to certain exceptions (debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loan indebtedness, certain farm indebtedness, and certain real property business indebtedness). In cases involving discharges of indebtedness excluded from gross income under the exceptions to the general rule, taxpayers generally must reduce certain tax attributes, including basis in the property, by the amount of the discharge of indebtedness. However, the amount of discharge of indebtedness excluded from gross income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. The amount of discharge of indebtedness generally is equal to the difference between the amount of debt being cancelled and the amount used to satisfy the debt. This Act expanded the types of discharges of indebtedness excluded from gross income to include up to $2 million (or up to $1 million per spouse, if a married couple files separately) of qualified principal residence indebtedness discharged on or after January 1, 2007 and before January 1, 2010. The exclusion does not apply to discharges on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer; in addition, the basis in the principal residence must be reduced by the amount of discharge of indebtedness excluded from gross income.

Extend the deduction for qualified mortgage insurance premiums.—This Act extended the deduction for certain premiums paid or accrued for qualified mortgage insurance for three years, to apply to amounts paid or accrued after December 31, 2007 and before January 1, 2011.

Increase maximum capital gains exclusion on certain sales of principal residences by surviving spouses.—Under current law, an individual taxpayer may exclude from tax up to $250,000 ($500,000 if married and filing a joint return) of gain realized on the sale or exchange of a principal residence, provided the taxpayer owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. Effective for sales or exchanges after December 31, 2007, this Act increased the maximum amount of gain a surviving spouse can exclude from tax on the sale or exchange of a principal residence to $500,000, provided the sale or exchange occurs within two years of death of the spouse.

Provide other housing-related tax relief.—Other housing-related tax relief provided in this Act: (1) amended the requirements for qualification as a cooperative housing corporation, and (2) modified the requirements for qualification as low-income housing units for purposes of the low-income housing tax credit.

Tax Relief for Volunteer Firefighters and Emergency Medical Responders

Provide exclusion from gross income for benefits provided to volunteer firefighters and emergency medical responders.—This Act provided an exclusion from gross income to any member of a qualified volunteer emergency response organization for: (1) any reduction or rebate of tax provided by a State or political division thereof on account of services performed as a member of a qualified volunteer emergency response organization, and (2) any payment, up to an annual maximum of $30 times the number of months during the year in which services were performed, provided by a State or political division thereof on account of the performance of services as a member of a qualified volunteer emergency response organization. Under this Act, a qualified emergency response organization is any volunteer organization: (1) organized and operated to provide firefighting or emergency medical services for persons in the State or political subdivision, and (2) required (by written agreement) by the State or political subdivision to furnish firefighting or emergency medical services in such State or political subdivision. The exclusion applies to payments, tax rebates and tax reductions provide on account of services performed in taxable years beginning after December 31, 2007 and before January 1, 2011.

Offsets

Increase the penalty for failure to file a partnership return.—This Act increased the penalty imposed on partnerships for failure to file a partnership return to $85 per partner for each month that the failure continues, up to a maximum of twelve months, effective for returns required to be filed after December 20, 2007.

Impose a penalty on S corporations for failure to file a return.—This Act imposed a penalty on S corporations that fail to file a return or that fail to file required information. The penalty of $85 per shareholder for each month that the failure continues, up to a maximum of twelve months, is effective for returns required to be filed after December 20, 2007.

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15, and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to 117.25 percent of the amount otherwise due in 2012. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly.

TAX INCREASE PREVENTION ACT OF 2007

This Act, which was signed by President Bush on December 26, 2007, provided Alternative Minimum Tax (AMT) relief for 2007, thereby protecting millions of Americans from an unexpected tax increase. The major provisions of this Act that affected governmental receipts are described below.

Increase and extend AMT exemption amounts.—A temporary provision of prior law increased the AMT exemption amounts to $42,500 for single taxpayers, $62,550 for married taxpayers filing a joint return and surviving spouses, and $31,275 for married taxpayers filing a separate return and estates and trusts. These temporary increases were effective for taxable years beginning after December 31, 2005 and before January 1, 2007. This Act increased the AMT exemption amounts, effective for taxable years beginning after December 31, 2006 and before January 1, 2008, to $44,350 for single taxpayers, $66,250 for married taxpayers filing a joint return and surviving spouses, and $33,125 for married taxpayers filing a separate return and estates and trusts.

Extend AMT relief for nonrefundable personal credits.—Under a temporary provision of prior law, taxpayers were permitted to offset both the regular tax and the AMT with nonrefundable personal tax credits, effective for taxable years beginning before January 1, 2007. This Act extended minimum tax relief for nonrefundable personal tax credits for one year, to apply to taxable year 2007. The extension does not apply to the child credit, the saver's credit, the earned income credit (EITC), or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut. The refundable portion of the child credit and the earned income tax credit are also allowed against the AMT through December 31, 2010.

TERRORISM RISK INSURANCE PROGRAM REAUTHORIZATION ACT OF 2007

This Act, which was signed by President Bush on December 26, 2007, extended for seven years the Federal terrorism risk insurance program that had been established under the Terrorism Risk Insurance Act of 2002 and was scheduled to expire on December 31, 2007. This Act also expanded coverage to include acts of domestic terrorism, required the issuance of regulations for determining the pro rata share of insured losses to be paid by each insurer that incurs losses when such losses exceed $100 billion in any program year, and set up a mechanism for the Federal government to recoup 133 percent of Federal payments under the program, up to a maximum of $27.5 billion, through a surcharge imposed on insurance premiums. These payments, which would be governmental receipts, would be collected as follows: (1) for any act of terrorism that occurred on or before December 31, 2010, all required payments would be due by September 30, 2012; (2) for any act of terrorism that occurred in calendar year 2011, 35 percent of required payments would be due by September 30, 2012 and the remainder would be due by September 30, 2017; and (3) for any act of terrorism that occurred on or after January 1, 2012, all required payments would be due by September 30, 2017.

TAX TECHNICAL CORRECTIONS ACT OF 2007

This Act, which was signed by President Bush on December 29, 2007, provided technical corrections to tax laws enacted between 1998 and 2006. The amendments provided in this Act clarified or adjusted previously enacted provisions in a manner consistent with the underlying legislative intent and generally took effect as if included in the original legislation.

ADMINISTRATION PROPOSALS

STIMULATE ECONOMIC GROWTH AND JOB CREATION IN 2008 AND IMPROVE THE TAX SYSTEM TO MAKE THE U.S. MORE COMPETITIVE

The President believes that it is critical for Congress to quickly pass an economic growth package that will keep our economy expanding and creating jobs and that puts more money in the hands of American workers and businesses, who are the engines of the Nation's economic growth. The Administration will work with Congress in a bipartisan manner to enact initiatives that provide temporary, immediate, and effective support to the Nation's economy.

As a longer-term consideration, Americans deserve a tax system that is simple, fair and pro-growth—in tune with the Nation's dynamic, 21st century economy. The tax system also should promote the competitiveness of American workers and businesses in the global economy. The report, *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century,* released by the Treasury Department in December, outlines several broad approaches to business tax reform to lay the groundwork for discussion of ways to ensure that the Nation's business tax system better meets the needs of American workers and businesses in today's global economy.

The President's tax relief enacted in 2001 and 2003 made the tax code simpler, fairer, and more pro-growth. The President has proposed changes that would move the tax code further in this direction. The Budget includes proposals to make health care more affordable and consumer-driven, to promote savings for all Americans, and to encourage investment by entrepreneurs.

MAKE PERMANENT CERTAIN TAX RELIEF ENACTED IN 2001 AND 2003

Permanently extend reductions in individual income taxes on capital gains and dividends.—The maximum individual income tax rate on net capital gains and dividends is 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008, 2009 and 2010) for lower income taxpayers. The Administration proposes to permanently extend these reduced rates (15 percent and zero), which are scheduled to expire on December 31, 2010.

Permanently extend increased expensing for small businesses.—Under temporary provisions of current law, small business taxpayers are allowed to expense up to $125,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning after 2006 and before 2011. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $500,000. Both the deduction and annual investment limits are indexed annually for inflation effective for taxable years beginning after 2007 and before 2011. Also, with respect to taxable years beginning after 2002 and before 2011, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to permanently extend each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning after 2010.

Permanently extend provisions expiring in 2010.—Most of the provisions of the 2001 tax relief sunset on December 31, 2010. The Administration proposes to extend those provisions permanently.

TAX INCENTIVES

Simplify and Encourage Saving

Expand tax-free savings opportunities.—Under current law, individuals can contribute to traditional IRAs, nondeductible IRAs, and Roth IRAs, each subject to different sets of rules. For example, contributions to traditional IRAs are deductible, while distributions are taxed; contributions to Roth IRAs are taxed, but distributions are excluded from income. In addition, eligibility to contribute is subject to various age and income limits. While primarily intended for retirement saving, withdrawals for certain education, medical, and other non-retirement expenses are penalty free. The eligibility and withdrawal restrictions for these accounts complicate compliance and limit incentives to save.

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $2,000 to an LSA and $5,000 (or earnings if less) to an RSA. Distributions from an LSA would be excluded from income and could be made at any time for any purpose without restriction. Distributions from an RSA would be excluded from income after attaining age 58 or in the event of death or disability. All other distributions would be included in income (to the extent they exceed basis) and subject to an additional tax. Distributions would be deemed to come from basis first. The proposal would be effective for contributions made after December 31, 2008 and future year contribution limits would be indexed for inflation.

Existing Roth IRAs would be renamed RSAs and would be subject to the new rules for RSAs. Existing traditional and nondeductible IRAs could be converted into an RSA by including the conversion amount (excluding basis) in gross income, similar to a current-law Roth conversion. However, no income limit would apply to the ability to convert. Taxpayers who convert IRAs to RSAs before January 1, 2010 could spread the included conversion amount over four years. Existing traditional or nondeductible IRAs that are not converted to RSAs could not accept new contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept new individual contributions. Individuals wishing to roll an amount directly from an employer plan to an RSA could do so by including the rollover amount (excluding basis) in gross income (i.e., "converting" the rollover, similar to a current law Roth conversion).

Consolidate employer-based savings accounts.—Current law provides multiple types of tax-preferred employer-based savings accounts to encourage saving for retirement. The accounts have similar goals but are subject to different sets of rules regulating eligibility, contribution limits, tax treatment, and withdrawal restrictions. For example, 401(k) plans for private employers, SIMPLE 401(k) plans for small employers, 403(b) plans for 501(c)(3) organizations and public schools, and 457 plans for State and local governments are all subject to different rules. To qualify for tax benefits, plans must satisfy multiple requirements. Among the requirements, the plan generally may not discriminate in favor of highly compensated employees with regard either to coverage or to amount or availability of contributions or benefits. Rules covering employer-based savings accounts are among the lengthiest and most complicated sections of the tax code and associated regulations. This complexity imposes substantial costs on employers, participants, and the Government, and likely has inhibited the adoption of retirement plans by employers, especially small employers.

The Administration proposes to consolidate 401(k), SIMPLE 401(k), 403(b), and 457 plans, as well as SIMPLE IRAs and SARSEPs, into a single type of plan—Employee Retirement Savings Accounts (ERSAs) that would be available to all employers. ERSA non-discrimination rules would be simpler and include a new ERSA non-discrimination safe-harbor. Under one of the safe-harbor options, a plan would satisfy the nondiscrimination rules with respect to employee deferrals and employee contributions if it provided a 50-percent match on elective contributions up to six percent of compensation. By creating a simplified and uniform set of rules, the proposal would substantially reduce complexity. The proposal would be effective for taxable years beginning after December 31, 2008.

Encourage Entrepreneurship and Investment

Increase expensing for small businesses.—Business taxpayers are currently allowed to expense up to $125,000 in annual investment expenditures for qualifying property (expanded to include off-the-shelf computer software) placed in service in taxable years beginning after 2006 and before 2011. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $500,000. Both the deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2007 and before 2011. Also, with respect to a taxable year beginning after 2002 and before 2011, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to increase the amount of annual investment expenditures that taxpayers are allowed to expense to $200,000, and to raise the amount of qualifying investment at which the phase-out begins to $800,000, effective for qualifying property placed in service in taxable years beginning after 2008. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2009.

Invest in Health Care

Provide a new standard deduction for health insurance ($15,000 for family coverage and $7,500 for individual coverage).—The Administration proposes to provide a standardized deduction for health insurance (SDHI) of $15,000 to all families who purchase health insurance ($7,500 for those purchasing individual coverage), whether directly or through an employer, that meets minimum requirements. The full deduction would apply regardless of how much a family or individual spends on health insurance; that is, a family or individual that spends less than the full deduction on health insurance would still receive the full deduction. The deduction would apply for purposes of both the income and payroll tax.

The new, flat deduction would replace the existing exclusion for employer-provided health insurance, the self-employed premium deduction, and the medical itemized deduction. Coverage under Medicare or Medicaid would not entitle an individual for the SDHI. As a result of the proposal, the current exclusion or deduction from income of health care spending, whether for insurance premiums or out-of-pocket expenses, except under a Health Savings Account (HSA), would also be repealed. However, itemized medical deductions would still be available for some taxpayers such as individuals enrolled in Medicare who are not otherwise eligible for the SDHI.

Businesses would continue to deduct employer-provided health insurance as a business expense. In addition, the phase-out rate for the EITC for taxpayers with qualifying children would be reduced to 15 percent. These provisions would be effective for tax years beginning after December 31, 2008.

Expand and make health savings accounts (HSAs) more flexible.—Current law allows individuals to accumulate funds in an HSA or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA-qualified high-deductible health plan (HDHP), and no other health plan. Under current law, individual contributions to HSAs are deductible for income tax purposes, while employer contributions to HSAs are excluded from both the income and payroll tax. The higher deductible under HSA-qualified health plans increases the cost consciousness of health care consumers by increasing their exposure to the cost of health care.

In addition to higher deductibles, the Administration also recognizes that higher coinsurance levels encourage cost consciousness among health care consumers. Therefore, the Administration proposes to allow health plans to be considered HSA-eligible if they meet all the existing requirements of an HDHP except that, in lieu of satisfying the minimum deductible requirement, they have at least a 50 percent coinsurance requirement and a minimum out-of-pocket exposure that would result in the same (or lower) premium as coverage under a high-deductible health plan under the current requirements for the same family or individual.

The Administration also proposes that additional changes be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans including: (1) allowing family coverage to include coverage where each individual in the family can receive benefits once they have reached the minimum deductible for an individual HDHP; (2) allowing both spouses to contribute the catch-up contribution to a single HSA owned by one spouse if both spouses are eligible individuals; (3) allowing an individual to be covered by a flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) with first dollar coverage and still contribute to an HSA, but offset the maximum allowable HSA contribution by the level of FSA or HRA coverage; (4) allowing qualified medical expenses to include any medical expense incurred on or after the first day of HDHP coverage if individuals have established an HSA by their return filing date for that year; and (5) excluding from the comparability rules extra employer contributions to HSAs on behalf of employees who are chronically ill or employees who have spouses or dependents who are chronically ill. All of the HSA-related proposals would be effective for years beginning after December 31, 2008.

Allow the orphan drug tax credit for certain pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions (“orphan drugs”). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA’s approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2007.

Provide Incentives for Charitable Giving

Permanently extend tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA and non-deductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included in gross income to the extent attributable to earnings. The Pension Protection Act of 2006 provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed $100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70 1/2, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision. The Administration proposes to permanently extend this exclusion, effective for distributions made in taxable years beginning after December 31, 2007.

Permanently extend the enhanced charitable deduction for contributions of food inventory.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis (typically cost) in the inventory or, if less, the fair market value of the inventory. However, for certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of: (1) basis plus one-half of the fair market value in excess of basis, or (2) two times basis. To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer contributed to a charitable organization and the donee must: (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants; (2) not transfer the property in exchange for money, other property, or services; and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. To use the enhanced deduction, the taxpayer must establish that the fair market value of the donated item exceeds basis.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. The Pension Protection Act of 2006 extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayers other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The Administration proposes to permanently extend the enhanced charitable deduction for contributions of food inventory to apply to contributions made after December 31, 2007.

Permanently extend the deduction for corporate donations of computer equipment for educational purposes.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for contributions of computer technology and equipment for education purposes. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. To qualify for the enhanced deduction, equipment contributed must have been constructed or assembled by the taxpayer and be donated no later than three years after completion. This provision expired with respect to donations made after December 31, 2007. The Administration proposes to permanently extend this deduction, effective for distributions made in taxable years beginning after December 31, 2007.

Permanently extend increased limits on contributions of partial interests in real property for conservation purposes.—In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Exceptions to these general rules are provided for certain types of contributions, including qualified conservation contributions. The special rules for qualified conservation contributions were enhanced under the Pension Protection Act of 2006, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. These special rules: (1) increased the cap on deductions for qualified conservation contributions from 30 percent to 50 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions; (2) increased the cap on deductions for qualified conservation contributions applicable to qualified ranchers and farmers to 100 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions in the case of individuals and to 100 percent of the excess of taxable income over the amount of all other allowable charitable contributions in the case of corporations; and (3) increased the number of years qualified conservation contributions in excess of the 50- and 100-percent caps may be carried forward from five to 15 years. The Administration proposes to permanently extend these special rules, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2007.

Permanently extend basis adjustment to stock of S corporations contributing appreciated property.—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under the Pension Protection Act of 2006, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1, 2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property. The Administration proposes to permanently extend this provision, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2007.

Reform excise tax based on investment income of private foundations.—Under current law, private foundations that are exempt from Federal income tax are subject to a two-percent excise tax on their net investment income (one percent if certain requirements are met). The excise tax on private foundations that are not exempt from Federal income tax, such as certain charitable trusts, is equal to the excess of the sum of the excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. To encourage increased charitable activity and simplify the tax laws, the Administration proposes to replace the two rates of tax on the net investment income of private foundations that are exempt from Federal income tax with a single tax rate of one percent. The excise tax on private foundations not exempt from Federal income tax would be equal to the excess of the sum of the one-percent excise tax that would have been imposed if the foundation were tax exempt and the amount of the unrelated business income tax that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation. The proposed change would be effective for taxable years beginning after December 31, 2007.

Strengthen Education

Permanently extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that, when combined with other miscellaneous itemized deductions, they exceeded two percent of AGI. Current law also allows certain teachers and other elementary and secondary school professionals to treat up to $250 in annual qualified out-of-pocket classroom expenses as a non-itemized deduction (deductible above-the-line). Unreimbursed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may not be claimed as an itemized deduction. This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2008. The Administration proposes to permanently extend the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2007.

Allow the saver's credit for contributions to qualified tuition programs (section 529 of the Internal Revenue Code).—Under current law, taxpayers age 18 or older who are not dependents or full-time students may receive a nonrefundable credit (the saver's credit) on up to $2,000 of their compensation contributed to employer-sponsored qualified retirement plans and IRAs. The credit ranges between 10 and 50 percent of the amount contributed, depending on the taxpayer's filing status and AGI (adjusted for inflation). In determining the credit, qualified contributions are reduced by distributions from qualified plans and IRAs during the current tax year, the two preceding tax years, and the following year, up to the due date of the return, including extensions.

Under current law, taxpayers may contribute to a section 529 qualified tuition program (QTP) to save for higher education expenses of a designated beneficiary. Contributions to a QTP are not deductible from income for Federal tax purposes, but earnings on contributions accumulate tax-free. Taxpayers may exclude from gross income amounts distributed from a QTP and used for qualified higher education expenses, provided the distribution is not used for the same educational expenses for which another tax benefit is claimed. Nonqualified distributions are subject to an additional tax.

The Administration proposes to allow the saver's credit for qualified contributions to QTPs controlled by the taxpayer. AGI would be modified to include the excludable portion of the taxpayer's Social Security benefits in determining the applicable rate for the saver's credit. The credit would apply to an annual aggregate contribution of up to $2,000 (or earnings includible in gross income, if less) to the taxpayer's elective deferral plans, IRAs, and QTPs. For an individual who is married filing a joint return, the earnings limitation would be binding only if the combined includible compensation of the spouses was less than $4,000. Qualified contributions would be reduced by distributions from elective deferral plans, IRAs, and QTPs during the current tax year, the two preceding tax years, and the following tax year up to the due date of the return, including extensions. The credit would be effective for years beginning after December 31, 2008.

Strengthen Housing

Expand tax-exempt qualified mortgage bond program to assist subprime borrowers.—Under current law, State and local governments may issue tax-exempt private activity bonds, called "qualified mortgage bonds," to provide low-interest rate new mortgage loans (as contrasted with refinancing loans) to qualified first-time homebuyers for the purchase, improvement, or rehabilitation of owner-occupied single-family housing. Several restrictions, including purchase price and mortgagor income limitations, apply. In addition, such bonds are subject to the annual private activity bond volume cap and various general eligibility requirements for tax-exempt private activity bonds. The Administration proposes to expand the mortgage bond program temporarily to allow State and local governments to use such bonds to refinance existing loans to eligible subprime borrowers during the three years, 2008 through 2010. The proposal would increase the private activity bond volume cap by a total amount of $15 billion to be dedicated to use for subprime refinancings during the three years from 2008 through 2010.

Protect the Environment

Permanently extend expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2008, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently, making it available for expenditures paid or incurred after December 31, 2007, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Eliminate the volume cap for private activity bonds for water infrastructure.—Bonds are classified as private activity bonds if they meet a private business use test and a private payments test. Private activity bonds may be issued on a tax-exempt basis only if they meet specified requirements, including targeting requirements that limit such bond financing to specifically defined facilities and programs. For example, qualified private activity bonds can be used to finance facilities for the furnishing of water and for sewer facilities. Qualified private activity bonds are subject to the same general rules applicable to governmental bonds. Most qualified private activity bonds are also subject to a number of additional rules and limitations, in particular an annual State volume cap limitation.

The Administration proposes to remove from the annual State volume cap limitation qualified private activity bonds issued to finance water and sewage facilities. These bonds are intended to complement local efforts to move towards full cost pricing for wastewater and drinking water services, helping municipalities become self-financing and minimizing the need for future Federal expenditures. The volume cap would be removed for obligations issued after December 31, 2008.

Restructure Assistance to New York City for Continued Recovery from the Attacks of September 11th

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose. The Administration also proposes to terminate the additional first-year depreciation deduction for certain real property, which was provided to eligible property within the New York Liberty Zone under the 2002 economic stimulus act.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Clarify uniform definition of a child.—The 2004 tax relief act created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members are eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers are able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower incomes, to claim the taxpayers' sons or daughters as qualifying children. The 2004 tax relief act had other unintended consequences, which made some of the eligibility rules less uniform. For example, it allowed dependent filers to claim the child tax credit, even though they are generally ineligible for most other child-related tax benefits. It also allowed taxpayers to claim the child tax credit on behalf of a married child who files a joint return with his or her spouse, even though the taxpayer generally cannot claim other benefits for the married child. These exceptions create confusion and add complexity to the tax code.

To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the uniform definition of a child. First, the definition of a qualifying child would be further simplified. A taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Also, under the proposal, an individual who is married and filing jointly (for any reason other than to obtain a refund of overwithheld taxes) would not be considered a qualifying child for the child-related tax benefits, including the child tax credit. Second, the proposal clarifies when a taxpayer is eligible to claim child-related tax benefits. If a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher AGI and is otherwise eligible for the tax benefits. In addition, dependent filers would not be allowed to claim qualifying children. The proposal is effective for taxable years beginning after December 31, 2008.

Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigrant status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, and their work and immigration status in the United States. These rules are confusing, require significant record-keeping, and are costly to administer. Under the proposal, married taxpayers who reside with children could claim the EITC without satisfying a complicated household maintenance test if they live apart from their spouse for the last six months of the year. In addition, certain taxpayers who live with children but do not qualify for the larger child-related EITC could claim the smaller EITC for very low-income childless workers. The simplification of the filing status and residency requirements would be effective for taxable years beginning after December 31, 2008. Effective January 1, 2009, the proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $12,050 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. Over 70 percent of additional child tax credit claimants also claim the EITC. However, the two credits have a different definition of earned income and different U.S. residency requirements. In addition, some taxpayers have to perform multiple computations to determine the amount of the additional child tax credit they can claim. First, they must compute the additional child tax credit using a formula based on earned income. Then, if they have three or more children, they may recalculate the credit using a formula based on social security taxes and claim the higher of the two amounts.

Under the proposal, the additional child tax credit would use the same definition of earned income as is used for the EITC. Taxpayers (other than members of the Armed Forces stationed overseas) would be required to reside with a child in the United States to claim the additional child tax credit (as they are currently required to do for the EITC). Taxpayers with three or more children would do only one computation based on earned income to determine the credit amount. The proposal would be effective for taxable years beginning after December 31, 2008.

IMPROVE TAX COMPLIANCE

The Federal tax system is based on voluntary compliance with the tax laws. Under this system, taxpayers report and pay their taxes voluntarily with minimal interaction with the IRS. While the vast majority of American taxpayers pay their taxes timely and accurately, there remains in aggregate a difference between what taxpayers should pay and what they actually pay on a timely basis. In 2001, the overall compliance rate was 86 percent, after including late payments and recoveries from IRS enforcement activities. While this rate of compliance is high, a large amount of the tax that should be paid is not, resulting in the so-called "tax gap".[1]

In September 2006, the Treasury Department released a comprehensive strategy to improve tax compliance.[2] The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance.

Four key principles guided development of the strategy:

- Unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Sources of non-compliance should be targeted with specificity.
- Enforcement activities should be combined with a commitment to taxpayer service.
- Tax policy and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

These principles point to the need for a comprehensive, integrated, multi-year strategy to improve tax compliance. Components of this strategy must include: (1) legislative proposals to reduce opportunities for evasion; (2) a multi-year commitment to compliance research; (3) continued improvements in information technology; (4) improvements in IRS compliance activities; (5) enhancements of taxpayer service; (6) simplification of the tax law; and (7) coordination between the government and its partners and stakeholders.

The IRS has taken a number of steps to improve compliance.[3] To enhance the IRS's efforts, the Administration's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Expand information reporting.—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would: (1) require information reporting on payments to corporations; (2) require basis reporting on security sales; (3) require information reporting on broker and merchant payment card reimbursements; (4) require a certified tax identification number (TIN) from non-employee service providers; (5) require increased information reporting for certain gov-

[1] See Chapter 13, Stewardship, in this volume.

[2] Comprehensive Strategy for Reducing the Tax Gap, U.S. Treasury Department, September 26, 2006.

[3] See Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance, IRS, August 2, 2007.

ernment payments for property and services; (6) increase information return penalties; and (7) improve the foreign trust reporting penalty.

Improve compliance by businesses.—Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would: (1) require electronic filing by certain large businesses; and (2) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes.

Strengthen tax administration.—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would: (1) expand IRS access to information in the National Directory of New Hires database; (2) permit the IRS to disclose to prison officials return information about tax violations; (3) make repeated failure to file a tax return a felony; (4) facilitate information sharing with local jurisdictions for purposes of tax compliance; (5) extend the statutory period for assessing additional Federal tax liability on State/local adjustments or amended returns; and (6) improve the investigative disclosure statute.

Expand penalties.—Penalties play an important role in discouraging intentional non-compliance. The Administration proposes to impose a penalty on failure to comply with electronic filing requirements.

IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

Implement IRS administrative reforms.—The Administration has three proposals relating to administrative reforms. The first proposal modifies employee infractions subject to mandatory termination and permits a broader range of available penalties. It strengthens taxpayer privacy while reducing employee anxiety resulting from unduly harsh discipline or unfounded allegations. The second proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The third proposal eliminates the requirement that the IRS Chief Counsel provide an opinion for any accepted offer-in-compromise of unpaid tax (including interest and penalties) equal to or exceeding $50,000. This proposal requires that the Secretary of the Treasury establish standards to determine when an opinion is appropriate.

Extend IRS authority to fund undercover operations.—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, placing it on equal footing with other Federal law enforcement agencies. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which expired on December 31, 2007, through December 31, 2012.

Increase transparency of the cost of employer-provided health insurance.—Employers providing health coverage to employees and their families would be required to report on the Form W-2 provided to employees and the IRS the value of the health coverage provided to the employee. For this purpose, employers would generally use the same value for all similarly situated employees receiving the same category (such as self-only or family) of coverage. It is expected that the amount reported as the value of coverage would be determined using the same methodology as the applicable premiums for purposes of COBRA continuation coverage under section 4980B. This provision would be effective for years beginning after December 31, 2008.

Equalize penalty standards between preparers and taxpayers.—The increase in applicable standards in order for a tax return preparer to take an undisclosed position on a return and avoid penalties may result in conflicts of interest between tax return preparers and their taxpayer clients. The proposal would make the standard applicable to preparers in order to take an undisclosed position on a return generally consistent with the taxpayer standard. The proposal would maintain the existing law requirement that the preparer have a reasonable belief that the position would more likely than not be sustained on the merits with respect to certain reportable transactions with a significant purpose of tax avoidance. The proposal would make the standard applicable to tax return preparers for disclosed positions (including positions described in section 6662(d)(2)(C)) reasonable basis. No penalty would be asserted against a tax return preparer if the preparer has reasonable cause and good faith.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 American Jobs Creation Act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion effective for taxable years beginning after December 31, 2008.

Limit related party interest deductions.—Current law (section 163(j) of the Internal Revenue Code) denies U.S. tax deductions for certain interest expenses paid to a related party where: (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1, and (2) net interest expenses exceed 50 percent of the corporation's adjusted taxable income (computed by adding back net interest expense, depreciation, amortization, depletion, and any net operating loss deduction). If these thresholds are exceeded, no deduction is allowed for interest in excess of the 50-percent limit that is paid to a related party or paid to an unrelated party but guaranteed by a related party, and that is not subject to U.S. tax. Any interest that is disallowed in a given year is carried forward indefinitely and may be deductible in a subsequent taxable year. A three-year carryforward for any excess limitation (the amount by which interest expense for a given year falls short of the 50-percent limit) is also allowed. Consistent with the findings of the Treasury Department's recent study of earnings stripping, section 163(j) would be revised to tighten the limitation on the deductibility of interest paid by "expatriated entities" to related persons. The current law 1.5 to 1 debt-to-equity safe harbor would be eliminated. The adjusted taxable income threshold for the limitation would be reduced from 50 percent to 25 percent of adjusted taxable income with respect to disqualified interest other than interest paid to unrelated parties on debt that is subject to a related-party guarantee ("guaranteed debt"). Interest on guaranteed debt generally would be subject to the current-law 50 percent of adjusted taxable income threshold. The indefinite carryforward for disallowed interest under the adjusted taxable income limitation of current law would be limited to ten years. The three-year carryforward of excess limitation would be eliminated.

Repeal excise tax on local telephone service.—A three-percent Federal excise tax is imposed on amounts paid for local telephone service, toll telephone service (essentially long distance telephone service), and teletypewriter exchange service. In accordance with multiple court decisions that concluded that the tax did not apply to long distance services sold at flat per-minute rates for interstate, intrastate, and international calls, the IRS is no longer collecting tax on telephone service other than local-only telephone service. The Administration proposes to repeal all taxes on communication services, including the tax on local telephone service, effective for amounts paid pursuant to bills first rendered more than 90 days after enactment of legislation repealing the tax.

Modify financing of the Airport and Airway Trust Fund.—The Administration transmitted a reauthorization proposal in February 2007 to reform the Federal Aviation Administration's (FAA's) financing system by adopting new cost-based user fees. The FAA's current financing system, largely based on taxes on the price of airline tickets, does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. The Administration will resubmit the proposal for the FAA to collect user fees from commercial aviation operators for air traffic control services starting in fiscal year 2010. For non-commercial users, FAA would continue to recover its costs for air traffic control services via a fuel tax. Both commercial and non-commercial users would continue to pay fuel taxes to support the FAA's Airport Improvement Program.

Improve financing of the Inland Waterways Trust Fund.—Commercial barges that use the inland waterways now pay an excise tax of 20 cents per gallon on diesel fuel, which is deposited in the Inland Waterways Trust Fund. The tax does not raise enough revenue to cover the required 50 percent non-Federal share of the costs that the Army Corps of Engineers is spending to construct, replace, expand, and rehabilitate the locks and dams and other features that make barge transportation possible on the inland waterways. To address this imbalance between receipts and expenditures, the Administration proposes to phase out the current excise tax for inland waterways users and replace it with a more efficient user fee tied to the level of spending for inland waterways construction, replacement, expansion, and rehabilitation work.

Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund.—The President's National Park Centennial Challenge encourages the public to increase donations to national parks by proposing to match contributions for signature projects and programs on a dollar-for-dollar basis up to $100 million a year for ten years. As part of a broader initiative to prepare for the National Park Service Centennial in 2016, this Challenge continues the National Park Service's legacy of leveraging philanthropic investment for the benefit of America's national parks.

Increase fees for Migratory Bird Hunting and Conservation Stamps.—Federal Migratory Bird Hunting and Conservation Stamps, commonly known as "Duck Stamps," were originally created in 1934 as the Federal licenses required for hunting migratory waterfowl. Today, ninety-eight percent of the receipts generated from the sale of these stamps ($15 per stamp per year) are used to acquire important migratory bird breeding areas, migration resting places, and wintering areas. The land and water interests located and acquired with the Duck Stamp funds establish or add to existing migratory bird refuges and waterfowl production areas. The price of the Duck Stamp has not increased since 1991; however, the cost of land and water has increased significantly over the past 16 years. The Administration proposes to increase these fees to $25 per stamp per year, effective beginning in 2009.

Transition from the non-foreign cost-of-living adjustment (COLA) to locality pay for employees in non-foreign areas.—Federal employees working outside the continental United States in Alaska, Hawaii or the U.S. territories presently receive a COLA, which is an untaxed annual pay adjustment that is not creditable for retirement. By transitioning to locality pay, Federal employees in the non-foreign areas will contribute a larger percentage of their pay into the Federal retirement fund as locality pay is retirement-creditable. The proposal would establish a yearly reduction in the COLA, offset by a yearly increase in applicable locality pay, with the intent of eliminating the COLA over seven years.

IMPROVE UNEMPLOYMENT INSURANCE

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a multi-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system and to encourage the early reemployment of UI beneficiaries. The Administration's proposal will boost States' ability to recover benefit overpayments and deter tax evasion schemes by permitting them to use a portion of recovered funds to expand enforcement efforts in these areas. In addition, the proposal would require States to impose a monetary penalty on UI benefit fraud, which would be used to reduce overpayments; make it easier for States to use private collection agencies in the recovery of hard-to-collect overpayments and delinquent employer taxes; require States to charge employers found to be at fault when their actions lead to overpayments; permit collection of delinquent UI overpayments and employer taxes through garnishment of Federal tax refunds; and improve the accuracy of hiring data in the National Directory of New Hires, which would reduce benefit overpayments. The Administration's proposal would also permit States to request waivers of certain Federal requirements in order to carry out demonstration projects that improve the administration of the UI program, such as speeding reemployment of UI beneficiaries. These efforts to strengthen the financial integrity of the UI system and encourage early reemployment of UI beneficiaries will keep State UI taxes down and improve the solvency of the State trust funds.

Extend unemployment insurance surtax.—The Federal unemployment tax on employers will drop from 0.8 percent to 0.6 percent with respect to wages paid after December 31, 2008. The 0.8 percent rate is proposed to be extended for one year, through December 31, 2009.

MODIFY ENERGY PROVISIONS

Repeal reduced recovery period for natural gas distribution lines.—The Energy Policy Act of 2005 reduced the recovery period for new natural gas distribution lines that are placed in service before January 1, 2011, from 20 years to 15 years. The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2008.

Modify amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the acquisition and retention of mineral properties by taxpayers exploring for minerals. Under the Energy Policy Act of 2005, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, could be amortized over two years. The Tax Increase Prevention and Reconciliation Act of 2006 increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applied only to integrated oil companies that had an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, had gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and were either a crude oil refiner or related to a crude oil refiner. The Energy Independence and Security Act of 2007 increased the amortization period for such integrated oil companies to seven years for costs paid or incurred after December 19, 2007. The Administration proposes to increase the amortization period to seven years for all companies, effective for amounts paid or incurred in taxable years beginning after December 31, 2008.

PROMOTE TRADE

Implement free trade agreements.—Free trade agreement negotiations with Columbia, Panama and Korea were completed, with the expectation that implementation could begin as early as 2009. A free trade agreement is expected to be completed with Malaysia, with implementation to begin in 2010. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of America's partner countries.

Establish Reconstruction Opportunity Zones (ROZs) in Pakistan and Afghanistan.—In March 2006, the President announced his intention to establish ROZs in Afghanistan and the border regions of Pakistan. ROZs are a critical part of the Administration's broader counterterrorism strategy in these areas, designed to connect isolated regions to the global economy and create vital employment opportunities in territories prone to extremism. The creation of ROZs will encourage investment and economic development in these areas by granting duty-free entry to the United States for certain goods produced in designated territories. By stimulating economic activity in remote and underdeveloped regions, ROZs can also serve as a powerful catalyst for peace, prosperity, stability, growth and good governance. The Administration will work closely with Congress and private sector stakeholders to implement this important initiative.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to approximately 3,400 products from eligible beneficiary developing countries that meet certain worker rights, intellectual property protection, and other statutory criteria. The Administration proposes to extend this program, which is scheduled to expire after December 31, 2008, through December 31, 2013.

Extend Andean Trade Preference Act (ATPA).—The ATPA was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking. The Administration proposes to extend the ATPA, which is scheduled to expire on February 29, 2008, through December 31, 2008.

Extend Caribbean Basin Initiative (CBI).—The trade programs known collectively as the CBI remain a vital element in the United States' economic relations with its neighbors in Central America and the Caribbean. The CBI, which is intended to facilitate the economic development and export diversification of the Caribbean Basin economies, currently provides 19 beneficiary countries with duty-free access to the U.S. market for most goods. The Administration proposes to extend the CBI, which is scheduled to expire on September 30, 2008, through December 31, 2011.

EXTEND EXPIRING PROVISIONS

Extend minimum tax relief for individuals.—A temporary provision of current law increased the alternative minimum tax (AMT) exemption amounts to $44,350 for single taxpayers, $66,250 for married taxpayers filing a joint return and surviving spouses, and $33,125 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2007, the AMT exemption amounts decline to $33,750 for single taxpayers, $45,000 for married taxpayers filing a joint return and surviving spouses, and $22,500 for married taxpayers filing a separate return and estates and trusts. A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the AMT for taxable years beginning before January 1, 2008.

The Administration proposes to increase the AMT exemption amounts to $46,250 for single taxpayers, $70,050 for married taxpayers filing a joint return, and $35,025 for married taxpayers filing a separate return and estates and trusts through taxable year 2008 to prevent the number of AMT taxpayers from increasing. Non-refundable personal tax credits also would be allowed to offset both the regular tax and the AMT through taxable year 2008.

Permanently extend the research and experimentation (R&E) tax credit.—The Administration proposes to permanently extend the tax credits for research and experimentation expenditures, which expired with respect to expenditures incurred after December 31, 2007.

Extend the first-time homebuyer credit for the District of Columbia (DC).—A one-time nonrefundable $5,000 credit is available to purchasers of a principal residence in the District of Columbia who have not owned a residence in the District during the year preceding the purchase. The credit phases out for taxpayers with modified adjusted gross income between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). The credit does not apply to purchases after December 31, 2007. The Administration proposes to extend the credit for two years, making the credit available with respect to purchases after December 31, 2007 and before January 1, 2010.

Extend deferral of gains from sales of electric transmission property.—Generally, the gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. One such special rule applies to qualifying electric transmission transactions. Under this rule, a taxpayer may elect to recognize the gain from a qualifying electric transmission transaction ratably over the eight-year period beginning with the year of the transaction. Deferral is allowed only with respect to proceeds that are used to purchase other gas or electric utility property during the four-year period beginning on the date of the transaction (the reinvestment period). A sale or other disposition of property is a qualifying electric transmission transaction if: (1) the property is used in the trade or business of providing electric transmission services or is an ownership interest in a entity whose principal trade or business is providing electric transmission services, and (2) the sale or other disposition is to an independent transmission company and occurs before January 1, 2008. In general, whether the purchaser qualifies as an independent transmission company depends on determinations by the Federal Energy Regulatory Commission (FERC) or, in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, by that Commission. The special rule allowing the deferral of tax on the gain from the sale or disposition of electric transmission property would be extended for one year, allowing taxpayers to elect deferral with respect to sales or dispositions that occur before January 1, 2009.

Extend the New Markets tax credit.—The New Markets tax credit is provided for qualified equity investments made to acquire stock in a corporation or a capital interest in a partnership that is a qualified community development entity (CDE). A credit of five percent is provided to the investor for the first three years of investment. The credit increases to six percent for the next four years. The maximum amount of annual qualifying equity investment is capped at $2.0 billion for calendar years 2004 and 2005, and $3.5 billion for calendar years 2006 through 2008. The Administration proposes to extend the New Markets tax credit through 2009 and to permit up to $3.5 billion in qualified equity investment for that calendar year.

Extend Subpart F "active financing" and "look-through" exceptions.—Under Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed. The income subject to current inclusion under Subpart F includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under current law, for taxable years beginning before January 1, 2009, exceptions from Subpart F are provided for: (1) certain income derived in the active conduct of a banking, financing, insurance, or similar business (active financing), and (2) dividends, interest, rents and royalties received by one CFC from a related CFC to the extent attributable or properly allocable to income of the related CFC that is neither Subpart F income nor income treated as effectively connected with the conduct of a trade or business in the United States (look-through). The Administration proposes to extend both the Subpart F active financing and look-through exceptions to apply to taxable years beginning before January 1, 2010.

Extend the exception for retirement plan distributions provided individuals called to active duty for at least 179 days.—Under current law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59 1/2, death or disability is subject to a 10-percent early withdrawal tax unless a specific exception to the tax applies. One of the exceptions to the tax applies to qualified reservist distributions. An individual who receives a qualified reservist distribution may, at any time during a two-year period beginning on the day after the end of the active duty period, make contributions to an IRA in an amount not exceeding the amount of the qualified reservist distribution. Such contributions are not subject to the dollar limitations otherwise applicable to contributions to IRAs. The exception to the tax for qualified reservist distributions applies to individuals ordered or called to active duty after September 11, 2001 and before December 31, 2007. The Administration proposes to extend the exception to individuals ordered or called to active duty before December 31, 2008.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—The disclosure of tax return information relating to terrorism is permitted in two situations. The first is when an executive of a Federal law enforcement or intelligence agency has reason to believe that the return information is relevant to a terrorist incident, threat or activity and submits a written request. The second is when the IRS wishes to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The Administration proposes to extend this disclosure authority, which expired on December 31, 2007, through December 31, 2008.

Extend authority permitting disclosure of tax return information to the Department of Veterans Affairs (VA).—Current law permits disclosure of certain tax information to the VA. This information assists the VA in determining eligibility and establishing correct benefit amounts for certain of its needs-based programs. The Administration proposes to extend and update this disclosure authority, which is scheduled to expire after September 30, 2008, through September 30, 2009.

Extend excise tax on coal at current rates.—Excise taxes levied on coal mined and sold for use in the United States are deposited in the Black Lung Disability Trust Fund. Amounts deposited in the Fund are used to cover the cost of program administration and to pay compensation, medical, and survivor benefits to eligible miners and their survivors, when mine employment terminated prior to 1970 or when no mine operator can be assigned liability. Current tax rates on coal sold by a producer are $1.10 per ton of coal from underground mines and $0.55 per ton of coal from surface mines; however, these rates may not exceed 4.4 percent of the price at which the coal is sold. Effective for coal sold after December 31, 2013, the tax rates on coal from underground mines and surface mines will decline to $0.50 per ton and $0.25 per ton, respectively, and will be capped at 2 percent of the price at which the coal is sold. The Administration proposes to repeal the reduction in these tax rates effective for sales after December 31, 2013, and keep current rates in effect until the Black Lung Disability Trust Fund debt is repaid.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	2008	2009	2010	2011	2012	2013	2009–13	2009–18
Economic growth package	–125,000	–20,000	10,000	8,000	6,000	4,000	8,000	8,000
Make Permanent Certain Tax Relief Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	....	425	–5,554	–24,361	–4,616	–13,873	–47,979	–196,413
Capital gains tax rate structure	....	....	–4,094	–17,416	–3,683	–8,461	–33,654	–104,804
Expensing for small businesses	....	....	....	–4,160	–5,810	–4,288	–14,258	–26,537
Marginal individual income tax rate reductions	....	....	....	–75,160	–119,341	–123,794	–318,295	–1,007,667
Child tax credit [1]	....	....	....	–5,062	–20,357	–20,777	–46,196	–155,731
Marriage penalty relief [1]	....	....	....	–5,117	–7,715	–7,001	–19,833	–46,939
Education incentives	....	....	....	–738	–1,339	–1,413	–3,490	–11,540
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	–422	–2,502	–3,453	–26,409	–57,639	–59,670	–149,673	–521,982
Other incentives for families and children	....	....	6	–364	–678	–678	–1,714	–5,157
Total, make permanent certain tax relief enacted in 2001 and 2003	–422	–2,077	–13,095	–158,787	–221,178	–239,955	–635,092	–2,076,770
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	1,527	3,545	3,023	1,075	–1,314	7,856	–592
Consolidate employer-based savings accounts	....	–80	–120	–132	–141	–150	–623	–1,484
Total, simplify and encourage saving	....	1,447	3,425	2,891	934	–1,464	7,233	–2,076
Encourage entrepreneurship and investment:								
Increase expensing for small businesses	....	–1,086	–1,495	–1,083	–851	–688	–5,203	–7,578
Invest in health care:								
Provide a new standard deduction for health insurance ($15,000 for family coverage and $7,500 for individual coverage) [1]	....	–23,002	–28,412	–22,680	–15,360	–4,692	–94,146	41,051
Expand and make health savings accounts (HSAs) more flexible	....	–420	–779	–931	–1,031	–1,123	–4,284	–11,511
Allow the orphan drug tax credit for certain pre-designation expenses [2]	....	....	....	....	....	....	....	....
Total, invest in health care	....	–23,422	–29,191	–23,611	–16,391	–5,815	–98,430	29,540
Provide incentives for charitable giving:								
Permanently extend tax-free withdrawals from IRAs for charitable contributions	....	–300	–551	–434	–284	–211	–1,780	–3,321
Permanently extend the enhanced charitable deduction for contributions of food inventory	–44	–96	–106	–116	–127	–140	–585	–1,524
Permanently extend the deduction for corporate donations of computer equipment for educational purposes	–50	–118	–147	–154	–162	–170	–751	–1,838
Permanently extend increased limits on contributions of partial interests in real property for conservation purposes	–48	–35	–22	–18	–21	–22	–118	–245
Permanently extend basis adjustment to stock of S corporations contributing appreciated property	–3	–15	–21	–25	–28	–32	–121	–354
Reform excise tax based on investment income of private foundations	–105	–152	–152	–153	–154	–155	–766	–1,578
Total, provide incentives for charitable giving	–250	–716	–999	–900	–776	–730	–4,121	–8,860
Strengthen education:								
Permanently extend the above-the-line deduction for qualified out-of-pocket classroom expenses	–18	–180	–183	–185	–188	–191	–927	–1,927
Allow the saver's credit for contributions to qualified tuition programs	....	–88	–183	–198	–213	–227	–909	–2,259
Total, strengthen education	–18	–268	–366	–383	–401	–418	–1,836	–4,186
Strengthen housing:								
Expand tax-exempt qualified mortgage bond program to assist subprime borrowers	–27	–116	–230	–305	–329	–331	–1,311	–2,687
Protect the environment:								
Permanently extend expensing of brownfields remediation costs	–180	–501	–356	–343	–327	–284	–1,811	–2,870
Eliminate the volume cap for private activity bonds for water infrastructure	....	....	–3	–6	–10	–15	–34	–214
Total, protect the environment	–180	–501	–359	–349	–337	–299	–1,845	–3,084
Restructure assistance to New York City for continued recovery from the attacks of September 11th								
Provide tax incentives for transportation infrastructure	....	–200	–200	–200	–200	–200	–1,000	–2,000

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2008	2009	2010	2011	2012	2013	2009–13	2009–18
Total, tax incentives	–475	–24,862	–29,415	–23,940	–18,351	–9,945	–106,513	–931
Simplify the Tax Laws for Families:								
Clarify uniform definition of a child [1]	....	6	30	38	17	23	114	275
Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigrant status [1]	....	35	–28	–26	–24	–23	–66	–181
Reduce computational complexity of refundable child tax credit [1]	....	....	....	....	....	....	....	....
Total, simplify the tax laws for families	....	41	2	12	–7	....	48	94
Improve Tax Compliance: [3]								
Expand information reporting	....	302	1,333	2,227	2,960	3,653	10,475	35,756
Improve compliance by businesses	....	3	5	5	5	6	24	57
Strengthen tax administration	....	....	....	3	6	8	17	72
Expand penalties	....	....	....	....	....	1	1	6
Total, improve tax compliance	....	305	1,338	2,235	2,971	3,668	10,517	35,891
Improve Tax Administration and Other Miscellaneous Proposals:								
Implement IRS administrative reforms and extend IRS authority to fund undercover operations [2]	....	....	....	....	....	....	....	....
Increase transparancy of the cost of employer-provided health insurance [2]	....	....	....	....	....	....	....	....
Equalize penalty standards between preparers and taxpayers	....	....	–1	–2	–2	–2	–7	–17
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	....	2	13	16	13	11	55	66
Limit related party interest deductions	....	64	109	115	120	126	534	1,267
Repeal excise tax on local telephone service [4]	....	–248	–170	–118	–83	–79	–698	–1,076
Modify financing of the Airport and Airway Trust Fund [4]	....	....	–6,768	–7,106	–7,526	–7,909	–29,309	–75,594
Improve financing of the Inland Waterways Trust Fund [4]	....	109	119	127	159	126	640	1,015
Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund	....	100	100	100	100	100	500	1,000
Increase fees for Migratory Bird Hunting and Conservation Stamps	....	14	14	14	14	14	70	140
Transition from the non-foreign cost-of-living adjustment (COLA) to locality pay for employees in non-foreign areas	....	1	2	3	4	5	15	50
Total, improve tax administration and other miscellaneous proposals [4]	....	42	–6,582	–6,851	–7,201	–7,608	–28,200	–73,149
Improve Unemployment Insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [4]	....	....	35	34	–107	–314	–352	–1,581
Extend unemployment insurance surtax [4]	....	1,079	465	....	....	....	1,544	590
Total, improve unemployment insurance [4]	....	1,079	500	34	–107	–314	1,192	–991
Modify Energy Provisions:								
Repeal reduced recovery period for natural gas distribution lines	....	20	73	114	110	89	406	580
Modify amortization for certain geological and geophysical expenditures	16	61	91	76	43	19	290	353
Total, modify energy provisions	16	81	164	190	153	108	696	933
Promote Trade:								
Implement free trade agreements and modify other trade-related provisions [4]	–86	–1,653	–2,319	–2,674	–2,408	–2,426	–11,480	–20,380
Extend Expiring Provisions:								
Minimum tax relief for individuals	–11,673	–60,908	14,216	....	....	....	–46,692	–46,692
Research and experimentation (R&E) tax credit	–3,221	–7,071	–9,145	–10,601	–11,809	–12,833	–51,459	–133,060
First-time homebuyer credit for the District of Columbia	–1	–20	–19	....	....	....	–39	–39
Deferral of gains from sales of electric transmission property	–31	–66	–61	–10	31	40	–66	30
New Markets tax credit	....	–132	–194	–191	–217	–231	–965	–1,287
Subpart F “active financing” exception	....	–1,598	–1,065	....	....	....	–2,663	–2,663
Subpart F “look-through” exception	....	–347	–231	....	....	....	–578	–578
Exception for retirement plan distributions provided individuals called to active duty for at least 179 days [2]	....	....	....	....	....	....	....	....
Disclosure of tax return information related to terrorist activity [2]	....	....	....	....	....	....	....	....
Disclosure of tax return information to the Department of Veterans Affairs [2]	....	....	....	....	....	....	....	....
Excise tax on coal [4]	....	....	....	....	....	....	....	1,387
Total, extend expiring provisions [4]	–14,926	–70,142	3,501	–10,802	–11,995	–13,024	–102,462	–182,902

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(In millions of dollars)

	2008	2009	2010	2011	2012	2013	2009–13	2009–18
Total budget proposals, including proposals assumed in the baseline [4]	–140,893	–117,186	–35,906	–192,583	–252,123	–265,496	–863,294	–2,310,205
Total budget proposals, excluding proposals assumed in the baseline [4]	–140,471	–115,109	–22,811	–33,796	–30,945	–25,541	–228,202	–233,435

[1] Affects both receipts and outlays. Only the receipt effect is shown here. For the outlay effect, see summary Table S–6 of the Budget volume.
[2] No net budgetary impact.
[3] "Tax gap"-related proposals.
[4] Net of income offsets.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2007 Actual	Estimate 2008	2009	2010	2011	2012	2013
Individual income taxes (federal funds):							
Existing law	1,163,472	1,231,955	1,337,632	1,433,193	1,652,986	1,781,816	1,898,384
Proposed legislation	....	–12,294	–78,591	–15,850	–153,991	–181,941	–189,312
Total individual income taxes	**1,163,472**	**1,219,661**	**1,259,041**	**1,417,343**	**1,498,995**	**1,599,875**	**1,709,072**
Corporation income taxes:							
Federal funds:							
Existing law	370,240	348,739	348,338	348,397	366,607	402,459	391,511
Proposed legislation	....	–3,403	–9,114	–9,463	–9,837	–11,150	–11,713
Total Federal funds corporation income taxes	370,240	345,336	339,224	338,934	356,770	391,309	379,798
Trust funds:							
Hazardous substance superfund	3	....	....	....	....	....	....
Total corporation income taxes	**370,243**	**345,336**	**339,224**	**338,934**	**356,770**	**391,309**	**379,798**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	542,901	566,104	595,659	632,980	667,995	699,735	734,126
Proposed legislation	....	....	–1,061	–239	–52	–6	290
Disability insurance (Off-budget)	92,188	96,111	101,146	107,487	113,433	118,823	124,663
Proposed legislation	....	....	–180	–40	–9	–1	49
Hospital insurance	184,908	195,453	205,360	217,240	229,679	240,987	253,007
Proposed legislation	....	....	–5,644	–7,207	–5,668	–3,880	–539
Railroad retirement:							
Social Security equivalent account	1,952	1,996	2,058	2,111	2,163	2,215	2,267
Rail pension and supplemental annuity	2,309	2,359	2,308	2,344	2,403	2,462	2,518
Total employment and general retirement	824,258	862,023	899,646	954,676	1,009,944	1,060,335	1,116,381
On-budget	189,169	199,808	204,082	214,488	228,577	241,784	257,253
Off-budget	635,089	662,215	695,564	740,188	781,367	818,551	859,128
Unemployment insurance:							
Deposits by States [1]	33,709	35,750	37,183	37,882	38,573	39,617	41,109
Proposed legislation	....	....	....	43	42	–134	–324
Federal unemployment receipts [1]	7,292	7,541	6,326	5,999	6,243	6,490	6,389
Proposed legislation	....	....	1,348	581	....	....	–67
Railroad unemployment receipts [1]	90	91	96	109	122	125	122
Total unemployment insurance	41,091	43,382	44,953	44,614	44,980	46,098	47,229
Other retirement:							
Federal employees' retirement—employee share	4,207	4,695	4,751	4,720	4,737	4,951	4,902
Proposed legislation	....	....	1	2	3	4	5
Non-Federal employees retirement [2]	51	25	26	27	26	23	20
Total other retirement	4,258	4,720	4,778	4,749	4,766	4,978	4,927
Total social insurance and retirement receipts	**869,607**	**910,125**	**949,377**	**1,004,039**	**1,059,690**	**1,111,411**	**1,168,537**
On-budget	234,518	247,910	253,813	263,851	278,323	292,860	309,409
Off-budget	635,089	662,215	695,564	740,188	781,367	818,551	859,128
Excise taxes:							
Federal funds:							
Alcohol taxes	8,648	8,894	9,017	9,180	9,365	9,535	9,765
Proposed legislation	....	–75	–102	–25	....	....	....
Tobacco taxes	7,556	7,622	7,526	7,436	7,353	7,274	7,200
Transportation fuels tax	–3,291	–4,261	–4,941	–5,724	–1,500	228	227
Telephone and teletype services	–2,125	586	330	227	158	111	105
Proposed legislation	....	....	–330	–227	–158	–111	–105
Other Federal fund excise taxes	288	2,089	2,083	2,107	2,130	2,166	2,211
Proposed legislation	....	–30	–50	–181	–209	–212	–215

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2007 Actual	Estimate 2008	2009	2010	2011	2012	2013
Total Federal fund excise taxes	11,076	14,825	13,533	12,793	17,139	18,991	19,188
Trust funds:							
Highway	39,361	39,203	39,928	40,674	41,148	41,702	42,334
Airport and airway	11,468	11,871	12,570	13,328	14,073	14,861	15,690
Proposed legislation	....	....	....	–8,969	–9,418	–9,975	–10,484
Sport fish restoration and boating safety	581	561	578	595	614	633	653
Tobacco assessments	934	960	960	960	960	960	960
Black lung disability insurance	639	638	648	666	686	699	711
Inland waterways	91	89	90	90	92	92	93
Proposed legislation	....	....	–41	–65	–92	–92	–93
Oil spill liability	452	273	261	252	245	245	249
Vaccine injury compensation	241	218	219	220	222	224	226
Leaking underground storage tank	226	197	200	203	204	206	208
Proposed legislation	....	....	....	–1	–1	–1	–2
Total trust funds excise taxes	53,993	54,010	55,413	47,953	48,733	49,554	50,545
Total excise taxes	**65,069**	**68,835**	**68,946**	**60,746**	**65,872**	**68,545**	**69,733**
Estate and gift taxes:							
Federal funds	26,044	26,733	27,785	20,997	19,400	48,176	54,565
Proposed legislation	....	24	–1,472	–1,454	–17,936	–47,755	–54,060
Total estate and gift taxes	**26,044**	**26,757**	**26,313**	**19,543**	**1,464**	**421**	**505**
Customs duties:							
Federal funds	24,671	27,906	29,815	32,245	34,286	36,272	38,240
Proposed legislation	....	–115	–2,204	–3,093	–3,567	–3,211	–3,236
Trust funds	1,339	1,417	1,511	1,623	1,753	1,894	2,039
Total customs duties	**26,010**	**29,208**	**29,122**	**30,775**	**32,472**	**34,955**	**37,043**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	510	528	529	532	534	537	539
United Mine Workers of America combined benefit fund	44	83	84	72	58	53	49
Deposit of earnings, Federal Reserve System	32,043	31,358	31,652	33,361	36,066	39,119	41,694
Defense cooperation	34	35	35	35	35	35	35
Fees for permits and regulatory and judicial services	10,395	10,657	11,758	12,453	12,896	13,994	13,618
Proposed legislation	....	....	154	182	210	242	210
Fines, penalties, and forfeitures	4,542	3,417	3,435	3,057	3,078	3,099	3,120
Gifts and contributions	238	197	199	198	205	205	204
Proposed legislation	....	....	100	100	100	100	100
Refunds and recoveries	–12	–22	–22	–22	–22	–22	–22
Total miscellaneous receipts	**47,794**	**46,253**	**47,924**	**49,968**	**53,160**	**57,362**	**59,547**
Economic growth package	....	**–125,000**	**–20,000**	**10,000**	**8,000**	**6,000**	**4,000**
Total budget receipts	**2,568,239**	**2,521,175**	**2,699,947**	**2,931,348**	**3,076,423**	**3,269,878**	**3,428,235**
On-budget	1,933,150	1,858,960	2,004,383	2,191,160	2,295,056	2,451,327	2,569,107
Off-budget	635,089	662,215	695,564	740,188	781,367	818,551	859,128
MEMORANDUM							
Federal funds	1,661,420	1,556,704	1,696,812	1,878,246	1,966,799	2,107,609	2,207,794
Trust funds	648,313	697,722	730,885	745,457	787,379	821,233	878,609
Interfund transactions	–376,583	–395,466	–423,314	–432,543	–459,122	–477,515	–517,296
Total on-budget	**1,933,150**	**1,858,960**	**2,004,383**	**2,191,160**	**2,295,056**	**2,451,327**	**2,569,107**
Off-budget (trust funds)	**635,089**	**662,215**	**695,564**	**740,188**	**781,367**	**818,551**	**859,128**
Total	**2,568,239**	**2,521,175**	**2,699,947**	**2,931,348**	**3,076,423**	**3,269,878**	**3,428,235**

[1] Deposits by States cover the benefit part of the program. Federal unemployment receipts cover administrative costs at both the Federal and State levels. Railroad unemployment receipts cover both the benefits and adminstrative costs of the program for the railroads.

[2] Represents employer and employee contributions to the civil service retirement and disability fund for covered employees of Government-sponsored, privately owned enterprises and the District of Columbia municipal government.

[3] Includes both Federal and trust funds.

18. USER CHARGES AND OTHER COLLECTIONS

In addition to collecting taxes and other receipts by the exercise of its sovereign powers, which is discussed in the previous chapter in this volume in Chapter 17, “Federal Receipts,” the Federal Government collects income from the public from market-oriented activities and the financing of regulatory expenses. These collections are classified as user charges, and examples of these charges include the sale of postage stamps and electricity, charges for admittance to national parks, premiums for deposit insurance, and proceeds from the sale of assets, such as rents and royalties for the right to extract oil from the Outer Continental Shelf.

Depending on the laws that authorize the user charges, most are credited to expenditure accounts as “offsetting collections,” or to receipt accounts as “offsetting receipts.” The budget refers to these amounts as “offsetting” because they are subtracted from gross outlays rather than added to taxes on the receipts side of the budget. The purpose of this treatment is to produce budget totals for receipts, outlays, and budget authority in terms of the amount of resources allocated governmentally, through collective political choice, rather than through the market.[1] In addition, some regulatory fees therefore are classified as governmental receipts and are on the receipts side of the budget.

Usually offsetting collections are authorized to be spent for the purposes of the account without further action by the Congress. Offsetting receipts may or may not be earmarked for a specific purpose, depending on the legislation that authorizes them. When earmarked, the authorizing legislation may either authorize them to be spent without further action by the Congress, or require them to be appropriated in annual appropriations acts before they can be spent.

Offsetting collections and receipts include most user charges, which are discussed below, as well as some amounts that are not user charges. Table 18–1 summarizes these transactions. For 2009, total offsetting collections and receipts from the public are estimated to be $330.2 billion, and total user charges are estimated to be $256.1 billion.

The following section discusses user charges and the Administration’s user charge proposals. The subsequent section displays more information on offsetting collections and receipts. The offsetting collections and receipts by agency are displayed in Table 21–1, which appears in Chapter 21, “Outlays to the Public, Gross and Net,” of this volume. Collections specifically related to credit programs are discussed in Chapter 7, “Credit and Insurance.”

Table 18–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(In billions)

	Actual 2007	Estimate	
		2008	2009
Gross outlays	3,050.9	3,269.6	3,437.6
Offsetting collections and receipts from the public:			
User charges[1]	229.5	248.0	252.1
Other	91.2	90.4	78.1
Subtotal, offsetting collections and receipts from the public	320.7	338.4	330.2
Net outlays	2,730.2	2,931.2	3,107.4

[1] Total user charges are shown below. They include user charges that are classified on the receipts side of the budget in addition to the amounts shown on this line. For additional details of total user charges, see Table 18–2, “Total User Charge Collections.”

Total user charges:			
Offsetting collections and receipts from the public	229.5	248.0	252.1
Receipts	3.9	3.5	4.0
Total, User charges	233.3	251.5	256.1

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the *Report of the President’s Commission on Budget Concepts in 1967*. The concept is discussed in Chapter 26: “The Budget System and Concepts” in this volume.

USER CHARGES

I. Introduction and Background

The Federal Government often assesses user charges on those who benefit directly from a particular activity or those subject to regulation. Based on the definition used in this chapter, Table 18–2 shows that user charges were $233.3 billion in 2007, and are estimated to increase to $251.5 billion in 2008 and to $256.1 billion in 2009, growing to an estimated $303.8 billion in 2013, including the user charges proposals that are shown in Table 18–3. This table shows that the Administration's user charge proposals, including extension of expiring charges, would increase user charges by an estimated $4.5 billion in 2009, growing to an estimated $19.7 billion in 2013.

Definition. User charges are fees, charges, and assessments levied on individuals or organizations directly benefiting from, or subject to regulation by, a Government program or activity. In addition, the payers of the charge must be limited to those benefiting from, or subject to regulation by, the program or activity, and may not include the general public, and generally does not apply to a broad segment of the public (such as those who pay income taxes or customs duties).

- Examples of business-type or market-oriented user charges include charges for the sale of postal services (the sale of stamps), electricity (e.g., sales by the Tennessee Valley Authority), proceeds from the sale of goods by defense commissaries, payments for Medicare voluntary supplemental medical insurance, life insurance premiums for veterans, recreation fees for parks, and proceeds from the sale of assets (property, plant, and equipment) and natural resources (such as timber, oil, and minerals).
- Examples of regulatory and licensing user charges include charges for regulating the nuclear energy industry, bankruptcy filing fees, immigration fees, food inspection fees, passport fees, and patent and trademark fees.

The "user charges" concept used here aligns these estimates with the concept that establishes policy for charging prices to the public for the sale or use of goods, services, property, and resources (see OMB Circular No. A–25, "User Charges," July 8, 1993).

User charges do not include all offsetting collections and receipts from the public, such as repayments received from credit programs; interest, dividends, and other earnings; payments from one part of the Federal Government to another; or cost sharing contributions. Nor do they include earmarked taxes (such as taxes paid to social insurance programs or excise taxes on gasoline), or customs duties, fines, penalties, and forfeitures.

Alternative definitions. The definition used in this chapter is useful because it is similar to the definition used in OMB Circular No. A–25, "User Charges," which provides policy guidance to Executive Branch agencies on setting prices for user charges. Alternative definitions may be used for other purposes. Much of the discussion of user charges below—their purpose, when they should be levied, and how the amount should be set—applies to these alternatives as well.

Other definitions of user charges could, for example:

- be narrower than the one used here, by limiting the definition to proceeds from the sale of goods and services (and excluding the sale of assets), and by limiting the definition to include only proceeds that are earmarked to be used specifically to finance the goods and services being provided. This definition is similar to one the House of Representatives uses as a guide for purposes of committee jurisdiction. (See the *Congressional Record,* January 3, 1991, p. H31, item 8.)
- be even narrower than the user fee concept described above, by excluding regulatory fees and focusing solely on business-type transactions.
- be broader than the one used in this chapter by including beneficiary- or liability-based excise taxes, such as gasoline taxes. [2]

What is the purpose of user charges? The purpose of user charges is to improve the efficiency and equity of certain Government activities, and to reduce the burden on taxpayers to finance activities whose benefits accrue to a relatively limited number of people, or to impose a charge on activities that impose a cost on the public.

User charges that are set to cover the costs of production of goods and services can provide efficiency in the allocation of resources within the economy. They allocate goods and services to those who value them the most, and they signal to the Government how much of the goods or services it should provide. Prices in private, competitive markets serve the same purposes.

User charges for goods and services that do not have special social benefits improve equity, or fairness, by requiring that those who benefit from an activity are the same people who pay for it. The public often perceives user charges as fair because those who benefit from the good or service pay for it in whole or in part, and those who do not benefit do not pay.

When should the Government charge a fee? Discussions of whether to finance spending with a tax or a fee often focus on whether the benefits of the activity are to the public in general or to a limited group of people. In general, if the benefits accrue broadly to the public, then the program should be financed by taxes paid by the public; in contrast, if the benefits

[2] Beneficiary- and liability-based taxes are terms taken from the Congressional Budget Office, *The Growth of Federal User Charges*, August 1993, and updated in October 1995. In addition to gasoline taxes, examples of beneficiary-based taxes include taxes on airline tickets, which finance air traffic control activities and airports. An example of a liability-based tax is the excise tax that formerly helped fund the hazardous substance superfund in the Environmental Protection Agency. This tax was paid by industry groups to finance environmental cleanup activities related to the industry activity but not necessarily caused by the payer of the fee.

accrue to a limited number of private individuals or organizations, then the program should be financed by charges paid by the private beneficiaries. For Federal programs where the benefits are entirely public or entirely private, applying this principle is relatively easy. For example, according to this principle, the benefits from national defense accrue to the public in general and should be (and are) financed by taxes. In contrast, the benefits of electricity sold by the Tennessee Valley Authority accrue exclusively to those using the electricity, and should be (and are) financed by user charges.

In many cases, however, an activity has benefits that accrue to both public and to private groups, and it may be difficult to identify how much of the benefits accrue to each. Because of this, it can be difficult to know how much of the program should be financed by taxes and how much by fees. For example, the benefits from recreation areas are mixed. Fees for visitors to these areas are appropriate because the visitors benefit directly from their visit, but the public in general also benefits because these areas protect the Nation's natural and historic heritage now and for posterity.

As a further complication, where a fee may be appropriate to finance all or part of an activity, some consideration must be given to the ease of administering the fee.

What should be the amount of the fee? For programs that have private beneficiaries, the amount of the charge should depend on the costs of producing the goods or services and the portion of the program that is for private benefits. If the benefit is primarily private and any public benefits are incidental, current policies support charges that cover the full cost to the Government, including both direct and indirect costs. When the Government is not acting in its capacity as sovereign and engages in a business-type transaction (i.e., leasing or selling goods, services, or resources), market price should be the basis for establishing the fee.[3]

The Executive Branch is working to put cost accounting systems in place across the Government that would make the calculation of full cost more feasible. The difficulties in measuring full cost are associated in part with allocating to an activity the full costs of capital, retirement benefits, and insurance, as well as other Federal costs that may appear in other parts of the budget. Guidance in the Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards" for the Federal Government (July 31, 1995), should underlie cost accounting in the Federal Government.

Classification of user charges in the budget. As shown in Table 18–1, most user charges are classified as offsets to outlays on the spending side of the budget, but a few are classified on the receipts side of the budget. An estimated $4.0 billion in 2009 are classified on the receipts side and are included in the totals described in Chapter 17. "Federal Receipts." They are classified as receipts because they are regulatory charges collected by the Federal Government by the exercise of its sovereign powers. Examples include filing fees in the United States courts, agricultural quarantine inspection fees, and passport fees. These regulatory charges are unlike user fees classified as offsets to outlays, which are normally for identifiable goods or services whose benefits primarily fall to the party paying the fee and for which alternatives may exist in the private sector or State and local sector.

The remaining user charges, an estimated $252.1 billion in 2009, are classified as offsetting collections and receipts on the spending side of the budget. Some of these are collected by the Federal Government by the exercise of its sovereign powers and conceptually would appear on the receipts side of the budget, but are required by law to be classified on the spending side as offsetting collections or receipts. Examples of these fees include immigration examination fees, U. S. customs processing fees, and nuclear regulatory fees.

As shown in Table 18–4, an estimated $157.2 billion of user charges for 2009 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $94.9 billion of user charges for 2009 are deposited in offsetting receipt accounts, and are available to be spent only according to the legislation that established the charges.

As a further classification, the accompanying Tables 18–2 and 18–3 identify the user charges as discretionary or mandatory. These classifications are terms from the Budget Enforcement Act of 1990 as amended and are used frequently in the analysis of the budget. "Discretionary" in this chapter refers to user charges generally controlled through annual appropriations acts and under the jurisdiction of the appropriations committees in the Congress. "Mandatory" refers to user charges controlled by permanent laws and under the jurisdiction of the authorizing committees.

These and other classifications are discussed further in this volume in Chapter 26, "The Budget System and Concepts."

II. TOTAL USER CHARGES

As shown in Table 18–2, total user charge collections (including those proposed in this Budget) are estimated to be $256.1 billion in 2009, increasing to $303.8 billion in 2013. User charge collections by the Postal Service

[3] Policies for setting user charges are promulgated in OMB Circular No. A–25: "User Charges" (July 8, 1993).

Table 18–2. TOTAL USER CHARGE COLLECTIONS

(In millions of dollars)

	Actual 2007	Estimates					
		2008	2009	2010	2011	2012	2013
Receipts							
Judicial Branch: Filing fees, U. S. courts	189	189	193	209	214	219	224
Department of Agriculture: Agricultural quarantine inspection fees	472	537	560	577	594	612	630
Department of the Interior: Abandoned mine reclamation fund	305	295	299	305	315	317	287
Department of State: Immigration, passport, and consular fees	1,067	821	915	1,036	1,033	1,029	1,029
Department of the Treasury: Premiums, terrorism risk insurance program	....	....	116	327	554	1,336	773
Corps of Engineers: Harbor maintenance fees	1,262	1,353	1,446	1,556	1,685	1,825	1,969
Other	562	330	446	402	408	443	415
Subtotal, receipts	3,857	3,525	3,975	4,412	4,803	5,781	5,327
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other charges	299	292	307	285	289	288	290
Department of Commerce: Patent and trademark, fees for weather services, and other charges	1,929	2,050	2,209	2,334	2,509	2,770	3,029
Department of Defense: Commissary and other charges	10,290	10,301	10,296	10,285	10,285	10,285	10,285
Department of Energy: Federal Energy Regulation Commission, power marketing, and other charges	998	1,601	1,548	1,486	1,499	1,492	1,484
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other charges	1,329	1,501	1,398	1,247	1,256	1,250	1,246
Department of Homeland Security: Border and Transportation Security and other charges	2,474	2,258	2,486	2,551	2,636	2,724	2,815
Department of the Interior: Minerals Management Service and other charges	660	723	858	815	841	835	817
Department of Justice: Charges for bankruptcy oversight and other charges	293	370	293	281	284	282	281
Department of State: Passport and other charges	1,189	2,138	2,216	2,283	2,353	2,424	2,498
Department of Transportation: Pipeline safety, aviation, and other charges	158	161	221	8,763	9,064	9,606	10,167
Department of the Treasury: Sale of commemorative coins and other charges	2,430	2,762	2,741	2,631	2,654	2,641	2,627
Department of Veterans Affairs: Medical care and other charges	2,334	2,448	2,579	2,738	2,851	2,959	3,136
General Services Administration: Federal buildings fund and other charges	155	82	42	40	41	40	40
Social Security Administration: State supplemental fees, supplemental security income	119	135	145	159	184	166	193
Federal Communications Commission: Regulatory fees	381	397	423	407	409	408	405
Federal Trade Commission: Regulatory fees	167	165	191	183	185	184	183
Nuclear Regulatory Commission: Regulatory fees	669	779	855	825	832	830	828
Securities and Exchange Commission: Regulatory fees	1,539	1,147	1,332	1,280	1,291	1,286	1,280
All other agencies, discretionary user charges	783	330	170	162	163	162	159
Subtotal, discretionary user charges	28,196	29,640	30,310	38,755	39,626	40,632	41,763
Mandatory							
Department of Agriculture: Crop insurance and other charges	2,053	1,983	3,054	3,057	2,956	2,874	2,875
Department of Defense: Commissary surcharge and other charges	992	816	779	599	601	558	558
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal, and other charges	4,540	4,559	4,689	4,500	4,636	4,609	4,499
Department of Health and Human Services: Medicare Part B and Part D insurance premiums and other charges	55,017	59,325	62,187	64,196	67,302	71,418	77,408
Department of Homeland Security: Customs, immigration, and other charges	7,715	8,671	9,230	9,060	9,390	9,677	9,547
Department of the Interior: Recreation and other charges	4,892	5,666	6,552	7,799	6,481	5,894	6,604
Department of Justice: Federal Prison Commissary fees and other charges	508	528	570	584	597	611	625
Department of Labor: Insurance premiums to guaranty private pensions and other charges	3,629	3,830	5,296	7,697	8,436	8,970	9,313
Department of the Treasury: Bank regulation, and other charges	1,077	1,137	1,197	1,242	1,284	1,329	1,376
Department of Veterans Affairs: Veterans life insurance and other charges	2,374	2,342	2,220	2,222	2,194	2,224	2,220
Office of Personnel Management: Federal employee health and life insurance fees	11,652	12,309	13,023	13,912	14,943	15,880	16,994
Federal Deposit Insurance Corporation: Deposit insurance and other charges	592	5,546	9,947	13,141	14,462	14,426	13,865
National Credit Union Administration: Credit union share insurance and other charges	440	390	434	446	453	481	500
Postal Service: Fees for postal services	73,891	76,961	78,322	80,395	82,784	84,822	86,254
Tennessee Valley Authority: Proceeds from the sale of energy	9,451	10,106	10,523	10,573	10,124	10,509	10,619
Undistributed Offsetting Receipts:							
Department of Commerce: Digital television transition and public safety fund	....	11,800	2,058	....	....	....	....
Department of the Interior: Arctic National Wildlife Refuge, lease bonuses	....	....	....	7,004	4	1,006	6
Executive Office of the President: Spectrum relocation receipts	6,850	....	....	....	....	....	....
Federal Communications Commission: Spectrum auction receipts	6,850	300	200	200	175	220	215
Outer Continental Shelf receipts and other collections	6,763	11,200	10,369	10,675	11,131	11,166	12,014
All other agencies, mandatory user charges	1,990	845	1,118	1,143	1,186	1,195	1,249
Subtotal, mandatory user charges	201,276	218,314	221,768	238,445	239,139	247,869	256,741
Subtotal, user charges that are offsetting collections and receipts from the public	229,472	247,954	252,078	277,200	278,765	288,501	298,504
TOTAL, User charges	**233,329**	**251,479**	**256,053**	**281,612**	**283,568**	**294,282**	**303,831**

and for Medicare premiums are the largest and are estimated to be more than half of total user charge collections in 2009.

III. USER CHARGE PROPOSALS

As shown in Table 18–3, the Administration is proposing new or increased user charges, including proposed extensions of expiring charges, that would increase collections by an estimated $4.5 billion in 2009, increasing to $19.7 billion in 2013. These amounts are collections and receipts only. They do not include related spending.

A. Discretionary User Charge Proposals

1. Offsetting collections

Department of Agriculture: Forest Service

Fees for ecosystem services. The Budget reflects the President's commitment to cooperative conservation and includes Ecosystems Services Demonstration Projects that bring new partners together with the Forest Service in a broad effort to advance market-based conservation. The Budget provides the Secretary of Agriculture with the authority to retain the proceeds of payments made by willing entities such as municipalities for services derived from a particular set of management activities that restore, enhance, and protect ecosystem function on National Forest System lands. Examples of the outcomes of these management activities include protecting water quality, restoring long leaf pine forests, or reducing the risk of catastrophic wildfires.

Department of Defense (DOD)

Medical care enrollment fees and deductible. The Budget gives DOD the authority to increase enrollment fees and deductibles for military retirees under age 65 (and families). The new cost shares differ for officer and enlisted retirees and for those in the different types of plans. The Budget also assumes that retail pharmacy co-payments for all military retirees will increase. None of these changes apply to active-duty members and their dependents. DOD will take into account the recommendations of the DOD Task Force on the Future of Military Health Care before final implementation. The total 2009 savings for these proposals is estimated to be $1,184 million.

Department of Health and Human Services: Food and Drug Administration (FDA)

Drug review user fees for generic animal drugs. The purpose of the user fee is to improve review times of generic animal drug applications. The Budget proposes a new user fee to generate additional resources to support FDA generic animal drug review activities. The proposed generic drug user fee would be targeted to improve review times and reduce the current backlog of generic animal drug applications.

Generic drug review activities fees. Generic drugs play an important role in reducing the cost of pharmaceuticals. The Budget proposes a new user fee to generate additional resources to support FDA's generic drug review activities. Similar to the purpose of FDA's current prescription drug user fees, the proposed generic drug user fee would be targeted towards improving review times and reducing the current backlog of applications.

Follow-on biologics user fees. The Budget proposes to establish a new regulatory pathway for FDA to approve follow-on biologics (FOB). FOBs are generic versions of therapies that contain proteins derived from living cells. The Administration proposal would protect patient safety, promote innovation, and include a financing structure to cover the costs of this activity through user fees. The 2009 Budget does not include user fee estimates.

Animal drug user fee reauthorization. The Animal Drug User Fee Act will expire on October 1, 2008. This law authorizes FDA to assess and collect fees associated with the pre-market review of animal drugs. The Administration supports reauthorizing the collection and spending of these fees.

Centers for Medicare and Medicaid Services

Survey and certification user fees. The Budget proposes a user fee for the survey and certification program within the Centers for Medicare and Medicaid Services. The agency would charge facilities participating in Medicare and Medicaid a fee for conducting follow-up surveys, which verify that they have taken appropriate action to correct identified deficiencies in compliance with specific Federal health, safety, and quality standards.

Department of the Interior

Bureau of Land Management: Repeal Energy Act fee prohibition. A last-minute addition to the 2005 Energy Policy Act prohibited the Bureau of Land Management from implementing new user fees for oil and gas permit processing and instead diverted existing rental receipts to make up for the lost program funding. The Budget proposes to repeal these changes and substitute user fees for the mandatory funding provided by the Act. The proposed fees are expected to generate at least $34 million per year beginning in 2009, thereby reducing the cost to taxpayers for operating a program that benefits specific users. Notwithstanding the fee prohibition, a comparable oil and gas permitting fee was enacted as part of the 2008 Consolidated Appropriations Act, but this fee is only in place for fiscal year 2008. The Administration is proposing a more permanent solution through a repeal of the Energy Policy Act fee prohibition.

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]

(Estimated collections in millions of dollars)

	2008	2009	2010	2011	2012	2013	2009–2013
OFFSETTING COLLECTIONS AND RECEIPTS							
DISCRETIONARY:							
1. Offsetting collections							
Department of Agriculture							
Forest Service: Fees for ecosystem services	....	10	....	....	....	....	10
Department of Defense							
Medical care enrollment fees and deductible	....	1,184	2,598	3,703	4,043	4,397	15,925
Department of Health and Human Services							
Food and Drug Administration:							
Drug review user fees for generic animal drugs	....	5	5	5	5	5	25
Generic drug review activities fees	....	17	17	17	17	17	84
Follow-on biologics user fees	....	....	....	....	....	....	....
Animal drug user fee reauthorization	....	14	14	14	14	15	70
Centers for Medicare and Medicaid Services: Survey and certification user fees	....	35	34	34	34	34	171
Department of the Interior							
Bureau of Land Management: Repeal Energy Act fee prohibition	....	34	34	34	34	34	170
Department of Transportation							
Federal Aviation Administration: User fee proposal	....	....	8,550	8,849	9,392	9,953	36,744
2. Offsetting receipts							
Department of Housing and Urban Development							
Office of Federal Housing Enterprise Oversight	....	–67	–64	–65	–65	–70	–331
Subtotal, discretionary user charge proposals	....	1,232	11,187	12,590	13,473	14,384	52,867
MANDATORY:							
1. Offsetting collections							
Department of Labor							
Pension Benefit Guaranty Corporation premiums	....	380	2,217	2,093	2,127	2,056	8,873
Federal Housing Enterprise Regulator							
Government-Sponsored Enterprises regulatory fee	....	107	110	113	116	119	565
Federal Housing Finance Board							
Federal Home Loan Bank fees	....	–38	–40	–41	–43	–43	–205
2. Offsetting receipts							
Department of Agriculture							
Food Safety and Inspection Service user fees [2]	....	96	98	100	102	104	500
Grain, Inspection, Packers, and Stockyards Administration user fees [2]	....	27	30	30	31	32	150
Animal and Plant Health Inspection Service user fees [2]	....	20	27	27	28	29	131
Agricultural Marketing Service inspection and grading services	....	10	10	10	10	10	50
Federal crop insurance fees [2]	....	....	15	15	15	15	60
Department of Health and Human Services							
Food and Drug Administration: Re-inspection fees and export certification fees [2]	....	27	28	28	29	30	142
Centers for Medicare and Medicaid: Additional Medicare premiums	....	410	730	1,000	1,320	1,720	5,180
Department of Homeland Security							
Passenger security fee surcharge to fund baggage screening systems	....	426	426	426	426	....	1,704
Department of Housing and Urban Development							
Government-Sponsored Enterprises oversight fees	....	6	6	6	6	6	30
Department of the Interior							
Arctic National Wildlife Refuge lease bonuses:							
Collections for payment to Alaska	....	....	3,502	2	503	3	4,010
Collections deposited in the Treasury	....	....	3,502	2	503	3	4,010
Require upfront payment of coal bonus bid receipts:							
Collections for payment to States	....	385	676	–48	–506	–225	282
Collections deposited in the Treasury	....	385	676	–48	–506	–225	282
Amend Bureau of Land Management's Federal land sale authority	....	5	10	50	50	55	170
Department of Labor							
Foreign labor certification fees	....	95	95	95	95	95	475
Department of Veterans Affairs							
Pharmacy co-pay increase [2]	....	335	292	287	334	355	1,603
Income-based medical care enrollment fees [2]	....	....	129	127	130	128	514
Third-party insurance co-payment offset [2]	....	44	44	44	43	43	218
Corps of Engineers—Civil Works							
Additional recreation fees	....	9	17	17	17	17	77
Environmental Protection Agency							
Pesticide user fees [2]	....	48	48	47	47	59	249
Pre-manufacture notice user fees [2]	....	4	8	8	8	8	36

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]—Continued

(Estimated collections in millions of dollars)

	2008	2009	2010	2011	2012	2013	2009–2013
Commodity Futures Trading Commission							
Transaction fees [2]	....	96	100	103	107	111	517
Federal Communications Commission							
Spectrum license fee authority	50	150	300	300	400	450	1,600
Prospective ancillary terrestrial component spectrum license fees	30	60	100	125	125	125	535
Extend spectrum auction authority	....	....	....	....	200	200	400
Domestic satellite spectrum auctions	250	100	100	75	20	15	310
Subtotal, mandatory user charge proposals	330	3,187	13,256	4,993	5,737	5,295	32,468
Subtotal, user charge proposals that are offsetting collections and receipts	330	4,419	24,443	17,583	19,210	19,679	85,335
GOVERNMENTAL RECEIPTS							
Department of the Interior							
Migratory bird hunting and conservation stamps	....	14	14	14	14	14	70
Department of Transportation							
Federal Aviation Administration overflight fees	....	....	–54	–56	–58	–60	–228
Corps of Engineers—Civil Works							
Inland waterways trust fund (net impact)	....	99	103	104	136	103	545
Subtotal, governmental receipts user charge proposals	....	113	63	62	92	57	387
Total, user charge proposals	**330**	**4,532**	**24,506**	**17,645**	**19,302**	**19,736**	**85,722**

[1] A negative sign indicates a decrease in collections.
[2] If enacted, the Administration will work to classify the collections as discretionary offsets beginning in 2010.

Department of Transportation: Federal Aviation Administration (FAA)

User fee proposal. The Budget includes a reauthorization proposal that would make the Federal Aviation Administration's financing system more cost-based. The FAA's current excise tax system, which generated $11.5 billion in 2007, is largely based on taxes on the price of airline tickets. This system does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under the reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control (ATC) services. Implementing user fees for ATC services creates incentives to make the system more efficient and responsive to user needs. FAA would have the authority to collect the user fees that directly offset the cost of its operations; expenditure of the proceeds from these fees would be subject to the appropriations process. The Budget assumes FAA will implement its new financing system starting in 2010, and estimates FAA will collect $8.6 billion in user fees during the first year.

2. Offsetting receipts

Department of Housing and Urban Development

Office of Federal Housing Enterprise Oversight. This proposal is discussed below in the section on the Federal Housing Enterprise Regulator.

B. Mandatory User Charge Proposals

1. Offsetting collections

Department of Labor

Pension Benefit Guaranty Corporation (PBGC) premiums. While the Deficit Reduction Act of 2005 and the Pension Protection Act of 2006 made significant structural changes to the retirement system, they did not fully address the long-term challenges facing PBGC. Further reforms are needed to address the current $14 billion gap between PBGC's liabilities and its assets. The Budget proposes to give PBGC's Board the authority to raise premiums to produce the revenue necessary to meet expected future claims and retire PBGC's deficit over ten years. Under this proposal, PBGC's Board would have the flexibility to make a broad range of changes to premiums in order to improve PBGC's financial condition and safeguard the future benefits of American workers. The Administration is committed to restoring the solvency of the pension insurance system and avoiding a future taxpayer bailout.

Federal Housing Enterprise Regulator

Government-Sponsored Enterprises (GSE) regulatory fee. The Administration will again propose broad reform of the supervisory system for GSEs in the housing market. Fees currently collected by the Office of Federal Housing Enterprise Oversight in the Department of Housing and Development and the Federal Housing Finance Board would instead be collected by a new housing GSE safety and soundness regulator. For additional information, see the "Credit and Insurance" chapter in this volume.

Federal Housing Finance Board

Federal Home Loan Bank fees. This proposal is discussed above in the section on the Federal Housing Enterprise Regulator.

2. Offsetting receipts

Department of Agriculture

Food Safety and Inspection Service (FSIS) user fees. This Budget proposes two new user fees, a licensing fee and a performance fee. These two fees do not try to completely offset a specific portion of the Food Safety and Inspection Services operational expenses. The recommended fees, estimated to be $96 million in the first year, include:

- $92 million for a licensing fee scaled to the size of the operation, and
- $4 million for a performance fee. Plants that have resampling and retesting due to positive samples, recalls, or are linked to outbreaks would pay a fee to FSIS for each incident.

Grain Inspection, Packers, and Stockyards Administration (GIPSA) user fees. The Administration proposes to establish a fee to cover the cost associated with GIPSA's standardization activities and a licensing fee to cover the cost associated with administering meat packers and stockyards activities.

Animal and Plant Health Inspection Service user fees. The Administration proposes to establish user fees for animal welfare inspections for animal research facilities, carriers, and in-transit handlers of animals, and for individuals or companies who need a license to market a veterinary biologic and for permits for biotechnologically derived products.

Agricultural Marketing Service (AMS) inspection and grading services. Country of Origin Labeling (COOL) becomes mandatory for all covered commodities on September 30, 2008. Currently, AMS operates a small COOL enforcement program for fish and shellfish compliance (the only commodities where labeling is now required). As part of the 2009 Budget, the agency will propose to charge a mandatory fee for the full implementation of a complete COOL enforcement program for the following commodities, in addition to the current fish and shellfish items: muscle cuts of beef (including veal), lamb, and pork; ground beef, ground lamb and ground pork; perishable agricultural commodities; and peanuts. Additional commodities may also be considered. The additional funds will be deposited into the agency's existing trust account.

Federal crop insurance fees. The Administration proposes to implement a participation fee in the Federal crop insurance program to fund modernization and future maintenance of the existing information technology (IT) system. The fee would be charged to insurance companies participating in the Federal crop insurance program based on a rate of about one-half cent per dollar of premium sold. Because it is the companies that will most benefit from better, more advanced computer systems, it is reasonable that they contribute to the modernization and maintenance of these systems.

Department of Health and Human Services: Food and Drug Administration (FDA)

Re-inspection fees. FDA conducts post-market inspections of food, human drug, biologic, animal drug and feed, and medical device manufacturers to assess their compliance with Good Manufacturing Practice requirements. The Administration proposes new fees that would be assessed for repeat inspections due to violations found during the first inspection.

Food and animal feed export certification fees. FDA collects user fees for the issuance of export certifications for human and animal drugs, and medical devices as authorized by the Federal Food, Drug, and Cosmetic Act. The Administration proposes to expand FDA's authority to collect user fees for the issuance of export certificates for foods and animal feed. Timely issuance of food/feed export certificates funded through user fees would improve the ability of food and animal feed producers to export their products.

Centers for Medicare and Medicaid Services

Additional Medicare premiums. Medicare beneficiaries share in the costs of their health services through premiums, deductibles, and co-insurance. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) began to limit the growth in subsidies for certain higher-income beneficiaries. Beneficiaries who are most able to contribute to the costs of their coverage have more responsibility and ownership over their health care utilization and costs. In order to increase beneficiary knowledge about health care choices and costs, the Budget proposes to encourage greater individual responsibility for health care use and costs for high-income beneficiaries who are most able to contribute to the costs of their coverage.

Department of Homeland Security

Passenger security fee surcharge to fund baggage screening systems. The President's Budget proposes a temporary, four-year surcharge on the passenger security fee of $0.50 per enplanement with a maximum increase of $1.00 per one-way trip. The additional fee collections of an estimated $426 million per year would be deposited in the Aviation Security Capital Fund to recapitalize checked baggage screening devices deployed immediately after September 11, 2001, and accelerate deployment of inline systems that will increase baggage throughput up to 300 percent.

Department of Housing and Urban Development (HUD)

Government-Sponsored Enterprises (GSE) oversight fees. Upon enactment of the Administration's proposal for a strengthened regulator for GSEs, the cost of HUD's responsibilities under the Federal Housing Enterprise Safety and Soundness Act of 1992, and amendments as proposed, would be assessed on Fannie Mae and Freddie Mac. These responsibilities include the establishment and enforcement of affordable housing goals for the GSEs, ensuring GSE compliance with fair housing laws, and providing consultation to the safety and soundness regulator on the GSEs' new activities. The cost of these regulatory responsibilities is currently in the HUD salaries and expenses account as a non-reimbursable expense.

Department of the Interior

Arctic National Wildlife Refuge lease bonuses. The Budget includes a proposal to authorize the Department of the Interior to conduct environmentally responsible oil and gas exploration and development within a small area of the Arctic National Wildlife Refuge, sometimes referred to as the "1002 Area," located in northern Alaska. The Department of the Interior estimates that recoverable oil from this area is between 5.7 billion and 16 billion barrels. The Budget assumes that the first oil and gas lease sale would be held in 2010 and would result in an estimated $7 billion in new revenues. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $6 million in annual rental payments. The Federal share of revenues would be deposited in the Treasury.

Require upfront payment of coal bonus bid receipts. The Budget proposes to amend the Mineral Leasing Act to change the current practice of allowing bonus bid payments for coal lease sales to be made over a five-year period. Instead, it would require the full payment to be made in the sale year, increasing near-term revenues, but reducing revenues in later years when deferred payments under the current system would otherwise be collected. Fifty percent of coal bonus bid revenues are currently provided to the States, so the proposal would have an identical impact on state revenues.

Amend Bureau of Land Management's (BLM) Federal land sale authority. The Administration will propose legislation to amend BLM's land sale authority under the Federal Land Transaction Facilitation Act (FLTFA) to: (1) allow BLM to use updated management plans to identify areas suitable for disposal; (2) allow a portion of the receipts to be used by BLM for restoration projects; (3) return 70 percent of the net proceeds from these sales to the Treasury; and (4) cap Department of the Interior receipt retention at $60 million per year. BLM is currently limited to selling lands that had been identified for disposal in land use plans that were in effect prior to enactment of FLTFA. Use of the receipts is currently limited to the purchase of other lands for conservation purposes. The new receipts shown in this chapter reflect only a portion of the savings from this proposal; additional savings will be generated by redirecting receipts under the existing FLFTA authority to the Treasury. The amounts shown in Table 18–3 reflect receipts only and do not include related spending.

Department of Labor

Foreign labor certification fees. The 2009 Budget proposes legislation to establish cost-based user fees for new applications under the permanent and H-2B temporary foreign labor certification programs, and proposes legislation to allow the Department to retain fees for applications under the H-2A temporary labor certification program and modify the fee to cover program costs. The fees would offset the State and Federal costs of administering these programs, and once fully implemented would eliminate the need for appropriations for this purpose. Upon enactment of the fee, requests for funding in the Foreign Labor Certification administration account would be adjusted accordingly.

Department of Veterans Affairs

Medical care fees. The President's Budget includes legislation to implement new or higher fees for non-disabled higher-income veterans (PL 7/8 veterans). These veterans will pay higher drug co-pays (from $8 to $15) and new income-based annual enrollment fees that start at $250 for those with household incomes of $50,000 and rise to $750 for those with incomes of $100,000 or greater. These proposals do not pertain to veterans who are considered among VA's core mission and the highest priority—those with service disabilities, lower incomes, or special needs. The Budget also includes technical correction language to ensure that current co-pays are charged to all eligible veterans equally and not reduced if a veteran has health insurance. These proposals will result in an additional $379 million in estimated receipts for 2009.

Corps of Engineers—Civil Works

Additional recreation fees. The Corps of Engineers manages 4,300 recreation areas at 465 Corps projects (mostly lakes and reservoirs) on 12 million acres in 43 States at an annual cost of about $300 million. The Administration re-proposes a recreation modernization ("RecMod") initiative that would encourage the collection of entrance fees (not currently authorized) and the creation of public/private partnerships to improve Corps recreation facilities and services at little or no cost to the Federal Government. The Corps would implement user fees and private/public partnerships selectively, at recreation areas where fees would be appropriate. Some Corps recreation areas are isolated and remote; raising fees there might not be productive. But others are integral parts of prosperous urban communities with valuable lake-front property. Those communities may decide to help upgrade the Corps recreation areas that their citizens enjoy to provide amenities that might not otherwise be available.

Environmental Protection Agency (EPA)

Pesticide user fees. EPA presently collects fees from entities seeking to register their pesticides and from entities with existing pesticides registered for use in the United States. The Administration proposes to better cover the costs of EPA's pesticide services by increasing collections of currently authorized, but soon to expire, pesticide user fees. Furthermore, the Federal Food, Drug, and Cosmetic Act requires EPA to collect fees for the establishment and reassessment of pesticide tolerances. However, collection of these fees has been blocked through 2012. The Administration proposes to eliminate the prohibition and collect the tolerance fee in 2009. In addition, amendments to the Federal Insecticide, Fungicide, and Rodenticide Act require EPA to implement a new program to review all registered pesticides on a 15 year cycle to ensure that registrations reflect current science. EPA initiated this new Registration Review program in 2007. If EPA determines that a pesticide adversely impacts an endangered species during registration review, additional work is required to ensure adequate protections are implemented. The proposed increase in maintenance fees is designed to cover the incremental cost of this work.

Pre-manufacture notice user fees. EPA presently collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are subject to an outdated statutory cap. The Administration proposes to eliminate the cap so that EPA can recover a greater portion of the cost of the program.

Commodity Futures Trading Commission (CFTC)

Transaction fees. The CFTC is the only Federal financial regulator that does not derive its funding from the specialized entities it regulates. The Administration will propose legislation to collect a fee on the settlement of contracts on commodity futures, options on futures, and other transactions cleared by derivatives clearing organizations. The fees would be set at a level to equal the costs to the taxpayer of funding CFTC's Market Oversight and Clearing and Intermediary Oversight functions, an estimated $96 million in 2009. Similar fees are already imposed on futures exchanges to fund the programs of the futures industry's self-regulatory organization, and will help to offset the deficit impact of general taxpayer funding of the CFTC's activities.

Federal Communications Commission

Spectrum license fee authority. To continue to promote efficient spectrum use, the Administration proposes legislation to provide the Federal Communications Commission with new authority to use other economic mechanisms, such as fees, as a spectrum management tool. The Commission would be authorized to set user fees on unauctioned spectrum licenses based on spectrum-management principles. Fees would be phased in over time as part of an ongoing rulemaking process to determine the appropriate application and level for fees. Fee collections are estimated to begin in 2008, and total $4.1 billion through 2018.

Prospective ancillary terrestrial component spectrum license fees. The Administration proposes legislation to improve the management of hybrid terrestrial - satellite mobile communications spectrum licenses by setting a fee on the terrestrial authority of these integrated networks. Under current policy, these licenses are granted free of charge, though providers will compete with terrestrial wireless carriers that have purchased licenses at auction. Setting a fee on the Ancillary Terrestrial Component of Mobile Satellite Service licenses will help to ensure that the radio spectrum is put to its most highly valued use by promoting consideration of the economic value of the spectrum, provide incentive for timely and robust network development, and improve equity relative to service providers that purchase their spectrum licenses in auctions. Receipts associated with this policy are estimated to begin in 2008, and total $1.2 billion through 2018.

Extend spectrum auction authority. The Administration proposes legislation to extend indefinitely the authority of the FCC to auction spectrum licenses, which expires on September 30, 2011. The additional receipts associated with this permanent extension are estimated to total $1.4 billion through 2018.

Domestic satellite spectrum auctions. The Administration proposes legislation to ensure that spectrum licenses for predominantly domestic satellite services are assigned efficiently and effectively through competitive bidding. Services such as Direct Broadcast Satellite and Satellite Digital Audio Radio Services were assigned by auction prior to a 2005 court decision that questioned this practice on technical grounds. By clarifying through legislation that auctions of licenses for these domestic satellite services are authorized, prior policy of the Federal Communications Commission will be restored. Auction receipts associated with this clarification are estimated to begin in 2008, and total $593 million through 2018.

C. User Charge Proposals that are Governmental Receipts

Department of the Interior

Migratory bird hunting and conservation stamps. Federal migratory bird hunting and conservation stamps, commonly know as "Duck Stamps," were originally created in 1934 as the Federal licenses required for hunting migratory waterfowl. Today, ninety-eight percent of the receipts generated from the sale of these stamps ($15 per stamp per year) are used to acquire important migratory bird breeding areas, migration resting places, and wintering areas. The land and water interests located and acquired with the Duck Stamp funds establish or add to existing migratory bird refuges and waterfowl production areas. The price of the Duck Stamp has not increased since 1991; however, the cost of land and water has increased significantly over the past 16 years. The Administration proposes to increase these fees to $25 per stamp per year, effective beginning in 2009.

Department of Transportation: Federal Aviation Administration

Overflight fees. This proposed change is part of the Department of Transportation proposal discussed above for Federal Aviation Administration user fees.

Corps of Engineers—Civil Works

Inland waterways trust fund (net impact). Commercial barges that use the inland waterways now pay an excise tax of 20 cents per gallon on diesel fuel, which is deposited in the Inland Waterways Trust Fund. The tax does not raise enough revenue to cover the required 50 percent non-Federal share of the costs that the Army Corps of Engineers is spending to construct, replace, expand, and rehabilitate the locks and dams and other features that make barge transportation possible on the inland waterways. To address this imbalance between receipts and expenditures, the Administration proposes to phase out the current excise tax for inland waterways users and replace it with a more efficient user fee tied to the level of spending for inland waterways construction, replacement, expansion, and rehabilitation work.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 18–4 shows the distribution of user charges and other offsetting collections and receipts from the public according to whether they are offsetting collections credited to expenditure accounts or offsetting receipts. The table shows that total offsetting collections and receipts from the public are estimated to be $330.2 billion in 2009. Of these, an estimated $183.3 billion are offsetting collections credited to expenditure accounts and an estimated $146.9 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 18–4 is available in Tables 18–2 and 18–3 and the discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges include collections by the Commodity Credit Corporation fund in the Department of Agriculture, which are related to loans; collections from States to supplement payments in the supplemental security income program; and pre-credit reform loan repayments. Major offsetting receipts that are not user charges include military assistance program sales and interest income.

Table 18–5 includes all offsetting receipts deposited in receipt accounts. These include offsetting receipts from the public (as summarized in Table 18–4) and also payments from one part of the Government to another, called intragovernmental transactions. These receipts are offset (deducted) from outlays in the Federal budget. In total, offsetting receipts are estimated to be $782.1 billion in 2009: $635.2 billion are intragovernmental transactions; and $146.9 billion are from the public. The $146.9 billion in offsetting receipts from the public consist of proprietary receipts from the public ($136.6 billion) and offsetting governmental receipts ($10.4 billion).

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, which appears in Chapter 21, “Outlays to the Public, Gross and Net,” of this volume.

Table 18–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(In billions of dollars)

	Actual 2007	Estimate	
		2008	2009
Offsetting collections (credited to expenditure accounts):			
User charges:			
Postal service stamps and other postal fees (off-budget)	73.9	77.0	78.3
Defense Commissary Agency	5.5	5.5	5.6
Employee contributions for employees and retired employees health benefits funds	9.4	9.9	10.6
Sale of energy:			
Tennessee Valley Authority	9.5	10.1	10.5
Bonneville Power Administration	3.3	3.2	3.5
All other user charges	36.4	41.5	48.8
Subtotal, user charges	138.0	147.2	157.2
Other collections credited to expenditure accounts:			
Commodity Credit Corporation fund	11.5	11.8	10.9
Supplemental security income (collections from the States)	4.3	4.5	4.7
Other collections	12.4	10.4	10.5
Subtotal, other collections	28.3	26.6	26.1
Subtotal, offsetting collections	166.3	173.9	183.3
Offsetting receipts (deposited in receipt accounts):			
User charges:			
Medicare premiums	50.3	54.4	57.1
Outer Continental Shelf rents, bonuses, and royalties	6.8	11.1	10.2
All other user charges	34.4	35.2	27.6
Subtotal, user charges deposited in receipt accounts	91.5	100.7	94.9
Other collections deposited in receipt accounts:			
Military assistance program sales	15.8	15.5	15.0
Interest income	16.0	16.9	15.8
All other collections deposited in receipt accounts	31.1	31.4	21.2
Subtotal, other collections deposited in receipt accounts	62.9	63.8	52.0
Subtotal, offsetting receipts	154.4	164.5	146.9
Total, offsetting collections and receipts from the public	**320.7**	**338.4**	**330.2**
Total, offsetting collections and receipts excluding off-budget	**246.7**	**261.3**	**251.8**
ADDENDUM:			
User charges that are offsetting collections and receipts [1]	229.5	248.0	252.1
Other offsetting collections and receipts from the public	91.2	90.4	78.1
Total, offsetting collections and receipts from the public	**320.7**	**338.4**	**330.2**

[1] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 18.1 or Table 18.2.

Table 18–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2007 Actual	Estimate 2008	2009	2010	2011	2012	2013
INTRAGOVERNMENTAL TRANSACTIONS:							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	737	699	858	1,110	1,299	1,544	1,721
Proposed Legislation (Non-PAYGO)	....	....	–15	–62	–143	–251	–385
Interest on Government capital in enterprises	1,957	1,455	1,529	752	775	803	835
Interest received by retirement and health benefits funds	191	165	175	186	201	220	240
General fund payments to retirement and health benefits funds:							
Employees health benefits fund	5,400	5,600	5,400	5,500	5,500	5,600	5,600
DOD retiree health care fund	19,653	17,734	19,175	20,767	22,542	24,471	26,536
Miscellaneous Federal retirement funds	345	357	423	520	483	485	468
Other	6,931	4,378	4,860	5,380	5,869	6,032	6,721
Undistributed by agency:							
Employing agency contributions							
DOD retiree health care fund	11,548	11,496	10,676	12,919	13,810	14,720	15,636
Subtotal, Federal intrafund transactions	46,762	41,884	43,081	47,072	50,336	53,624	57,372
Trust intrafund transactions:							
Distributed by agency:							
Payment to railroad retirement (from off-budget)	5,411	5,388	5,590	5,928	6,300	6,201	6,593
Other	1	1	6	6	6	6	6
Subtotal, Trust intrafund transactions	5,412	5,389	5,596	5,934	6,306	6,207	6,599
Subtotal, intrafund transactions	52,174	47,273	48,677	53,006	56,642	59,831	63,971
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	26,048	46,187	47,919	49,717	51,581	53,515	55,523
Supplementary medical insurance	179,183	181,032	193,263	202,304	219,366	227,564	254,325
Proposed Legislation (Non-PAYGO)	....	....	–1,804	–3,625	–5,331	–6,955	–8,615
Hospital insurance	11,355	13,273	16,244	16,933	18,225	19,677	21,937
Railroad social security equivalent benefit fund	131	140	164	174	186	203	223
Rail industry pension fund	329	306	339	352	365	379	392
Civilian supplementary retirement contributions	31,303	30,531	31,310	32,110	32,699	33,499	34,501
Unemployment insurance	756	750	786	802	933	884	848
Other contributions	850	937	895	899	863	842	829
Other payments:							
Miscellaneous payments	1,506	1,433	1,537	1,468	1,470	1,461	1,453
Proposed Legislation (Non-PAYGO)	....	....	2,710	....	....	....	....
Trust fund payments to Federal funds							
Other	18,825	1,858	1,900	1,958	2,007	2,067	2,117
Proposed Legislation (Non-PAYGO)	....	....	2,288	–411	–398	–392	–388
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disablity insurance	14,480	14,664	15,955	17,392	19,017	20,694	22,957
Proposed Legislation (Non-PAYGO)	....	....	2	8	15	23	31
CSRDI from Postal Service	2,883	3,600	3,865	4,144	4,434	4,736	5,048
Hospital insurance (contribution as employer)	2,826	2,931	3,007	3,105	3,254	3,340	3,505
Postal Service contributions to FHI	712	767	799	835	874	916	959
Military retirement fund	16,817	17,702	19,523	19,841	20,583	21,388	22,092
Other federal employees retirements	210	195	197	200	202	204	207
Interest received by on-budget trust funds	71,964	83,527	86,957	88,706	92,369	95,699	99,835
Proposed Legislation (Non-PAYGO)	....	....	122	610	1,716	3,423	5,524
Subtotal, Interfund transactions	380,178	399,833	427,978	437,522	464,430	483,167	523,303
Subtotal, On-budget receipts	432,352	447,106	476,655	490,528	521,072	542,998	587,274

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2007 Actual	Estimate					
		2008	2009	2010	2011	2012	2013
Off-budget receipts:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors and disablitity, insurance	19,325	18,725	22,887	25,326	27,484	30,251	33,622
Undistributed by agency:							
Employer share, employee retirement (off-budget)	12,299	13,087	13,784	14,551	15,543	16,281	17,317
Interest received by off-budget trust funds	106,003	114,311	121,864	131,441	142,233	154,719	167,659
Proposed Legislation (Non-PAYGO)	....	....	....	....	....	....	–397
Proposed Legislation (PAYGO)	....	....	–14	–52	–62	–68	–67
Subtotal, Off-budget receipts	137,627	146,123	158,521	171,266	185,198	201,183	218,134
Subtotal, Intragovernmental Transactions	569,979	593,229	635,176	661,794	706,270	744,181	805,408
PROPRIETARY RECEIPTS:							
Distributed by agency:							
Interest and dividends:							
Interest on foreign loans and deferred foreign collections	190	107	107	107	107	107	107
Interest on deposits and loan accounts	1,174	1,026	866	901	928	930	930
Proposed Legislation (PAYGO)	....	....	10	10	10	10	10
Other interest	10,394	12,799	13,420	14,226	15,195	16,197	17,225
Dividends and other earnings	4,248	2,953	1,436	1,487	1,524	1,525	1,513
Subtotal, Interest and dividends	16,006	16,885	15,839	16,731	17,764	18,769	19,785
Royalties and rents:							
Royalties and rents	4,129	4,665	4,836	5,333	5,614	5,904	6,011
Proposed Legislation (PAYGO)	....	....	719	1,304	–146	–1,061	–501
Subtotal, Royalties and rents	4,129	4,665	5,555	6,637	5,468	4,843	5,510
Sale of products:							
Sale of timber and other natural land products	162	250	230	237	247	272	298
Sale of minerals and mineral products	56	159	86	89	94	96	100
Sale of power and other utilities	648	697	627	675	630	622	648
Proposed Legislation (PAYGO)	....	....	17	207	17	17	17
Other	98	121	115	102	122	119	105
Proposed Legislation (PAYGO)	....	....	–8	–8	–8	–8	–8
Subtotal, Sale of products	964	1,227	1,067	1,302	1,102	1,118	1,160
Fees and other charges for services and special benefits:							
Medicare premiums and other charges	50,273	54,401	57,098	59,054	62,167	66,199	72,035
Proposed Legislation (PAYGO)	....	....	–13	–115	–272	–339	–286
Nuclear waste displosal revenues	754	766	764	764	767	769	771
Veterans life insurance (trust funds)	139	127	118	108	99	89	77
Other services and special benefits	11,465	11,196	11,634	12,164	12,807	13,476	14,349
Proposed Legislation (Non-PAYGO)	....	....	34	34	34	34	34
Proposed Legislation (PAYGO)	....	....	692	824	826	883	904
Subtotal, Fees and other charges for services and special benefits	62,631	66,490	70,327	72,833	76,428	81,111	87,884
Sale of Government property:							
Military assistance program sales (trust funds)	15,833	15,508	15,011	12,462	12,687	12,915	13,147
Sale of land and other real property	146	298	242	387	193	200	207
Proposed Legislation (PAYGO)	....	....	–15	–13	20	20	21
Other sales of government property	204	220	232	130	131	115	115
Subtotal, Sale of Government property	16,183	16,026	15,470	12,966	13,031	13,250	13,490
Realization upon loans and investments:							
Negative and downward reestimates	12,827	12,882	1,195	891	870	833	903
Proposed Legislation (Non-PAYGO)	....	....	–462	–444	–447	–445	–443
Proposed Legislation (PAYGO)	....	....	1,591	6	1	1	1
Other realization upon loans and investments	72	63	76	76	76	76	76
Subtotal, Realization upon loans and investments	12,899	12,945	2,400	529	500	465	537

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2007 Actual	Estimate 2008	2009	2010	2011	2012	2013
Recoveries and refunds:							
Recoveries and refunds	13,104	13,698	13,854	14,396	14,424	14,920	15,369
Proposed Legislation (Non-PAYGO)	....	....	....	67	140	146	151
Proposed Legislation (PAYGO)	....	....	1	477	517	378	386
Subtotal, Recoveries and refunds	13,104	13,698	13,855	14,940	15,081	15,444	15,906
Miscellaneous receipt accounts:							
Miscellaneous receipt accounts	1,500	1,822	1,864	1,876	1,889	1,901	1,913
Proposed Legislation (PAYGO)	....	....	14	14	14	14	14
Subtotal, Miscellaneous receipt accounts	1,500	1,822	1,878	1,890	1,903	1,915	1,927
Subtotal, Distributed by agency	127,416	133,758	126,391	127,828	131,277	136,915	146,199
Undistributed by agency:							
Outer Continental Shelf escrow account	1	....	....	....	....	....	....
Outer Continental Shelf rents and bonuses	694	4,762	1,437	955	662	616	532
Outer Continental Shelf royalties	6,069	6,358	8,672	9,270	9,994	9,652	10,857
Proposed Legislation (PAYGO)	....	....	50	50	50	50	50
Artic National Wildlife Refuge—Proposed Legislation (PAYGO)	....	....	....	7,004	4	1,006	6
Sale of major assets	....	....	....	....	....	323	....
Other undistributed offsetting receipts	6,850	....	....	....	....	....	....
Subtotal, Undistributed by agency	13,614	11,120	10,159	17,279	10,710	11,647	11,445
Subtotal, Proprietary Receipts	141,030	144,878	136,550	145,107	143,987	148,562	157,644
OFFSETTING GOVERNMENTAL RECEIPTS:							
Distributed by agency:							
Regulatory Fees	6,365	7,301	7,281	7,423	7,630	7,768	7,918
Proposed Legislation (Non-PAYGO)	....	....	–67	–64	–65	–65	–70
Proposed Legislation (PAYGO)	....	....	521	521	521	521	95
Other	164	124	134	144	131	132	134
Proposed Legislation (PAYGO)	....	....	27	28	28	29	30
Subtotal, Distributed by agency	6,529	7,425	7,896	8,052	8,245	8,385	8,107
Undistributed by agency:							
Spectrum auction proceeds	6,850	11,850	2,158	100	100	....	....
Proposed Legislation (PAYGO)	....	330	310	500	500	745	790
Subtotal, Undistributed by agency	6,850	12,180	2,468	600	600	745	790
Subtotal, Offsetting Governmental Receipts	13,379	19,605	10,364	8,652	8,845	9,130	8,897
Total offsetting receipts	**724,388**	**757,712**	**782,090**	**815,553**	**857,102**	**901,873**	**971,949**

19. TAX EXPENDITURES

The Congressional Budget Act of 1974 (Public Law 93–344) requires that a list of "tax expenditures" be included in the budget. Tax expenditures are defined in the law as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability." These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs.

Identification and measurement of tax expenditures depends importantly on the baseline tax system against which the actual tax system is compared. In general, the tax expenditure estimates presented in this chapter are patterned on a comprehensive income tax, which defines income as the sum of consumption and the change in net wealth in a given period of time. An alternative approach would be to pattern the tax expenditure estimates on a comprehensive consumption tax. Which approach is used is perhaps the most important factor determining what is included as a tax expenditure. For example, because a consumption tax does not tax the return to saving or investment, using a comprehensive consumption tax as the normative baseline for determining tax expenditures would exclude current tax exemptions related to retirement and education saving accounts. Similarly, business provisions that provide accelerated depreciation or expensing of investment would also be excluded as tax expenditures because investment is generally deducted immediately under a comprehensive consumption tax.

The choice of the baseline—a comprehensive income or a comprehensive consumption tax—is arbitrary when viewed from the perspective of the current so-called income tax system, which includes elements of both income and consumption taxes. According to Treasury Department analysis, roughly 35 percent of household financial assets receive consumption tax treatment because assets are held in tax-preferred accounts such as individual retirement accounts (IRAs), defined-contribution retirement plans (401(k) type plans), defined-benefit pension plans, and tax-preferred annuities and various life insurance products. The balance of household financial assets reflecting most other saving vehicles receive income tax treatment.

The ambiguities in the tax expenditure concept are reviewed in greater detail in Appendix A. This review focuses on defining tax expenditures relative to a comprehensive income tax baseline and a consumption tax baseline, and defining negative tax expenditures, i.e., provisions of current law that over-tax certain items or activities.

The tax expenditure estimates presented below differ from a comprehensive income tax in a number of other important respects. While under a comprehensive income tax all income is taxed once, the U.S. income tax system generally taxes corporate income twice, first at the corporate level through the corporate income tax and then again when the income is received by investors as dividends or capital gains. This "double tax" is accounted for in some of the tax expenditure estimates, such as those related to retirement savings, but not in the corporate tax expenditures. Indeed, the tax expenditure estimates, in large part, view the individual and corporation income taxes separately, rather than as an integrated system as appropriate under comprehensive income tax principles. Other areas of divergence from a comprehensive income tax are detailed below.

An important assumption underlying each tax expenditure estimate reported below is that other parts of the tax code remain unchanged. The estimates would be different if tax expenditures were changed simultaneously because of potential interactions among provisions. For that reason, this chapter does not present a grand total for the estimated tax expenditures.

Tax expenditures relating to the individual and corporate income taxes are estimated for fiscal years 2007–2013 using two methods of accounting: current revenue effects and present value effects. The present value approach provides estimates of the revenue effects for tax expenditures that generally involve deferrals of tax payments into the future.

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

TAX EXPENDITURES IN THE INCOME TAX

Tax Expenditure Estimates

All tax expenditure estimates presented here are based upon current tax law enacted as of December 31, 2007. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2007. Due to the time required to estimate the large number of tax expenditures, the estimates are based on Mid-Session economic assumptions; exceptions are the earned income tax credit and child credit provisions, which involve outlay components and hence are updated to reflect the economic assumptions used elsewhere in the Budget.

The total revenue effects for tax expenditures for fiscal years 2007–2013 are displayed according to the Budget's functional categories in Table 19–1. Descriptions of the specific tax expenditure provisions follow the tables of estimates and the discussion of general features of the tax expenditure concept.

Two baseline concepts—the normal tax baseline and the reference tax law baseline—are used to identify and estimate tax expenditures. [1] For the most part, the two concepts coincide. However, items treated as tax expenditures under the normal tax baseline, but not the reference tax law baseline, are indicated by the designation "normal tax method" in the tables. The revenue effects for these items are zero using the reference tax rules. The alternative baseline concepts are discussed in detail following the tables.

Table 19–2 reports the respective portions of the total revenue effects that arise under the individual and corporate income taxes separately. The location of the estimates under the individual and corporate headings does not imply that these categories of filers benefit from the special tax provisions in proportion to the respective tax expenditure amounts shown. Rather, these breakdowns show the specific tax accounts through which the various provisions are cleared. The ultimate beneficiaries of corporate tax expenditures could be shareholders, employees, customers, or other providers of capital, depending on economic forces.

Table 19–3 ranks the major tax expenditures by the size of their 2009–2013 revenue effect. The first column provides the number of the provision in order to cross reference this table to Tables 19–1 and 19–2 as well as to the descriptions below. Outlay Equivalent Estimates of Income Tax Expenditures, which were included in the FY2007 and prior volumes of Analytical Perspectives, are no longer included in this chapter. [2]

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 19–1, 19–2, and 19–3 do not necessarily equal the increase in Federal revenues (or the change in the budget balance) that would result from repealing these special provisions, for the following reasons.

First, eliminating a tax expenditure may have incentive effects that alter economic behavior. These incentives can affect the resulting magnitudes of the activity or of other tax provisions or Government programs. For example, if capital gains were taxed at ordinary rates, capital gain realizations would be expected to decline, potentially resulting in a decline in tax receipts. Such behavioral effects are not reflected in the estimates.

Second, tax expenditures are interdependent even without incentive effects. Repeal of a tax expenditure provision can increase or decrease the tax revenues associated with other provisions. For example, even if behavior does not change, repeal of an itemized deduction could increase the revenue costs from other deductions because some taxpayers would be moved into higher tax brackets. Alternatively, repeal of an itemized deduction could lower the revenue cost from other deductions if taxpayers are led to claim the standard deduction instead of itemizing. Similarly, if two provisions were repealed simultaneously, the increase in tax liability could be greater or less than the sum of the two separate tax expenditures, because each is estimated assuming that the other remains in force. In addition, the estimates reported in Table 19–1 are the totals of individual and corporate income tax revenue effects reported in Table 19–2 and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 19–1 should be regarded as approximations.

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(in millions of dollars)

		Total from corporations and individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	3,220	3,350	3,480	3,620	3,780	3,930	4,090	18,900
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,630	2,760	2,900	3,050	3,200	3,360	3,530	16,040
3	Exclusion of certain allowances for Federal employees abroad	840	880	920	970	1,020	1,070	1,120	5,100
4	Inventory property sales source rules exception	1,940	2,180	2,410	2,610	2,820	3,060	3,310	14,210
5	Deferral of income from controlled foreign corporations (normal tax method)	12,490	13,120	13,780	14,480	15,220	15,990	16,810	76,280
6	Deferred taxes for financial firms on certain income earned overseas	2,370	2,490	1,060	....	....	....	....	1,060
	General science, space, and technology:								
7	Expensing of research and experimentation expenditures (normal tax method)	5,190	4,720	4,990	4,470	4,320	4,400	4,420	22,600
8	Credit for increasing research activities	10,320	4,660	2,100	920	360	70	....	3,450
	Energy:								
9	Expensing of exploration and development costs, fuels	530	510	460	390	310	240	150	1,550
10	Excess of percentage over cost depletion, fuels	790	910	950	910	880	850	840	4,430

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

[2] The Administration has dropped the estimates of the outlay equivalents because they were often the same as the normal tax expenditure estimates, and the criteria for applying the concepts as to when they should differ were often judgmental and hard to apply with consistency across time and across tax expenditure items.

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13
11	Alternative fuel production credit	2,920	1,310	70	80	10	10	....	170
12	Exception from passive loss limitation for working interests in oil and gas properties	30	20	20	20	30	30	30	130
13	Capital gains treatment of royalties on coal	180	190	190	200	190	140	150	870
14	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150
15	New technology credit	410	800	1,000	1,030	1,010	1,000	970	5,010
16	Alcohol fuel credits [1]	40	40	50	50	30	....	....	130
17	Bio-Diesel and small agri-biodiesel producer tax credits	180	200	30	20	10	10	10	80
18	Tax credit and deduction for clean-fuel burning vehicles	260	150	130	–20	–50	–60	–50	–50
19	Exclusion of utility conservation subsidies	120	120	120	110	110	110	110	560
20	Credit for holding clean renewable energy bonds	20	40	70	70	70	70	70	350
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	610	250	–60	–290	–490	–590	–570	–2,000
22	Credit for investment in clean coal facilities	30	50	80	130	180	245	290	925
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	30	120	240	260	180	–50	–160	470
24	Natural gas distribution pipelines treated as 15–year property	60	80	90	110	120	110	100	530
25	Amortize all geological and geophysical expenditures over 2 years	50	40	30	10	10	10	10	70
26	Allowance of deduction for certain energy efficient commercial building property	190	170	90	30	....	....	....	120
27	Credit for construction of new energy efficient homes	20	30	20	10	....	....	....	30
28	Credit for energy efficiency improvements to existing homes	380	150	....	....	....	....	....	....
29	Credit for energy efficient appliances	80	....	....	....	....	....	....	....
30	30% credit for residential purchases/installations of solar and fuel cells	10	10	10	....	....	....	....	10
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	80	130	50	–10	–10	–10	–10	10
32	Partial expensing for advanced mine safety equipment	10	20	....	....	....	....	....	....
	Natural resources and environment:								
33	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50
34	Excess of percentage over cost depletion, nonfuel minerals	380	400	410	440	450	460	480	2,240
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	370	390	410	420	430	440	450	2,150
36	Capital gains treatment of certain timber income	180	190	190	200	190	140	150	870
37	Expensing of multiperiod timber growing costs	290	290	310	310	320	340	340	1,620
38	Tax incentives for preservation of historic structures	400	430	440	470	490	520	540	2,460
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	30	50	30	–10	....	....	70
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites	10	30	40	40	40	30	30	180
	Agriculture:								
41	Expensing of certain capital outlays	110	110	110	120	120	120	120	590
42	Expensing of certain multiperiod production costs	80	80	80	80	90	90	90	430
43	Treatment of loans forgiven for solvent farmers	10	10	10	20	20	20	20	90
44	Capital gains treatment of certain income	980	1,030	1,030	1,090	1,060	760	800	4,740
45	Income averaging for farmers	80	80	80	80	80	80	80	400
46	Deferral of gain on sale of farm refiners	20	20	20	20	20	20	20	100
	Commerce and housing:								
	Financial institutions and insurance:								
47	Exemption of credit union income	1,310	1,380	1,450	1,530	1,610	1,690	1,780	8,060
48	Excess bad debt reserves of financial institutions	20	10	10	10	....	....	....	20
49	Exclusion of interest on life insurance savings	19,910	21,840	23,500	25,200	27,600	30,750	33,590	140,640
50	Special alternative tax on small property and casualty insurance companies	40	40	40	40	40	50	50	220
51	Tax exemption of certain insurance companies owned by tax-exempt organizations	180	190	190	200	200	210	210	1,010
52	Small life insurance company deduction	50	50	50	50	50	60	60	270
53	Exclusion of interest spread of financial institutions	520	450	480	500	630	660	690	2,960
	Housing:								
54	Exclusion of interest on owner-occupied mortgage subsidy bonds	900	960	990	1,020	1,060	1,090	1,120	5,280
55	Exclusion of interest on rental housing bonds	830	880	900	930	960	990	1,020	4,800
56	Deductibility of mortgage interest on owner-occupied homes	84,850	94,790	100,810	107,020	115,280	123,130	130,440	576,680
57	Deductibility of State and local property tax on owner-occupied homes	19,120	16,360	16,640	16,820	28,230	34,570	35,400	131,660
58	Deferral of income from installment sales	1,210	1,230	1,250	1,370	1,500	1,650	1,810	7,580
59	Capital gains exclusion on home sales	31,480	33,050	34,710	36,440	38,260	40,180	42,180	191,770
60	Exclusion of net imputed rental income	3,890	5,440	7,550	10,478	14,543	20,183	28,012	80,766
61	Exception from passive loss rules for $25,000 of rental loss	7,840	8,430	8,840	9,160	9,580	10,090	10,240	47,910
62	Credit for low-income housing investments	5,030	5,380	5,780	6,180	6,520	6,840	7,120	32,440
63	Accelerated depreciation on rental housing (normal tax method)	9,860	10,780	11,760	12,720	14,570	16,160	17,550	72,760
64	Discharge of mortgage indebtedness	....	293	239	176	....	....	....	415
	Commerce:								
65	Cancellation of indebtedness	110	90	60	40	30	30	30	190
66	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
67	Capital gains (except agriculture, timber, iron ore, and coal)	53,230	55,540	55,940	59,170	57,490	41,390	43,240	257,230
68	Capital gains exclusion of small corporation stock	270	320	340	370	490	540	590	2,330
69	Step-up basis of capital gains at death	32,600	35,900	36,750	37,950	39,450	41,010	42,632	197,792
70	Carryover basis of capital gains on gifts	650	760	800	1,270	6,340	1,500	1,600	11,510

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13
71	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	60	60	60	60	290
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	–4,610	–4,420	–4,140	–3,850	–3,920	–3,750	–3,110	–18,770
73	Accelerated depreciation of machinery and equipment (normal tax method)	26,410	35,180	44,120	49,760	53,330	58,440	64,390	270,040
74	Expensing of certain small investments (normal tax method)	3,660	3,660	3,400	500	–950	–960	–60	1,930
75	Graduated corporation income tax rate (normal tax method)	5,400	5,220	5,290	5,510	5,660	5,840	6,090	28,390
76	Exclusion of interest on small issue bonds	350	380	390	410	420	420	440	2,080
77	Deduction for US production activities	9,800	14,020	15,330	21,110	26,030	27,710	29,090	119,270
78	Special rules for certain film and TV production	90	70	–40	–90	–60	–50	–40	–280
	Transportation:								
79	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
80	Exclusion of reimbursed employee parking expenses	2,830	2,950	3,070	3,200	3,310	3,430	3,540	16,550
81	Exclusion for employer-provided transit passes	420	440	470	500	520	550	580	2,620
82	Tax credit for certain expenditures for maintaining railroad tracks	130	130	40	20	10	10	....	80
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	40	80	90	100	100	90	60	440
	Community and regional development:								
84	Investment credit for rehabilitation of structures (other than historic)	40	40	40	40	40	40	40	200
85	Exclusion of interest for airport, dock, and similar bonds	850	900	930	960	990	1,020	1,050	4,950
86	Exemption of certain mutuals' and cooperatives' income	70	70	70	70	70	70	80	360
87	Empowerment zones and renewal communities	1,450	1,550	1,760	1,170	480	660	790	4,860
88	New markets tax credit	810	990	970	860	730	590	340	3,490
89	Expensing of environmental remediation costs	300	130	–40	–20	–20	–20	–10	–110
90	Credit to holders of Gulf Tax Credit Bonds	10	10	10	10	10	10	10	50
	Education, training, employment, and social services:								
	Education:								
91	Exclusion of scholarship and fellowship income (normal tax method)	1,870	1,960	2,050	2,150	2,250	2,360	2,470	11,280
92	HOPE tax credit	3,370	3,380	3,640	3,750	4,400	4,790	4,980	21,560
93	Lifetime Learning tax credit	2,210	2,220	2,340	2,420	2,810	3,050	3,180	13,800
94	Education Individual Retirement Accounts	20	30	50	60	70	80	90	350
95	Deductibility of student-loan interest	810	820	830	840	780	530	540	3,520
96	Deduction for higher education expenses	1,450	1,180	....	....	....	....	....	....
97	State prepaid tuition plans	850	1,040	1,290	1,600	2,020	2,280	2,430	9,620
98	Exclusion of interest on student-loan bonds	440	460	480	490	510	520	540	2,540
99	Exclusion of interest on bonds for private nonprofit educational facilities	1,750	1,870	1,930	1,980	2,050	2,110	2,170	10,240
100	Credit for holders of zone academy bonds	140	160	170	170	170	160	140	810
101	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	20	20	20	20	20	20	100
102	Parental personal exemption for students age 19 or over	2,690	1,880	1,760	1,710	2,790	3,130	2,860	12,250
103	Deductibility of charitable contributions (education)	4,330	4,880	5,270	5,670	6,110	6,600	7,010	30,660
104	Exclusion of employer-provided educational assistance	630	660	690	730	40	....	....	1,460
105	Special deduction for teacher expenses	170	160	....	....	....	....	....	....
106	Discharge of student loan indebtedness	20	20	20	20	20	20	20	100
	Training, employment, and social services:								
107	Work opportunity tax credit	370	490	600	680	670	500	260	2,710
108	Welfare-to-work tax credit	80	80	50	20	10	10	....	90
109	Employer provided child care exclusion	1,170	1,340	1,400	1,470	1,480	1,520	1,600	7,470
110	Employer-provided child care credit	10	10	10	20	10	....	....	40
111	Assistance for adopted foster children	350	380	420	450	480	520	560	2,430
112	Adoption credit and exclusion	370	380	400	410	370	70	80	1,330
113	Exclusion of employee meals and lodging (other than military)	930	970	1,010	1,060	1,110	1,170	1,230	5,580
114	Child credit [2]	30,910	30,160	29,950	29,870	23,270	13,590	13,080	109,760
115	Credit for child and dependent care expenses	2,780	1,810	1,720	1,650	1,560	1,410	1,340	7,680
116	Credit for disabled access expenditures	30	30	30	30	30	30	30	150
117	Deductibility of charitable contributions, other than education and health	38,200	43,370	46,980	50,550	54,600	59,070	62,790	273,990
118	Exclusion of certain foster care payments	420	420	420	420	420	420	420	2,100
119	Exclusion of parsonage allowances	510	550	580	610	640	670	700	3,200
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	30	10	....	....	....	....	....	....
121	Exclusion for benefits provided to volunteer EMS and firefighters	....	23	78	82	59	....	....	219
	Health:								
122	Exclusion of employer contributions for medical insurance premiums and medical care	133,790	151,810	168,460	185,250	210,110	233,320	254,810	1,051,950
123	Self-employed medical insurance premiums	4,260	4,680	5,170	5,710	6,590	7,450	8,180	33,100
124	Medical Savings Accounts / Health Savings Accounts	760	1,140	1,480	1,590	1,620	1,540	1,450	7,680
125	Deductibility of medical expenses	4,470	5,060	5,920	6,800	9,150	10,550	11,490	43,910
126	Exclusion of interest on hospital construction bonds	2,760	2,950	3,040	3,120	3,210	3,310	3,410	16,090
127	Deductibility of charitable contributions (health)	4,310	4,890	5,300	5,700	6,160	6,660	7,080	30,900
128	Tax credit for orphan drug research	260	290	320	360	410	460	510	2,060
129	Special Blue Cross/Blue Shield deduction	620	640	650	660	670	680	680	3,340

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13
130	Tax credit for health insurance purchased by certain displaced and retired individuals[3]	10	10	10	10	10	20	20	70
131	Distributions from retirement plans for premiums for health and long-term care insurance	250	240	280	310	340	380	420	1,730
	Income security:								
132	Exclusion of railroad retirement system benefits	380	370	370	360	360	350	330	1,770
133	Exclusion of workers' compensation benefits	5,740	5,830	5,920	6,010	6,110	6,200	6,300	30,540
134	Exclusion of public assistance benefits (normal tax method)	470	490	510	530	550	580	600	2,770
135	Exclusion of special benefits for disabled coal miners	50	40	40	40	40	40	40	200
136	Exclusion of military disability pensions	100	110	130	150	180	220	260	940
	Net exclusion of pension contributions and earnings:								
137	Employer plans	47,060	46,120	45,670	44,370	42,420	42,230	41,620	216,310
138	401(k) plans	46,000	49,000	51,000	55,000	68,000	74,000	77,000	325,000
139	Individual Retirement Accounts	9,500	10,800	11,700	12,200	13,400	14,900	15,200	67,400
140	Low and moderate income savers credit	760	880	900	880	870	880	860	4,390
141	Keogh plans	11,000	12,000	13,000	14,000	16,000	18,000	21,000	82,000
	Exclusion of other employee benefits:								
142	Premiums on group term life insurance	2,100	2,170	2,250	2,290	2,400	2,570	2,620	12,130
143	Premiums on accident and disability insurance	300	310	320	330	340	350	360	1,700
144	Income of trusts to finance supplementary unemployment benefits	30	30	30	40	40	50	50	210
145	Special ESOP rules	1,500	1,600	1,700	1,800	1,900	1,900	2,000	9,300
146	Additional deduction for the blind	30	30	30	30	40	40	40	180
147	Additional deduction for the elderly	1,590	1,610	1,710	1,850	2,460	2,920	3,070	12,010
148	Tax credit for the elderly and disabled	10	10	10	10	10	10	10	50
149	Deductibility of casualty losses	560	600	630	670	730	760	790	3,580
150	Earned income tax credit[4]	4,990	5,200	5,440	5,720	5,860	7,890	8,170	33,080
151	Additional exemption for housing Hurricane Katrina displaced individuals	20	....	....	....	....	....	....	....
	Social Security:								
	Exclusion of social security benefits:								
152	Social Security benefits for retired workers	17,690	18,480	18,640	19,720	20,760	22,650	24,320	106,090
153	Social Security benefits for disabled	5,050	5,540	5,810	6,150	6,590	7,110	7,560	33,220
154	Social Security benefits for dependents and survivors	3,270	3,320	3,240	3,340	3,400	3,600	3,740	17,320
	Veterans benefits and services:								
155	Exclusion of veterans death benefits and disability compensation	3,760	3,870	3,950	4,140	4,480	4,850	5,260	22,680
156	Exclusion of veterans pensions	180	180	180	180	190	220	220	990
157	Exclusion of GI bill benefits	250	280	280	290	300	330	330	1,530
158	Exclusion of interest on veterans housing bonds	30	30	30	30	30	30	30	150
	General purpose fiscal assistance:								
159	Exclusion of interest on public purpose State and local bonds	23,540	25,140	25,900	26,670	27,470	28,300	29,150	137,490
160	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	37,500	32,730	33,200	34,450	54,470	66,030	68,390	256,540
	Interest:								
161	Deferral of interest on U.S. savings bonds	1,290	1,310	1,320	1,330	1,380	1,470	1,490	6,990
	Addendum: Aid to State and local governments:								
	Deductibility of:								
	Property taxes on owner-occupied homes	19,120	16,360	16,640	16,820	28,230	34,570	35,400	131,660
	Nonbusiness State and local taxes other than on owner-occupied homes	37,500	32,730	33,200	34,450	54,470	66,030	68,390	256,540
	Exclusion of interest on State and local bonds for:								
	Public purposes	23,540	25,140	25,900	26,670	27,470	28,300	29,150	137,490
	Energy facilities	30	30	30	30	30	30	30	150
	Water, sewage, and hazardous waste disposal facilities	370	390	410	420	430	440	450	2,150
	Small-issues	350	380	390	410	420	420	440	2,080
	Owner-occupied mortgage subsidies	900	960	990	1,020	1,060	1,090	1,120	5,280
	Rental housing	830	880	900	930	960	990	1,020	4,800
	Airports, docks, and similar facilities	850	900	930	960	990	1,020	1,050	4,950
	Student loans	440	460	480	490	510	520	540	2,540
	Private nonprofit educational facilities	1,750	1,870	1,930	1,980	2,050	2,110	2,170	10,240
	Hospital construction	2,760	2,950	3,040	3,120	3,210	3,310	3,410	16,090
	Veterans' housing	30	30	30	30	30	30	30	150
	Credit for holders of zone academy bonds	140	160	170	170	170	160	140	810

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2007 $3,320; 2008 $4,020; 2009 $4,560; 2010 $4,740; 2011 $1,330; 2012 $0; 2013 $0.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2007 $16,159; 2008 $16,321; 2009 $16,780; 2010 $16,738; 2011 $16,394; 2012 $1,554; and 2013 $1,537

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

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2007 $38,270;2008 $39,460; 2009 $41,020; 2010 $42,940; 2011 $43,460; 2012 $39,890; and 2013 $40,850.

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

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

Present-Value Estimates

The annual value of tax expenditures for tax deferrals is reported on a cash basis in all tables except Table 19–4. Cash-based estimates reflect the difference between taxes deferred in the current year and incoming revenues that are received due to deferrals of taxes from prior years. Although such estimates are useful as a measure of cash flows into the Government, they do not accurately reflect the true economic cost of these provisions. For example, for a provision where activity levels have changed, so that incoming tax receipts from past deferrals are greater than deferred receipts from new activity, the cash-basis tax expenditure estimate can be negative, despite the fact that in present-value terms current deferrals have a real cost to the Government. Alternatively, in the case of a newly enacted deferral provision, a cash-based estimate can overstate the real effect on receipts to the Government because the newly deferred taxes will ultimately be received. Present-value estimates, which are a useful complement to the cash-basis estimates for provisions involving deferrals, are discussed below.

Discounted present-value estimates of revenue effects are presented in Table 19–4 for certain provisions that involve tax deferrals or other long-term revenue effects. These estimates complement the cash-based tax expenditure estimates presented in the other tables.

The present-value estimates represent the revenue effects, net of future tax payments that follow from activities undertaken during calendar year 2007 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2007 would cause a deferral of tax payments on wages in 2007 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2007 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 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(in millions of dollars)

		Corporations								Individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13	2007	2008	2009	2010	2011	2012	2013	2009–13
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	....	....	....	....	....	....	....	....	3,220	3,350	3,480	3,620	3,780	3,930	4,090	18,900
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,630	2,760	2,900	3,050	3,200	3,360	3,530	16,040
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	840	880	920	970	1020	1070	1120	5,100
4	Inventory property sales source rules exception	1,940	2,180	2,410	2,610	2,820	3,060	3,310	14,210	....	....	....	....	....	....	....	....
5	Deferral of income from controlled foreign corporations (normal tax method)	12,490	13,120	13,780	14,480	15,220	15,990	16,810	76,280	....	....	....	....	....	....	....	....
6	Deferred taxes for financial firms on certain income earned overseas	2,370	2,490	1,060	....	....	....	....	1,060	....	....	....	....	....	....	....	....
	General science, space, and technology:																
7	Expensing of research and experimentation expenditures (normal tax method)	5,090	4,620	4,890	4,380	4,220	4,300	4,320	22,110	100	100	100	90	100	100	100	490
8	Credit for increasing research activities	10,260	4,610	2,100	920	360	70	....	3,450	60	50	....	....	....	....	....	....
	Energy:																
9	Expensing of exploration and development costs, fuels	460	440	400	340	270	210	130	1,350	70	70	60	50	40	30	20	200
10	Excess of percentage over cost depletion, fuels	710	820	860	820	790	770	760	4,000	80	90	90	90	90	80	80	430
11	Alternative fuel production credit	2,800	1,260	70	80	10	10	....	170	120	50	....	....	....	....	....	....
12	Exception from passive loss limitation for working interests in oil and gas properties	....	....	....	....	....	....	....	....	30	20	20	20	30	30	30	130
13	Capital gains treatment of royalties on coal	....	....	....	....	....	....	....	....	180	190	190	200	190	140	150	870
14	Exclusion of interest on energy facility bonds	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
15	New technology credit	380	730	910	940	920	910	880	4,560	30	70	90	90	90	90	90	450
16	Alcohol fuel credits [1]	30	30	40	40	20	....	....	100	10	10	10	10	10	....	....	30
17	Bio-Diesel and small agri-biodiesel producer tax credits	....	....	....	....	....	....	....	....	180	200	30	20	10	10	10	80
18	Tax credit and deduction for clean-fuel burning vehicles	30	....	–30	–30	–40	–50	–40	–190	230	150	160	10	–10	–10	–10	140
19	Exclusion of utility conservation subsidies	....	....	....	....	....	....	....	....	120	120	120	110	110	110	110	560
20	Credit for holding clean renewable energy bonds	10	10	20	20	20	20	20	100	10	30	50	50	50	50	50	250
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	610	250	–60	–290	–490	–590	–570	–2,000	....	....	....	....	....	....	....	....
22	Credit for investment in clean coal facilities	30	50	80	130	180	245	290	925	....	....	....	....	....	....	....	....
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	30	120	240	260	180	–50	–160	470	....	....	....	....	....	....	....	....
24	Natural gas distribution pipelines treated as 15–year property	60	80	90	110	120	110	100	530	....	....	....	....	....	....	....	....
25	Amortize all geological and geophysical expenditures over 2 years	40	30	20	10	10	10	10	60	10	10	10	....	....	....	....	10
26	Allowance of deduction for certain energy efficient commercial building property	140	130	70	20	....	....	....	90	50	40	20	10	....	....	....	30
27	Credit for construction of new energy efficient homes	20	20	20	10	....	....	....	30	....	10	....	....	....	....	....	....
28	Credit for energy efficiency improvements to existing homes	....	....	....	....	....	....	....	....	380	150	....	....	....	....	....	....
29	Credit for energy efficient appliances	80	....	....	....	....	....	....	....	....	....	....	....	....	....	....	....
30	30% credit for residential purchases/installations of solar and fuel cells	....	....	....	....	....	....	....	....	10	10	10	....	....	....	....	10
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	20	30	10	....	....	....	....	10	60	100	40	–10	–10	–10	–10	....
32	Partial expensing for advanced mine safety equipment	10	20	....	....	....	....	....	....	....	....	....	....	....	....	....	....
	Natural resources and environment:																
33	Expensing of exploration and development costs, nonfuel minerals	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
34	Excess of percentage over cost depletion, nonfuel minerals	360	380	390	410	420	430	450	2,100	20	20	20	30	30	30	30	140
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	120	120	130	130	130	140	140	670	250	270	280	290	300	300	310	1,480
36	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	180	190	190	200	190	140	150	870
37	Expensing of multiperiod timber growing costs	180	180	190	190	200	210	210	1,000	110	110	120	120	120	130	130	620
38	Tax incentives for preservation of historic structures	310	330	340	360	380	400	420	1,900	90	100	100	110	110	120	120	560
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	10	30	50	30	–10	....	....	70	....	....	....	....	....	....	....	....
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites	10	20	30	30	30	20	20	130	....	10	10	10	10	10	10	50
	Agriculture:																
41	Expensing of certain capital outlays	10	10	10	10	10	10	10	50	100	100	100	110	110	110	110	540
42	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	50	70	70	70	70	80	80	80	380

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13	2007	2008	2009	2010	2011	2012	2013	2009–13
43	Treatment of loans forgiven for solvent farmers									10	10	10	20	20	20	20	90
44	Capital gains treatment of certain income									980	1030	1030	1090	1060	760	800	4,740
45	Income averaging for farmers									80	80	80	80	80	80	80	400
46	Deferral of gain on sale of farm refiners	20	20	20	20	20	20	20	100								
	Commerce and housing:																
	Financial institutions and insurance:																
47	Exemption of credit union income	1310	1380	1450	1530	1610	1690	1780	8,060								
48	Excess bad debt reserves of financial institutions	20	10	10	10				20								
49	Exclusion of interest on life insurance savings	2540	2740	2920	3100	3260	3480	3740	16,500	17370	19100	20580	22100	24340	27270	29850	124,140
50	Special alternative tax on small property and casualty insurance companies	40	40	40	40	40	50	50	220								
51	Tax exemption of certain insurance companies owned by tax-exempt organizations	180	190	190	200	200	210	210	1,010								
52	Small life insurance company deduction	50	50	50	50	50	60	60	270								
53	Exclusion of interest spread of financial institutions									520	450	480	500	630	660	690	2,960
	Housing:																
54	Exclusion of interest on owner-occupied mortgage subsidy bonds	280	300	310	320	330	340	350	1,650	620	660	680	700	730	750	770	3,630
55	Exclusion of interest on rental housing bonds	260	270	280	290	300	310	320	1,500	570	610	620	640	660	680	700	3,300
56	Deductibility of mortgage interest on owner-occupied homes									84,850	94,790	100,810	107,020	115,280	123,130	130,440	576,680
57	Deductibility of State and local property tax on owner-occupied homes									19,120	16,360	16,640	16,820	28,230	34,570	35,400	131,660
58	Deferral of income from installment sales	310	310	320	320	320	330	330	1,620	900	920	930	1,050	1,180	1,320	1,480	5,960
59	Capital gains exclusion on home sales									31,480	33,050	34,710	36,440	38,260	40,180	42,180	191,770
60	Exclusion of net imputed rental income									3,890	5,440	7,550	10,478	14,543	20,183	28,012	80,766
61	Exception from passive loss rules for $25,000 of rental loss									7,840	8,430	8,840	9,160	9,580	10,090	10,240	47,910
62	Credit for low-income housing investments	4,660	4,980	5,360	5,720	6,040	6,330	6,590	30,040	370	400	420	460	480	510	530	2,400
63	Accelerated depreciation on rental housing (normal tax method)	620	660	700	740	800	860	920	4,020	9,240	10,120	11,060	11,980	13,770	15,300	16,630	68,740
64	Discharge of mortgage indebtedness										293	239	176				415
	Commerce:																
65	Cancellation of indebtedness									110	90	60	40	30	30	30	190
66	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
67	Capital gains (except agriculture, timber, iron ore, and coal)									53,230	55,540	55,940	59,170	57,490	41,390	43,240	257,230
68	Capital gains exclusion of small corporation stock									270	320	340	370	490	540	590	2,330
69	Step-up basis of capital gains at death									32,600	35,900	36,750	37,950	39,450	41,010	42,632	197,792
70	Carryover basis of capital gains on gifts									650	760	800	1,270	6,340	1,500	1,600	11,510
71	Ordinary income treatment of loss from small business corporation stock sale									50	50	50	60	60	60	60	290
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	–1,320	–1,240	–1,110	–990	–900	–800	–650	–4,450	–3,290	–3,180	–3,030	–2,860	–3,020	–2,950	–2,460	–14,320
73	Accelerated depreciation of machinery and equipment (normal tax method)	14,760	21,540	28,600	34,130	38,090	41,690	45,440	187,950	11,650	13,640	15,520	15,630	15,240	16,750	18,950	82,090
74	Expensing of certain small investments (normal tax method)	730	720	630	–220	–380	–380	–140	–490	2930	2940	2770	720	–570	–580	80	2,420
75	Graduated corporation income tax rate (normal tax method)	5,400	5,220	5,290	5,510	5,660	5,840	6,090	28,390								
76	Exclusion of interest on small issue bonds	110	120	120	130	130	130	140	650	240	260	270	280	290	290	300	1,430
77	Deduction for US production activities	7,380	10,710	11,690	16,030	19,340	20,310	21,320	88,690	2,420	3,310	3,640	5,080	6,690	7,400	7,770	30,580
78	Special rules for certain film and TV production	70	60	–30	–70	–50	–40	–30	–220	20	10	–10	–20	–10	–10	–10	–60
	Transportation:																
79	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
80	Exclusion of reimbursed employee parking expenses									2,830	2,950	3,070	3,200	3,310	3,430	3,540	16,550
81	Exclusion for employer-provided transit passes									420	440	470	500	520	550	580	2,620
82	Tax credit for certain expenditures for maintaining railroad tracks	120	120	40	20	10	10		80	10	10						
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	10	20	20	30	30	20	10	110	30	60	70	70	70	70	50	330
	Community and regional development:																
84	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	20	20	100
85	Exclusion of interest for airport, dock, and similar bonds	270	280	290	300	310	320	330	1,550	580	620	640	660	680	700	720	3,400
86	Exemption of certain mutuals' and cooperatives' income	70	70	70	70	70	70	80	360								
87	Empowerment zones and renewal communities	360	380	420	200	70	110	140	940	1,090	1,170	1,340	970	410	550	650	3,920
88	New markets tax credit	210	250	240	210	180	140	80	850	600	740	730	650	550	450	260	2,640

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13	2007	2008	2009	2010	2011	2012	2013	2009–13
89	Expensing of environmental remediation costs	250	110	–30	–20	–20	–20	–10	–100	50	20	–10	....	....	....	....	–10
90	Credit to holders of Gulf Tax Credit Bonds	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50
	Education, training, employment, and social services:																
	Education:																
91	Exclusion of scholarship and fellowship income (normal tax method)	....	....	....	....	....	....	....	....	1,870	1,960	2,050	2,150	2,250	2,360	2,470	11,280
92	HOPE tax credit	....	....	....	....	....	....	....	....	3,370	3,380	3,640	3,750	4,400	4,790	4,980	21,560
93	Lifetime Learning tax credit	....	....	....	....	....	....	....	....	2,210	2,220	2,340	2,420	2,810	3,050	3,180	13,800
94	Education Individual Retirement Accounts	....	....	....	....	....	....	....	....	20	30	50	60	70	80	90	350
95	Deductibility of student-loan interest	....	....	....	....	....	....	....	....	810	820	830	840	780	530	540	3,520
96	Deduction for higher education expenses	....	....	....	....	....	....	....	....	1,450	1,180	....	....	....	....	....	....
97	State prepaid tuition plans	....	....	....	....	....	....	....	....	850	1,040	1,290	1,600	2,020	2,280	2,430	9,620
98	Exclusion of interest on student-loan bonds	140	140	150	150	160	160	170	790	300	320	330	340	350	360	370	1,750
99	Exclusion of interest on bonds for private nonprofit educational facilities	550	580	600	620	640	660	680	3,200	1200	1290	1330	1360	1410	1450	1490	7,040
100	Credit for holders of zone academy bonds	140	160	170	170	170	160	140	810	....	....	....	....	....	....	....	....
101	Exclusion of interest on savings bonds redeemed to finance educational expenses	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
102	Parental personal exemption for students age 19 or over	....	....	....	....	....	....	....	....	2,690	1,880	1,760	1,710	2,790	3,130	2,860	12,250
103	Deductibility of charitable contributions (education)	600	630	670	710	750	790	830	3,750	3,730	4,250	4,600	4,960	5,360	5,810	6,180	26,910
104	Exclusion of employer-provided educational assistance	....	....	....	....	....	....	....	....	630	660	690	730	40	....	....	1,460
105	Special deduction for teacher expenses	....	....	....	....	....	....	....	....	170	160	....	....	....	....	....	....
106	Discharge of student loan indebtedness	....	....	....	....	....	....	....	....	20	20	20	20	20	20	20	100
	Training, employment, and social services:																
107	Work opportunity tax credit	330	440	510	560	550	410	220	2,250	40	50	90	120	120	90	40	460
108	Welfare-to-work tax credit	70	60	40	20	10	10	....	80	10	20	10	....	....	....	....	10
109	Employer provided child care exclusion	....	....	....	....	....	....	....	....	1170	1340	1400	1470	1480	1520	1600	7,470
110	Employer-provided child care credit	10	10	10	20	10	....	....	40	....	....	....	....	....	....	....	....
111	Assistance for adopted foster children	....	....	....	....	....	....	....	....	350	380	420	450	480	520	560	2,430
112	Adoption credit and exclusion	....	....	....	....	....	....	....	....	370	380	400	410	370	70	80	1,330
113	Exclusion of employee meals and lodging (other than military)	....	....	....	....	....	....	....	....	930	970	1,010	1,060	1,110	1,170	1,230	5,580
114	Child credit [2]	....	....	....	....	....	....	....	....	30,910	30,160	29,950	29,870	23,270	13,590	13,080	109,760
115	Credit for child and dependent care expenses	....	....	....	....	....	....	....	....	2,780	1,810	1,720	1,650	1,560	1,410	1,340	7,680
116	Credit for disabled access expenditures	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
117	Deductibility of charitable contributions, other than education and health	1,370	1,440	1,510	1,580	1,650	1,720	1790	8,250	36,830	41,930	45,470	48,970	52,950	57,350	61,000	265,740
118	Exclusion of certain foster care payments	....	....	....	....	....	....	....	....	420	420	420	420	420	420	420	2,100
119	Exclusion of parsonage allowances	....	....	....	....	....	....	....	....	510	550	580	610	640	670	700	3,200
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	10	....	....	....	....	....	....	....	20	10	....	....	....	....	....	....
121	Exclusion for benefits provided to volunteer EMS and firefighters	....	....	....	....	....	....	....	....	....	23	78	82	59	....	....	219
	Health:																
122	Exclusion of employer contributions for medical insurance premiums and medical care	....	....	....	....	....	....	....	....	133,790	151,810	168,460	185,250	210,110	233,320	254,810	1,051,950
123	Self-employed medical insurance premiums	....	....	....	....	....	....	....	....	4,260	4,680	5,170	5,710	6,590	7,450	8,180	33,100
124	Medical Savings Accounts / Health Savings Accounts	....	....	....	....	....	....	....	....	760	1,140	1,480	1,590	1,620	1,540	1,450	7,680
125	Deductibility of medical expenses	....	....	....	....	....	....	....	....	4,470	5,060	5,920	6,800	9,150	10,550	11,490	43,910
126	Exclusion of interest on hospital construction bonds	870	920	950	970	1,000	1,030	1,060	5,010	1,890	2,030	2,090	2,150	2,210	2,280	2,350	11,080
127	Deductibility of charitable contributions (health)	180	190	200	210	220	230	240	1,100	4,130	4,700	5,100	5,490	5,940	6,430	6,840	29,800
128	Tax credit for orphan drug research	260	290	320	360	410	460	510	2,060	....	....	....	....	....	....	....	....
129	Special Blue Cross/Blue Shield deduction	620	640	650	660	670	680	680	3,340	....	....	....	....	....	....	....	....
130	Tax credit for health insurance purchased by certain displaced and retired individuals [3]	....	....	....	....	....	....	....	....	10	10	10	10	10	20	20	70
131	Distributions from retirement plans for premiums for health and long-term care insurance	....	....	....	....	....	....	....	....	250	240	280	310	340	380	420	1,730
	Income security:																
132	Exclusion of railroad retirement system benefits	....	....	....	....	....	....	....	....	380	370	370	360	360	350	330	1,770
133	Exclusion of workers' compensation benefits	....	....	....	....	....	....	....	....	5,740	5,830	5,920	6,010	6,110	6,200	6,300	30,540
134	Exclusion of public assistance benefits (normal tax method)	....	....	....	....	....	....	....	....	470	490	510	530	550	580	600	2,770
135	Exclusion of special benefits for disabled coal miners	....	....	....	....	....	....	....	....	50	40	40	40	40	40	40	200
136	Exclusion of military disability pensions	....	....	....	....	....	....	....	....	100	110	130	150	180	220	260	940
	Net exclusion of pension contributions and earnings:																
137	Employer plans	....	....	....	....	....	....	....	....	47,060	46,120	45,670	44,370	42,420	42,230	41,620	216,310

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2007	2008	2009	2010	2011	2012	2013	2009–13	2007	2008	2009	2010	2011	2012	2013	2009–13
138	401(k) plans	....	....	....	....	....	....	....	....	46,000	49,000	51,000	55,000	68,000	74,000	77,000	325,000
139	Individual Retirement Accounts	....	....	....	....	....	....	....	....	9,500	10,800	11,700	12,200	13,400	14,900	15,200	67,400
140	Low and moderate income savers credit	....	....	....	....	....	....	....	....	760	880	900	880	870	880	860	4,390
141	Keogh plans	....	....	....	....	....	....	....	....	11,000	12,000	13,000	14,000	16,000	18,000	21,000	82,000
	Exclusion of other employee benefits:																
142	Premiums on group term life insurance	....	....	....	....	....	....	....	....	2,100	2,170	2,250	2,290	2,400	2,570	2,620	12,130
143	Premiums on accident and disability insurance	....	....	....	....	....	....	....	....	300	310	320	330	340	350	360	1,700
144	Income of trusts to finance supplementary unemployment benefits	....	....	....	....	....	....	....	....	30	30	30	40	40	50	50	210
145	Special ESOP rules	1,100	1,200	1,300	1,300	1,400	1,400	1,500	6,900	400	400	400	500	500	500	500	2,400
146	Additional deduction for the blind	....	....	....	....	....	....	....	....	30	30	30	30	40	40	40	180
147	Additional deduction for the elderly	....	....	....	....	....	....	....	....	1,590	1,610	1,710	1,850	2,460	2,920	3,070	12,010
148	Tax credit for the elderly and disabled	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50
149	Deductibility of casualty losses	....	....	....	....	....	....	....	....	560	600	630	670	730	760	790	3,580
150	Earned income tax credit [4]	....	....	....	....	....	....	....	....	4,990	5,200	5,440	5,720	5,860	7,890	8,170	33,080
151	Additional exemption for housing Hurricane Katrina displaced individuals	....	....	....	....	....	....	....	....	20	....	....	....	....	....	....	....
	Social Security:																
	Exclusion of social security benefits:																
152	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	17,690	18,480	18,640	19,720	20,760	22,650	24,320	106,090
153	Social Security benefits for disabled	....	....	....	....	....	....	....	....	5,050	5,540	5,810	6,150	6,590	7,110	7,560	33,220
154	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	3,270	3,320	3,240	3,340	3,400	3,600	3,740	17,320
	Veterans benefits and services:																
155	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,760	3,870	3,950	4,140	4,480	4,850	5,260	22,680
156	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	180	180	180	180	190	220	220	990
157	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	250	280	280	290	300	330	330	1,530
158	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
	General purpose fiscal assistance:																
159	Exclusion of interest on public purpose State and local bonds	7,410	7,840	8,080	8,320	8,570	8,830	9,090	42,890	16,130	17,300	17,820	18,350	18,900	19,470	20,060	94,600
160	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	37,500	32,730	33,200	34,450	54,470	66,030	68,390	256,540
	Interest:																
161	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	1,290	1,310	1,320	1,330	1,380	1,470	1,490	6,990
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	19,120	16,360	16,640	16,820	28,230	34,570	35,400	131,660
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	37,500	32,730	33,200	34,450	54,470	66,030	68,390	256,540
	Exclusion of interest on State and local bonds for:																
	Public purposes	7,410	7,840	8,080	8,320	8,570	8,830	9,090	42,890	16,130	17,300	17,820	18,350	18,900	19,470	20,060	94,600
	Energy facilities	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
	Water, sewage, and hazardous waste disposal facilities	120	120	130	130	130	140	140	670	250	270	280	290	300	300	310	1,480
	Small-issues	110	120	120	130	130	130	140	650	240	260	270	280	290	290	300	1,430
	Owner-occupied mortgage subsidies	280	300	310	320	330	340	350	1,650	620	660	680	700	730	750	770	3,630
	Rental housing	260	270	280	290	300	310	320	1,500	570	610	620	640	660	680	700	3,300
	Airports, docks, and similar facilities	270	280	290	300	310	320	330	1,550	580	620	640	660	680	700	720	3,400
	Student loans	140	140	150	150	160	160	170	790	300	320	330	340	350	360	370	1,750
	Private nonprofit educational facilities	550	580	600	620	640	660	680	3,200	1,200	1,290	1,330	1,360	1,410	1,450	1,490	7,040
	Hospital construction	870	920	950	970	1000	1030	1060	5,010	1,890	2,030	2,090	2,150	2,210	2,280	2,350	11,080
	Veterans' housing	10	10	10	10	10	10	10	50	20	20	20	20	20	20	20	100
	Credit for holders of zone academy bonds	140	160	170	170	170	160	140	810	....	....	....	....	....	....	....	....

[1] In addition, the alcohol fuel credit results in a reduction in excise tax receipts (in millions of dollars) as follows: 2007 $3,380; 2008 $4,300; 2009 $5,140; 2010 $5,940; 2011 $1,720; 2012 $0; 2013 $0.

[2] The figures in the table indicate the effect of the child tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2007 $16,159; 2008 $16,321; 2009 $16,780; 2010 $16,738; 2011 $16,394; 2012 $1,554; and 2013 $1,537

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

[4] The figures in the table indicate the effect of the earned income tax credit on receipts. The effect of the credit on outlays (in millions of dollars) is as follows: 2007 $38,270;2008 $39,460; 2009 $41,020; 2010 $42,940; 2011 $43,460; 2012 $39,890; and 2013 $40,850.

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

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

Tax Expenditure Baselines

A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment. As in prior years, most of this year's tax expenditure estimates are presented using two baselines: the normal tax baseline and the reference tax law baseline. An exception is provided for the lower tax rate on dividends and capital gains on corporate shares as discussed below.

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 deduction of expenses incurred in earning income. It is not limited to a particular structure of tax rates, or by a specific definition of the taxpaying unit.

In the case of income taxes, the reference tax law baseline is also patterned on a comprehensive income tax, but it is closer to existing law. Tax expenditures under the reference law baseline are generally tax expenditures under the normal tax baseline, but the reverse is not always true.

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

- Income is taxable only when it is realized in exchange. Thus, the deferral of tax on unrealized capital gains is not regarded as tax expenditure. Accrued income would be taxed under a comprehensive income tax.
- A comprehensive income tax would generally not exclude from the tax base amounts for personal exemptions or a standard deduction, except perhaps to ease tax administration.
- A separate corporate income tax is not part of a comprehensive income tax.
- Tax rates vary by level of income. Multiple tax rates exist as a means to facilitate the redistribution of income.
- Tax rates are allowed to vary with marital status.
- Values of assets and debt are not generally adjusted for inflation. A comprehensive income tax would adjust the cost basis of capital assets and debt for changes in the price level during the time the assets or debt are held. Thus, under a comprehensive income tax baseline, the failure to take account of inflation in measuring depreciation, capital gains, and interest income would be regarded as a negative tax expenditure (i.e., a tax penalty), and failure to take account of inflation in measuring interest costs would be regarded as a positive tax expenditure (i.e., a tax subsidy).

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

Tax rates . The separate schedules applying to the various taxpaying units are included in the reference law baseline. Thus, corporate tax rates below the maximum statutory rate do not give rise to a tax expenditure. The normal tax baseline is similar, except that, by convention, it specifies the current maximum rate as the baseline for the corporate income tax. The lower tax rates applied to the first $10 million of corporate income are thus regarded as a tax expenditure. Again, by convention, the Alternative Minimum Tax is treated as part of the baseline rate structure under both the reference and normal tax methods.

Income subject to the tax . Income subject to tax is defined as gross income less the costs of earning that income. 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 nor does gross income include most transfer payments which can be thought of as gifts from the Government. [3] 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. [4]

Capital recovery . Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. Under the normal tax baseline, the depreciation allowance for property is computed using estimates of economic depreciation. The latter represents a change in the calculation of the tax expenditure under normal law first made in the 2004 Budget. Appendix A provides further details on the new methodology and how it differs from the prior methodology.

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.

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

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

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2009–2013 PROJECTED REVENUE EFFECT

(in millions of dollars)

	Provision	2009	2009–13
122	Exclusion of employer contributions for medical insurance premiums and medical care	168,460	1,051,950
56	Deductibility of mortgage interest on owner-occupied homes	100,810	576,680
138	401(k) plans	51,000	325,000
117	Deductibility of charitable contributions, other than education and health	46,980	273,990
73	Accelerated depreciation of machinery and equipment (normal tax method)	44,120	270,040
67	Capital gains (except agriculture, timber, iron ore, and coal)	55,940	257,230
160	Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	33,200	256,540
137	Employer plans	45,670	216,310
69	Step-up basis of capital gains at death	36,750	197,792
59	Capital gains exclusion on home sales	34,710	191,770
49	Exclusion of interest on life insurance savings	23,500	140,640
159	Exclusion of interest on public purpose State and local bonds	25,900	137,490
57	Deductibility of State and local property tax on owner-occupied homes	16,640	131,660
77	Deduction for U.S. production activities	15,330	119,270
114	Child credit	29,950	109,760
152	Social Security benefits for retired workers	18,640	106,090
141	Keogh plans	13,000	82,000
60	Exclusion of net imputed rental income	7,550	80,766
5	Deferral of income from controlled foreign corporations (normal tax method)	13,780	76,280
63	Accelerated depreciation on rental housing (normal tax method)	11,760	72,760
139	Individual Retirement Accounts	11,700	67,400
61	Exception from passive loss rules for $25,000 of rental loss	8,840	47,910
125	Deductibility of medical expenses	5,920	43,910
153	Social Security benefits for disabled	5,810	33,220
123	Self-employed medical insurance premiums	5,170	33,100
150	Earned income tax credit	5,440	33,080
62	Credit for low-income housing investments	5,780	32,440
127	Deductibility of charitable contributions (health)	5,300	30,900
103	Deductibility of charitable contributions (education)	5,270	30,660
133	Exclusion of workers' compensation benefits	5,920	30,540
75	Graduated corporation income tax rate (normal tax method)	5,290	28,390
155	Exclusion of veterans death benefits and disability compensation	3,950	22,680
7	Expensing of research and experimentation expenditures (normal tax method)	4,990	22,600
92	HOPE tax credit	3,640	21,560
1	Exclusion of benefits and allowances to armed forces personnel	3,480	18,900
154	Social Security benefits for dependents and survivors	3,240	17,320
80	Exclusion of reimbursed employee parking expenses	3,070	16,550
126	Exclusion of interest on hospital construction bonds	3,040	16,090
2	Exclusion of income earned abroad by U.S. citizens	2,900	16,040
4	Inventory property sales source rules exception	2,410	14,210
93	Lifetime Learning tax credit	2,340	13,800
102	Parental personal exemption for students age 19 or over	1,760	12,250
142	Premiums on group term life insurance	2,250	12,130
147	Additional deduction for the elderly	1,710	12,010
70	Carryover basis of capital gains on gifts	800	11,510
91	Exclusion of scholarship and fellowship income (normal tax method)	2,050	11,280
99	Exclusion of interest on bonds for private nonprofit educational facilities	1,930	10,240
97	State prepaid tuition plans	1,290	9,620
145	Special ESOP rules	1,700	9,300
47	Exemption of credit union income	1,450	8,060
115	Credit for child and dependent care expenses	1,720	7,680
124	Medical Savings Accounts / Health Savings Accounts	1,480	7,680
58	Deferral of income from installment sales	1,250	7,580
109	Employer provided child care exclusion	1,400	7,470
161	Deferral of interest on U.S. savings bonds	1,320	6,990
113	Exclusion of employee meals and lodging (other than military)	1,010	5,580
54	Exclusion of interest on owner-occupied mortgage subsidy bonds	990	5,280
3	Exclusion of certain allowances for Federal employees abroad	920	5,100
15	New technology credit	1,000	5,010
85	Exclusion of interest for airport, dock, and similar bonds	930	4,950
87	Empowerment zones, Enterprise communities, and Renewal communities	1,760	4,860
55	Exclusion of interest on rental housing bonds	900	4,800
44	Capital gains treatment of certain income	1,030	4,740
10	Excess of percentage over cost depletion, fuels	950	4,430
140	Low and moderate income savers credit	900	4,390
149	Deductibility of casualty losses	630	3,580

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2009–2013 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

	Provision	2009	2009–13
95	Deductibility of student-loan interest	830	3,520
88	New markets tax credit	970	3,490
8	Credit for increasing research activities	2,100	3,450
129	Special Blue Cross/Blue Shield deduction	650	3,340
119	Exclusion of parsonage allowances	580	3,200
53	Exclusion of interest spread of financial institutions	480	2,960
134	Exclusion of public assistance benefits (normal tax method)	510	2,770
107	Work opportunity tax credit	600	2,710
81	Exclusion for employer-provided transit passes	470	2,620
98	Exclusion of interest on student-loan bonds	480	2,540
38	Tax incentives for preservation of historic structures	440	2,460
111	Assistance for adopted foster children	420	2,430
68	Capital gains exclusion of small corporation stock	340	2,330
34	Excess of percentage over cost depletion, nonfuel minerals	410	2,240
35	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	410	2,150
118	Exclusion of certain foster care payments	420	2,100
76	Exclusion of interest on small issue bonds	390	2,080
128	Tax credit for orphan drug research	320	2,060
74	Expensing of certain small investments (normal tax method)	3,400	1,930
132	Exclusion of railroad retirement system benefits	370	1,770
131	Distributions from retirement plans for premiums for health and long-term care insurance	280	1,730
143	Premiums on accident and disability insurance	320	1,700
37	Expensing of multiperiod timber growing costs	310	1,620
9	Expensing of exploration and development costs, fuels	460	1,550
157	Exclusion of GI bill benefits	280	1,530
104	Exclusion of employer-provided educational assistance	690	1,460
112	Adoption credit and exclusion	400	1,330
6	Deferred taxes for financial firms on certain income earned overseas	1,060	1,060
51	Tax exemption of certain insurance companies owned by tax-exempt organizations	190	1,010
156	Exclusion of veterans pensions	180	990
136	Exclusion of military disability pensions	130	940
22	Credit for investment in clean coal facilities	80	925
13	Capital gains treatment of royalties on coal	190	870
36	Capital gains treatment of certain timber income	190	870
100	Credit for holders of zone academy bonds	170	810
41	Expensing of certain capital outlays	110	590
19	Exclusion of utility conservation subsidies	120	560
24	Natural gas distribution pipelines treated as 15–year property	90	530
23	Temporary 50% expensing for equipment used in the refining of liquid fuels	240	470
83	Exclusion of interest on bonds for Financing of Highway Projects and rail-truck transfer facilities	90	440
42	Expensing of certain multiperiod production costs	80	430
64	Discharge of mortgage indebtedness	239	415
45	Income averaging for farmers	80	400
86	Exemption of certain mutuals' and cooperatives' income	70	360
20	Credit for holding clean renewable energy bonds	70	350
94	Education Individual Retirement Accounts	50	350
71	Ordinary income treatment of loss from small business corporation stock sale	50	290
52	Small life insurance company deduction	50	270
66	Exceptions from imputed interest rules	50	250
50	Special alternative tax on small property and casualty insurance companies	40	220
121	Exclusion for benefits provided to volunteer EMS and firefighters	78	219
144	Income of trusts to finance supplementary unemployment benefits	30	210
84	Investment credit for rehabilitation of structures (other than historic)	40	200
135	Exclusion of special benefits for disabled coal miners	40	200
65	Cancellation of indebtedness	60	190
40	Exclusion of gain or loss on sale or exchange of certain brownfield sites	40	180
146	Additional deduction for the blind	30	180
11	Alternative fuel production credit	70	170
14	Exclusion of interest on energy facility bonds	30	150
116	Credit for disabled access expenditures	30	150
158	Exclusion of interest on veterans housing bonds	30	150
12	Exception from passive loss limitation for working interests in oil and gas properties	20	130
16	Alcohol fuel credits	50	130
26	Allowance of deduction for certain energy efficient commercial building property	90	120
46	Deferral of gain on sale of farm refiners	20	100
79	Deferral of tax on shipping companies	20	100
101	Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
106	Discharge of student loan indebtedness	20	100

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2009–2013 PROJECTED REVENUE EFFECT—Continued

(in millions of dollars)

	Provision	2009	2009–13
43	Treatment of loans forgiven for solvent farmers	10	90
108	Welfare-to-work tax credit	50	90
17	Alcohol fuel credits	30	80
82	Tax credit for certain expenditures for maintaining railroad tracks	40	80
25	Amortize all geological and geophysical expenditures over 2 years	30	70
39	Expensing of capital costs with respect to complying with EPA sulfur regulations	50	70
130	Tax credit for health insurance purchased by certain displaced and retired individuals	10	70
33	Expensing of exploration and development costs, nonfuel minerals	10	50
90	Credit to holders of Gulf Tax Credit Bonds.	10	50
148	Tax credit for the elderly and disabled	10	50
110	Employer-provided child care credit	10	40
27	Credit for construction of new energy efficient homes	20	30
48	Excess bad debt reserves of financial institutions	10	20
30	30% credit for residential purchases/installations of solar and fuel cells	10	10
31	Credit for business installation of qualified fuel cells and stationary microturbine power plants	50	10
28	Credit for energy efficiency improvements to existing homes	....	....
29	Credit for energy efficient appliances	....	....
32	Partial expensing for advanced mine safety equipment	....	....
96	Deduction for higher education expenses	....	....
105	Special deduction for teacher expenses	....	....
120	Employee retention credit for employers affected by Hurricane Katrina, Rita, and Wilma	....	....
151	Additional exemption for housing Hurricane Katrina displaced individuals	....	....
18	Tax credit and deduction for clean-fuel burning vehicles	130	–50
89	Expensing of environmental remediation costs	–40	–110
78	Special rules for certain film and TV production	–40	–280
21	Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	–60	–2,000
72	Accelerated depreciation of buildings other than rental housing (normal tax method)	–4,140	–18,770

Table 19–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2007
(in millions of dollars)

	Provision	2007 Present Value of Revenue Loss
5	Deferral of income from controlled foreign corporations (normal tax method)	11,460
6	Deferred taxes for financial firms on income earned overseas	2,500
7	Expensing of research and experimentation expenditures (normal tax method)	2,620
18	Credit for holding clean renewable energy bonds	360
9	Expensing of exploration and development costs—fuels	220
33	Expensing of exploration and development costs—nonfuels	10
37	Expensing of multiperiod timber growing costs	190
42	Expensing of certain multiperiod production costs—agriculture	150
41	Expensing of certain capital outlays—agriculture	200
49	Deferral of income on life insurance and annuity contracts	19,060
63	Accelerated depreciation on rental housing	12,860
72	Accelerated depreciation of buildings other than rental	3,000
73	Accelerated depreciation of machinery and equipment	39,040
74	Expensing of certain small investments (normal tax method)	680
79	Deferral of tax on shipping companies	20
100	Credit for holders of zone academy bonds	160
62	Credit for low-income housing investments	5,630
97	Deferral for state prepaid tuition plans	7,000
137	Exclusion of pension contributions—employer plans	74,120
138	Exclusion of 401(k) contributions	121,000
139	Exclusion of IRA contributions and earnings	4,300
139	Exclusion of Roth earnings and distributions	9,200
139	Exclusion of non-deductible IRA earnings	480
141	Exclusion of contributions and earnings for Keogh plans	8,600
159	Exclusion of interest on public-purpose bonds	19,930
	Exclusion of interest on non-public purpose bonds	6,980
161	Deferral of interest on U.S. savings bonds	320

Double Taxation of Corporate Profits

In a gradual transition to a more economically neutral tax system under which all income is taxed no more than once, the lower tax rates on dividends and capital gains on corporate equity under current law have not been considered tax preferences since the 2005 Budget. Thus, the difference between ordinary tax rates and the lower tax rates on dividends, introduced by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), does not give rise to a tax expenditure. Similarly, the lower capital gains tax rates applied to gains realized from the disposition of corporate equity do not give rise to a tax expenditure. As a consequence, tax expenditure estimates for the lower tax rates on capital, step-up in basis, and the inside build-up on pension assets, 401k plans, IRAs, among others, are limited to capital gains from sources other than corporate equity. Appendix A provides a greater discussion of alternative baselines.

Descriptions of Income Tax Provisions

Descriptions of the individual and corporate income tax expenditures reported on in this chapter follow. These descriptions relate to current law as of December 31, 2007, and do not reflect proposals made elsewhere in the Budget. Legislation enacted in 2007, such as the Small Business and Work Opportunity Tax Act of 2007 and the Mortgage Forgiveness Debt Relief Act of 2007, expanded the scope of a number of provisions.

Provisions extended or expanded by the Small Business and Work Opportunity Tax Act include:

- enhanced and extended expensing
- enhanced and extended expensing for property used in highly damaged Gulf Opportunity (GO) Zone areas
- eased tax-exempt qualified mortgage bond treatment for rehabilitating GO Zone residences
- eased low-income housing credit rules for buildings in the GO Zones

Provisions in the Mortgage Forgiveness Debt Relief Act include:

- exclude discharges of principal residence acquisition indebtedness from gross income
- extension of deduction for private mortgage insurance as deductible qualified interest for three years
- exclusion from income for benefits provided to volunteer Emergency Medical Services (EMS) and firefighters

Other changes also introduced in 2007 are not listed as they have small revenue consequences.

Chapter 17 on Federal Receipts has more detailed descriptions of the provisions of these three bills.

National Defense

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

International Affairs

2. ***Income earned abroad.***—U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement may exclude up to $80,000 in foreign earned income from U.S. taxes. In addition, if these taxpayers receive a specific allowance for foreign housing from their employers, then they may also exclude the value of that allowance. If they do not receive a specific allowance for housing expenses, they may deduct against their U.S. taxes that portion of such expenses that exceeds one-sixth the salary of a civil servant at grade GS-14, step 1 ($79,115 in 2007).

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

4. ***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.***—Certain active income of foreign corporations controlled by U.S. shareholders is not subject to U.S. taxation when it is earned. The income becomes taxable only when the controlling U.S. shareholders receive dividends or other distributions from their foreign stockholding. Under the normal tax method, the currently attributable foreign source pre-tax income from such a controlling interest is considered to be subject to U.S. taxation, whether or not distributed. Thus, the normal tax method considers the amount of controlled foreign corporation income not yet 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. Taxes on income earned through December 31, 2006 can be deferred.

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 is 20 percent of qualified research expenditures in excess of a base amount. The base amount is generally determined by multiplying a "fixed-base percentage" by the average amount of the company's gross receipts for the prior four years. The taxpayer's fixed base percentage generally is the ratio of its research expenses to gross receipts for 1984 through 1988. Taxpayers may also elect an alternative incremental credit regime. Under the alternative incremental credit regime the taxpayer is assigned a three-tiered fixed-base percentage that is lower than the fixed-base percentage that would otherwise apply, and the credit rate is reduced (the rates range from 2.65 percent to 3.75 percent). Beginning in 2007, the rates for the alternative incremental credit increases to a range of 3 percent to 5 percent. An alternative simplified credit is also allowed which is equal to 12 percent of qualified research expenses that exceed 50 percent of the average qualified research expenses for the three preceding taxable years. A 20-percent credit with a separate threshold is provided for a taxpayer's payments to universities for basic research. A 20-percent "flat" credit with no threshold base amount is available for energy research expenditures paid to certain research consortia. The credit applies to research conducted before January 1, 2008 and extends to research conducted in Puerto Rico and the U.S. possessions.

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.

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 credit of $3 per oil-equivalent barrel of production (in 1979 dollars) is provided for gas produced from biomass and liquid, gaseous, or solid synthetic fuels produced from coal. The credit is generally available if the price of oil stays below $29.50 (in 1979 dollars). The credit applies only to fuel (1) produced at a facility placed in service before July 1, 1998, and (2) sold before January 1, 2008. A credit is also available for the production of coke or coke gas from a qualified facility. Qualified facilities must have been placed in service before January 1, 1993, or after June 30, 1998, and before January 1, 2010.

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 taxexempt. These bonds are generally subject to the State private-activity bond annual volume cap.

15. ***New technology, refined coal, and Indian coal credits.***—A credit is provided equal to 10 percent of the basis of solar energy property (30 percent for purchases beginning in 2006 through 2008) and 10 percent of the basis of geothermal energy property placed in service during the taxable year. A credit is also available for certain electricity produced from wind energy, biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, or qualified hydropower and sold to an unrelated party. The credit rate in 2007 is 2.0 cents per kilowatt hour (1.0 cents per kilowatt hour for open-loop biomass, small irrigation power, municipal solid waste and qualified hydropower) and the rate is indexed in subsequent years. Another credit is available for refined coal. The credit rate in 2007 is $5.877 per ton and the rate is indexed in subsequent years. An additional credit is available for the production of Indian coal. The value of the credit is $1.544 per ton in 2007 and indexed for inflation in subsequent years.

16. ***Alcohol fuel credits.***—An income tax credit is provided for ethanol that is derived from renewable sources and used as fuel. The credit equals 51 cents per gallon through 2010. In lieu of the alcohol mixture credit, the taxpayer may claim a refundable excise tax credit. In addition, small ethanol producers are eligible for a separate 10 cents per gallon credit.

17. ***Bio-Diesel tax credit.***—An income tax credit of $0.50, similar to Ethanol benefits, is available for each gallon of biodiesel used or sold. Biodiesel derived from virgin sources (agri-biodiesel) receives an increased credit of $1.00 per gallon. The Energy Tax Incentives Act of 2005 extends the income tax credit, excise tax credit, and payment provisions through December 31, 2008 and adds a credit for small agri-biodiesel producers. The conference agreement also creates a similar income tax credit, excise tax credit and payment system for renewable diesel, however there is no credit for small producers of renewable diesel. Renewable diesel means diesel fuel derived form biomass using thermal depolymerization process.

18. ***Credit and deduction for clean-fuel vehicles and property and alternative motor vehicle credits.***—A tax credit of 10 percent (not to exceed $4,000) is provided for purchasers of electric vehicles. The credit is reduced by 75 percent for vehicles placed in service in 2006 and is not available for vehicles placed in service after December 31, 2006. No deduction is available to taxpayers for vehicles placed in service after December 31, 2005. The deduction for clean-fuel property is available for costs incurred before January 1, 2007. A taxpayer may claim a 30 percent credit for the cost of installing clean-fuel vehicle refueling property for property placed in service after December 31, 2005 and before January 1, 2008. The taxpayer may not claim deductions with respect to property for which the credit is claimed. A tax credit is also available for the purchase of hybrid vehicles, fuel cell vehicles, alternative fuel vehicles and advanced lean burn vehicles. The provision applies to vehicles placed in service after December 31, 2005, in the case of qualified fuel cell motor vehicles, before January 1, 2015; in the case of qualified hybrid motor vehicles that are automobiles and light trucks and in the case of advanced lean-burn technology vehicles, before January 1, 2011; in the case of qualified hybrid motor vehicles that are medium and heavy trucks, before January 1, 2010; and in the case of qualified alternative fuel motor vehicles, before January 1, 2011. The credit ranges from $250 to $40,000 per vehicle depending upon the vehicle's energy efficiency, weight and other characteristics. The number of hybrid and lean burn vehicles eligible for the credit phases out when a manufacturer has sold 60,000 vehicles.

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

20. ***Credit to holders of clean renewable energy bonds.***—This provision provides for up to $1.2 billion in aggregate issuance of Clean Renewable Energy Bonds (CREBs) through December 31, 2008. Taxpayers

holding CREBs on a credit allowance date are entitled to a tax credit in lieu of interest.

21. ***Deferral of gain from dispositions of transmission property to implement FERC restructuring policy.***—Utilities that sell their transmission assets to a FERC-approved independent transmission company are allowed a longer recognition period for their gains from sale. Rather than paying tax on any gain from the sale in the year that the sale is completed, utilities will have 8 years to pay the tax on any gain from the sale. The rule expires at the end of 2007.

22. ***Credit for investment in clean coal facilities.***—Three investment tax credits for clean coal facilities are available: a 15 percent and 20 percent investment tax credit for clean coal facilities producing electricity; and a 20 percent credit for industrial gasification projects. Integrated gasification combined cycle (IGCC) projects get a 20 percent investment tax credit and other advanced coal-based projects that produce electricity get a 15 percent credit. The Secretary of the Treasury may allocate up to $800 million for IGCC projects and up to $500 million for other advanced coal-based technologies and up to $350 million for industrial gasification. These credits are effective for investments made after August 8, 2005.

23. ***Temporary 50 percent expensing for equipment used in the refining of liquid fuels.***—Taxpayers may expense 50 percent of the cost of refinery investments which increase the capacity of an existing refinery by at least 5 percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil from shale and tar sands. Investments must be placed in service before January 1, 2012.

24. ***Natural gas distribution pipelines treated as 15-year property.***—The depreciation period is shortened to 15 years for any gas distribution lines the original use of which occurred after April 11, 2004 and before January 1, 2011. The provision does not apply to any property which the taxpayer or a related party had entered into a binding contract for the construction thereof or self-constructed on or before April 11, 2005.

25. ***Amortize all geological and geophysical expenditures over 2 years.***—Geological and geophysical amounts incurred in connection with oil and gas exploration in the United States may be amortized over two years for non-integrated oil companies and seven years for certain major integrated oil companies. In the case of abandoned property, any remaining basis may no longer be recovered in the year of abandonment of a property as all basis is recovered over the two-year amortization period.

26. ***Allowance of deduction for certain energy efficient commercial building property.***—A deduction for energy efficient commercial buildings that reduce annual energy and power consumption by 50 percent compared to the American Society of Heating, Refrigerating, and Air Conditioning Engineers (ASHRAE) standard is allowed. The deduction generally is limited to $1.80 per square foot. The provision is effective for property placed in service after December 31, 2005 and prior to January 1, 2008.

27. ***Credit for construction of new energy efficient homes.***—A credit is available to eligible contractors for construction of a qualified new energy-efficient home. The maximum credit is $2,000. The credit applies to homes whose construction is substantially completed after December 31, 2005 and which are purchased after December 31, 2005 and prior to January 1, 2009.

28. ***Credit for energy efficiency improvements to existing homes.***—A 10 percent investment tax credit up to a maximum credit of $500 per dwelling is available for expenditures on insulation, exterior windows and doors that improve the energy efficiency of homes and meet certain standards. Credits for purchases of advanced main air circulating fans, natural gas, propane, or oil furnaces or hot water boilers, and other qualified energy efficient property are also available. Credit applies to property placed in service after December 31, 2005 and prior to January 1, 2009.

29. ***Credit for energy efficient appliances.***—Tax credits for the manufacture of efficient dishwashers, clothes washers, and refrigerators are available. Credits vary depending on the efficiency of the unit. The provision is effective for appliances manufactured in 2006 and 2007.

30. ***Credit for residential purchases/installations of solar and fuel cell property.***—A credit, equal to 30 percent of qualifying expenditures, for purchase for qualified photovoltaic property and solar water heating property is available. The maximum credit for each of these types of property is $2,000 per tax year. A 30 percent credit for the purchase of qualified fuel cell power plants up to $500 for each 0.5 kilowatt of capacity is also allowed. The credit applies to property placed in service after December 31, 2005 and prior to January 1, 2009.

31. ***Credit for business installation of qualified fuel cells and stationary microturbine power plants.***—A 30 percent business energy credit for purchase of qualified fuel cell power plants for businesses (up to $500 for each 0.5 kilowatt of capacity) and a 10 percent credit for purchase of qualifying stationary microturbine power plants (up to a maximum of $200 for each kilowatt of capacity) are allowed. The credit applies to property placed in service prior to January 1, 2009.

32. ***Expensing for advanced mine safety equipment.***—The cost of qualified mine safety equipment may be expensed rather than recovered through depreciation (subject to certain limitations). Provision limited to property placed in service on or before December 31, 2008.

Natural Resources and Environment

33. ***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.

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

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

36. ***Capital gains treatment of certain timber.***—Certain timber sales can be treated as a capital gain rather than ordinary income.

37. ***Expensing multi-period 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.

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

39. ***Expensing of capital costs with respect to complying with EPA sulfur regulations.***—Small refiners are allowed to deduct 75 percent of qualified capital costs incurred by the taxpayer during the taxable year.

40. ***Exclusion of gain or loss on sale or exchange of certain brownfield sites.***—In general, an organization that is otherwise exempt from federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purpose. The AJCA of 2004 created a special exclusion from unrelated business taxable income of the gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. In order to qualify, a minimum amount of remediation expenditures must be incurred by the organization.

Agriculture

41. ***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.

42. ***Expensing multi-period 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.

43. ***Loans forgiven solvent farmers.***—Farmers are forgiven the tax liability on certain forgiven debt. Normally, debtors must include the amount of loan forgiveness as income or reduce their recoverable basis in the property to which the loan relates. If the debtor elects to reduce basis and the amount of forgiveness exceeds the basis in the property, the excess forgiveness is taxable. For insolvent (bankrupt) debtors, however, the amount of loan forgiveness reduces carryover losses, then unused credits, and then basis; any remainder of the forgiven debt is excluded from tax. Farmers with forgiven debt are considered insolvent for tax purposes, and thus qualify for income tax forgiveness.

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

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

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

Commerce and Housing

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

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

48. ***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.

49. ***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.

50. ***Small property and casualty insurance companies.***—For taxable years beginning before January 1, 2004, insurance companies that were not life insur-

ance companies and which had annual net premiums of less than $350,000 were exempt from tax; those with $350,000 to $1.2 million of annual net premiums could elect to pay tax only on the income earned by their taxable investment portfolio. For taxable years beginning after December 31, 2003, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed $600,00 and more than 50 percent of such gross receipts consists of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed $150,000 and more than 35 percent of gross receipts consist of premiums. Also, for taxable years beginning after December 31, 2003, non-life insurance companies with no more than $1.2 million of annual net premiums may elect to pay tax only on their taxable investment income.

51. ***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.

52. ***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.

53. ***Exclusion of interest spread of financial institutions.***—Consumers and non-profit organizations pay for some deposit-linked services, such as check cashing, by accepting a below-market interest rate on their demand deposits. If they received a market rate of interest on those deposits and paid explicit fees for the associated services, they would pay taxes on the full market rate and (unlike businesses) could not deduct the fees. The government thus foregoes tax on the difference between the risk-free market interest rate and below-market interest rates on demand deposits, which under competitive conditions should equal the value added of deposit services.

54. ***Mortgage housing bonds.***—Interest earned on State and local bonds used to finance homes purchased by first-time, low-to-moderate-income buyers is tax-exempt. The amount of State and local tax-exempt bonds that can be issued to finance these and other private activity is limited. The combined volume cap for private activity bonds, including mortgage housing bonds, rental housing bonds, student loan bonds, and industrial development bonds was $62.50 per capita ($187.5 million minimum) per State in 2001, and $75 per capita ($225 million minimum) in 2002. The Community Renewal Tax Relief Act of 2000 accelerated the scheduled increase in the state volume cap and indexed the cap for inflation, beginning in 2003. States may issue mortgage credit certificates (MCCs) in lieu of mortgage revenue bonds. MCCs entitle home buyers to income tax credits for a specified percentage of interest on qualified mortgages. The total amount of MCCs issued by a State cannot exceed 25 percent of its annual ceiling for mortgage-revenue bonds.

55. ***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.

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

57. ***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.

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

59. ***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.

60. ***Imputed net rental income on owner-occupied housing.***—The implicit rental value of home ownership, net of expenses such as mortgage interest and depreciation, is excluded from income. Appendix A provides a fuller explanation of this new addition to the tax expenditure budget.

61. ***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.

62. ***Low-income housing credit.***—Taxpayers who invest in certain low-income housing are eligible for a tax credit. The credit rate is set so that the present value of the credit is equal to 70 percent for new construction and 30 percent for (1) housing receiving other Federal benefits (such as tax-exempt bond financing), or (2) substantially rehabilitated existing housing. The credit is allowed in equal amounts over 10 years. State agencies determine who receives the credit; States are limited in the amount of credit they may authorize annually. The Community Renewal Tax Relief Act of 2000 increased the per-resident limit to $1.50 in 2001 and to $1.75 in 2002 and indexed the limit for inflation, beginning in 2003. The Act also created a $2 million minimum annual cap for small States beginning in 2002; the cap is indexed for inflation, beginning in 2003.

63. ***Accelerated depreciation of rental property.***— The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under the reference method. Under the normal tax method, however, economic depreciation is assumed. This calculation is described in more detail in Appendix A.

64. ***Discharge of mortgage indebtedness.***—This provision excludes from the income of a taxpayer any discharge of indebtedness of a qualified principal residence. Provision sunsets on December 31, 2009.

65. ***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.

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

67. ***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. Under the revised reference law baseline used for the 2005 Budget, the lower rate on capital gains is considered a tax expenditure under the reference law method, but only for capital gains that have not been previously taxed under the corporate income tax. As discussed above, this treatment partially adjusts for the double tax on corporate income and is more consistent with a comprehensive income tax base.

The Jobs Growth Tax Relief Reconciliation Act (JGTRRA) lowered the top tax rate on capital gains from 20 percent to 15 percent, which is effective through 2010. For taxpayers in the 15 percent or below ordinary tax bracket, JGTRRA lowered the tax rate on capital gains to 5 percent (0 percent in 2008). These lower rates apply to assets held for more than one year.

Previously, for assets acquired after December 31, 2000, the top capital gains tax rate for assets held for more than 5 years was 18 percent. Since January 1, 2001, taxpayers may mark-to-market existing assets to start the 5-year holding period. Losses from the mark-to-market are not recognized. For assets held for more than 1 year by taxpayers in the 15-percent ordinary tax bracket, the top capital gains tax rate was 10 percent. After December 31, 2000, the top capital gains tax rate for assets held by these taxpayers for more than 5 years was 8 percent.

68. ***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.

69. ***Step-up in basis of capital gains at death.***— Capital gains on assets held at the owner's death are not subject to capital gains taxes. The cost basis of the appreciated assets is adjusted upward to the market value at the owner's date of death. After repeal of the estate tax for 2010 under the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, the basis for property acquired from a decedent will be the lesser of fair market value or the decedent's basis. Certain types of additions to basis will be allowed so that assets in most estates that are not currently subject to estate tax will not be subject to capital gains tax in the hands of the heirs.

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

71. ***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.

72. ***Accelerated depreciation of non-rental-housing buildings.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under normal law, however, economic depreciation is assumed. This calculation is described in more detail in Appendix A.

73. ***Accelerated depreciation of machinery and equipment.***—The tax depreciation allowance provisions are part of the reference law rules, and thus do not give rise to tax expenditures under reference law. Under the normal tax baseline, this tax depreciation allowance is measured relative to economic depreciation. This calculation is described in more detail in Appendix A.

74. ***Expensing of certain small investments.***—As of 2003, under prior law, qualifying investments in tangible property up to $25,000 could have been expensed rather than depreciated over time. The amount eligible for expensing was decreased to the extent the taxpayer's qualifying investment during the year exceeded $200,000. For 2003, however, the expensing limit was temporarily increased to $100,000, the phase-out limit was temporarily increased to $400,000, and computer software became temporarily eligible for expensing treatment. For 2004 through 2009, these higher limits are indexed for inflation, and computer software continues to be an eligible investment. In all years, the amount expensed cannot exceed the taxpayer's taxable income for the year. The prior rules will apply for taxable years beginning after 2009.

75. ***Graduated corporation income tax rate schedule.***—The corporate income tax schedule is graduated, with rates of 15 percent on the first $50,000 of taxable income, 25 percent on the next $25,000, and 34 percent on the next $9.925 million. Compared with a flat 34-percent rate, the lower rates provide an $11,750 reduction in tax liability for corporations with taxable income of $75,000. This benefit is recaptured for corporations with taxable incomes exceeding $100,000 by a 5-percent additional tax on corporate incomes in excess of $100,000 but less than $335,000.

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

76. ***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.

77. ***Deduction for U.S. production activities.***—This provision was introduced by the AJCA in 2004 and allows for a deduction equal to a portion of taxable income attributable to domestic production. For taxable years beginning in 2004, 2005, 2006, 2007, and 2008, the amount of the deduction is 5, 5, 5, 6, and 7 percent, respectively. For taxable years beginning after 2008, the amount of the deduction is 9 percent.

78. ***Special rules for certain film and TV production.***—Taxpayers may deduct up to $15 million ($15 million in certain distressed areas) per production expenditures in the year incurred. Excess expenditures may be deducted over three years using the straight line method. This provision was introduced by the AJCA enacted in 2004. Under prior law, production expenses were depreciated.

Transportation

79. ***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.

80. ***Exclusion of employee parking expenses.***—Employee parking expenses that are paid for by the employer or that are received in lieu of wages are excludable from the income of the employee. In 2007, the maximum amount of the parking exclusion is $215 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

81. ***Exclusion of employee transit pass expenses.***—Transit passes, tokens, fare cards, and vanpool expenses paid for by an employer or provided in lieu of wages to defray an employee's commuting costs are excludable from the employee's income. In 2007, the maximum amount of the exclusion is $110 (indexed) per month.

82. ***Tax credit for certain expenditures for maintaining railroad tracks.***—Eligible taxpayers may claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of $3,500 and the number of miles of track owned or leased.

83. ***Exclusion of interest on bonds for Financing of Highway Projects and Rail-Truck Transfer Facilities.***—This provision provides for $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities. The authority to issue these bonds expires on December 31, 2015.

Community and Regional Development

84. ***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.

85. ***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.

86. ***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.

87. ***Empowerment zones and renewal communities.***—Qualifying businesses in designated economically depressed areas can receive tax benefits such as an employer wage credit, increased expensing of investment in equipment, special tax-exempt financing, accelerated depreciation, and certain capital gains incentives. Empowerment zone and renewal community designations expire at the end of 2009. The Job Creation and Worker Assistance Act of 2002 expanded the existing provisions by adding the "New York City Liberty Zone." In addition, the Working Families Tax Relief Act of 2004 extended the District of Columbia Enterprise Zone and the District of Columbia first time homebuyer credit by two years through 2007.

The Gulf Opportunity Zone Act of 2005 added several provisions targeted to encourage the redevelopment of areas affected by hurricanes Katrina, Rita and Wilma, including some provisions that have already been listed elsewhere in this table. Gulf Opportunity Zone Act provisions not listed elsewhere include additional tax-exempt bond financing authority, accelerated depreciation of investment in both structures and equipment, partial expensing for certain demolition and clean-up costs, increased carryback of certain net operating losses, increased authority to allocate low-income housing tax credits and new markets tax credits within the affected areas and other provisions.

88. ***New markets tax credit.***—Taxpayers who make qualified equity investments in a community development entity (CDE), which then makes qualified investments in low-income communities, are eligible for a tax credit received over 7 years. The amount of the credit equals (1) 5 percent in the year of purchase and the following 2 years, and (2) 6 percent in the following 4 years. A CDE is any domestic firm the primary mission of which is to serve or provide investment capital for low-income communities/individuals; a CDE must be accountable to residents of low-income communities. The total equity investment available for the credit across all CDEs is $1.0 billion in 2001, $1.5 billion in 2002 and 2003, $2.0 billion in 2004 and 2005, and $3.5 billion in 2006 and 2008. Credit authority is allocated to CDEs through a competitive application process.

89. ***Expensing of environmental remediation costs.***—Taxpayers who clean up certain hazardous substances at a qualified site may expense the clean-up costs, even though the expenses will generally increase the value of the property significantly or appreciably prolong the life of the property. The Working Families Tax Relief Act of 2004 extended this provision for two years, allowing remediation expenditures incurred before December 31, 2007 to be eligible for expensing.

90. ***Credit to holders of Gulf Tax Credit Bonds.***—Taxpayers that own Gulf Tax Credit bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. The maximum amount that can be issued is $200 million in the case of Louisiana, $100 million in the case of Mississippi, and $50 million in the case of Alabama.

Education, Training, Employment, and Social Services

91. ***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).

92. ***HOPE tax credit.***—The non-refundable HOPE tax credit allows a credit for 100 percent of an eligible student's first $1,100 of tuition and fees and 50 percent of the next $1,100 of tuition and fees. The credit only covers tuition and fees paid during the first two years of a student's post-secondary education. In 2007, the credit is phased out ratably for taxpayers with modified AGI between $94,000 and $114,000 ($47,000 and $57,000 for singles), indexed.

93. ***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, up to a maximum credit per return is $2,000. The credit is phased out ratably for taxpayers with modified AGI between $90,000 and $110,000 ($47,000 and $57,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

94. ***Education Individual Retirement Accounts.***—Contributions to an education IRA are not tax-deductible. Investment income earned by education IRAs is not taxed when earned, and investment income from an education IRA is tax-exempt when withdrawn to pay for a student's tuition and fees. The maximum contribution to an education IRA in 2007 is $2000 per beneficiary. The maximum contribution is phased down

ratably for taxpayers with modified AGI between $190,000 and $220,000 ($95,000 and $110,000 for singles).

95. ***Student-loan interest.***—Taxpayers may claim an above-the-line deduction of up to $2,500 on interest paid on an education loan. Interest may only be deducted for the first five years in which interest payments are required. In 2007, the maximum deduction is phased down ratably for taxpayers with modified AGI between $110,000 and $140,000 ($55,000 and $70,000 for singles), indexed.

96. ***Deduction for Higher Education Expenses.***—The maximum annual deduction for qualified higher education expenses is $4,000 in 2007 for taxpayers with adjusted gross income up to $130,000 on a joint return ($65,000 for singles). Taxpayers with adjusted gross income up to $160,000 on a joint return ($80,000 for singles) may deduct up to $2,000 beginning in 2004. No deduction is allowed for expenses paid after December 31, 2007.

97. ***State prepaid tuition plans.***—Some States have adopted prepaid tuition plans and prepaid room and board plans, which allow persons to pay in advance for college expenses for designated beneficiaries. In 2001 taxes on the earnings from these plans are paid by the beneficiaries and are deferred until tuition is actually paid. Beginning in 2002, investment income is not taxed when earned, and is tax-exempt when withdrawn to pay for qualified expenses.

98. ***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.

99. ***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.

100. ***Credit for holders of zone academy bonds.***—Financial institutions that own zone academy bonds receive a non-refundable tax credit (at a rate set by the Treasury Department) rather than interest. The credit is included in gross income. Proceeds from zone academy bonds may only be used to renovate, but not construct, qualifying schools and for certain other school purposes. The total amount of zone academy bonds that may be issued is limited to $1.6 billion—$400 million in each year from 1998 to 2007.

101. ***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 $98,400 and $128,400 ($65,600 and $80,600 for singles) in 2007.

102. ***Dependent students age 19 or older.***—Taxpayers may claim personal exemptions for dependent children who are over the age of 18 or under the age of 24 and who (1) reside with the taxpayer for over half the year (with exceptions for temporary absences from home, such as for school attendance), (2) are full-time students, and (3) do not claim a personal exemption on their own tax returns.

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

104. ***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.

105. ***Special deduction for teacher expenses.***—Educators in both public and private elementary and secondary schools, who work at least 900 hours during a school year as a teacher, instructor, counselor, principal or aide, may subtract up to $250 of qualified expenses when figuring their adjusted gross income (AGI). Provision expires at end of December 31, 2007.

106. ***Discharge of student loan indebtedness.***—Certain professionals who perform in underserved areas, and as a consequence get their student loans discharged, may not recognize such discharge as income.

106. ***Work opportunity tax credit.***— Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before August 31, 2011 and who are certified as members of various targeted groups. The amount of the credit that can be claimed is 25 percent of qualified wages for employment less than 400 hours and 40 percent for employment of 400 hours or more. The maximum credit per employee is generally $2,400 and can only be claimed on the first year of wages an individual earns from an employer. Employees must work at least 120 hours to be eligible for the credit. Employers must reduce their deduction for wages paid by the amount of the credit claimed. The Katrina Emergency Tax Relief Act of 2005 expanded WOTC eligibility to Hurricane Katrina Employees, defined as persons whose principal places of abode on August 28, 2005 were in the core disaster area and who beginning on such date and through August 28, 2007 are hired for a position principally located in the core disaster area; and beginning on such date and through December 31, 2005, are hired for a position regardless of its location. The usual certification process rules are waived for Hurricane Katrina employees. The Tax Relief and Health Care Act of 2006 modified the Work opportunity tax credit by changing definitions of the Food Stamp and Ex-Convict target groups and adding persons eligible for the Welfare-to-work credit as a new WOTC target group with a $10,000 ceiling on qualified first year wages and a 50 percent credit on qualified second year wages up to $10,000. The 2006

Act extended credits to qualified employees of WOTC target groups as defined by the 2006 Act hired through December 31, 2007 . The Small Business and Work Opportunity Act of 2007 expanded WOTC's Vocational Rehabilitation and Zone target groups and made WOTC credits useable against both the regular and AMT taxes. Specifically the Act authorized enhanced WOTC credits of up to $4,800 for qualified Veterans with service connected disabilities and increased the qualifying age limit for the Enterprise Zone/Enterprise Community/Renewal Community target group from 18–24 to 18–39. The 2007 Act extended credits to qualified employees of WOTC target groups as defined by the 2007 Act hired through August 31, 2011.

108. ***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. Employees must work at least 400 hours to be eligible for the credit. The maximum credit is $8,500 per employee. The credit applies to wages paid to employees who are hired on or before December 31, 2006. The Tax Relief and Health Care Act of 2006 modified the Welfare to Work credit by making qualified long-term family assistance recipients a WOTC target group after December 31, 2007.

109. ***Employer-provided child care exclusion.***—Up to $5,000 of employer-provided child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

110. ***Employer-provided child care credit.***—The credit is equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. Employer deductions for such expenses are reduced by the amount of the credit. The maximum total credit is limited to $150,000 per taxable year.

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

112. ***Adoption credit and exclusion.***—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $11,390per child for 2007, and is phased-out ratably for taxpayers with modified AGI between $170,820 and $210,820. The credit amounts and the phase-out thresholds are indexed for inflation beginning in 2003. Unused credits may be carried forward and used during the five subsequent years. Taxpayers may also exclude qualified adoption expenses from income, subject to the same maximum amounts and phase-out as the credit. The same expenses cannot qualify for tax benefits under both programs; however, a taxpayer may use the benefits of the exclusion and the tax credit for different expenses. Stepchild adoptions are not eligible for either benefit.

113. ***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.

114. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $1,000 partially refundable per child credit. The maximum credit declines to $500 in 2011 and later years. The credit is phased out for taxpayers at the rate of $50 per $1,000 of modified AGI above $110,000 ($75,000 for singles).

115. ***Child and dependent care expenses.***—Married couples with child and dependent care expenses may claim a tax credit when one spouse works full time and the other works at least part time or goes to school. The credit may also be claimed by single parents and by divorced or separated parents who have custody of children. In 2007, expenditures up to a maximum $3,000 for one dependent and $6,000 for two or more dependents are eligible for the credit. The credit is equal to 35 percent of qualified expenditures for taxpayers with incomes of $15,000. The credit is reduced to a minimum of 20 percent by one percentage point for each $2,000 of income in excess of $15,000.

116. ***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.

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

118. ***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.

119. ***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.

120. ***Provide an employee retention credit to employers affected by hurricane Katrina, Rita, and Wilma.***—Businesses located within the Gulf Opportunity (GO) Zone on August 28, 2005 are eligible for a 40 percent tax credit on the first $6,000 in qualified wages paid to qualified employees employed within the GO Zone. Qualified wages are those paid by an eligible employer to an eligible employee on any day after Au-

gust 28, 2005 and before January 1, 2006 during the period beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee by reason of hurricane Katrina and ending on the date on which such trade or business resumed significant operations at such principal place of employment. Similar rules apply to the Rita GO Zone and the Wilma GO Zone with initial effective dates of September 23, 2005, and October 23, 2005, respectively.

121. ***Exclusion for benefits provided to volunteer EMS and firefighters.***—Certain benefits received by volunteer EMS and firefighters excluded from income. This provision sunsets on December 31, 2010.

Health

122. ***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.

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

124. ***Medical and health savings accounts.***—Individual contributions to Archer Medical Savings Accounts (Archer MSAs) and Health Savings Accounts (HSAs) are allowed as a deduction in determining adjusted gross income whether or not the individual itemizes deductions. Employer contributions to Archer MSAs and HSAs are excluded from income and employment taxes. Archer MSAs and HSAs require that the individual have coverage by a qualifying high deductible health plan. Earnings from the accounts are excluded from taxable income. Distributions from the accounts used for medical expenses are not taxable. The rules for HSAs are generally more flexible than for Archer MSAs and the deductible contribution amounts are greater (in 2007, $2850 for taxpayers with individual coverage and $5,650 for taxpayers with family coverage). Thus, HSAs have largely replaced MSAs.

125. ***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.

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

127. ***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.

128. ***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.

129. ***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.

130. ***Tax credit for health insurance purchased by certain displaced and retired individuals.***—The Trade Act of 2002 provided a refundable tax credit of 65 percent for the purchase of health insurance coverage by individuals eligible for Trade Adjustment Assistance and certain PBGC pension recipients.

131. ***Distributions for premiums for health and long-term care insurance.***—This provision provides for tax-free distributions of up to $3,000 from governmental retirement plans for premiums for health and long term care premiums of public safety officers.

Income Security

132. ***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.

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

134. ***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.

135. ***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.

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

137. ***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.

138. ***401(k) plans.***—Individual taxpayers can make tax-preferred contributions to certain types of employer-provided 401(k) plans (and 401(k)-type plans like 403(b) plans and the Federal government's Thrift Savings Plan). In 2007, an employee could exclude up to $15,500

(indexed) of wages from AGI under a qualified arrangement with an employer's 401(k) plan. The tax on the investment income earned by 401(k)-type plans is deferred until withdrawn.

Employees are allowed to make after-tax contributions to 401(k) and 401(k)-type plans. These contributions are not excluded from AGI, but the investment income of such after-tax contributions is not taxed when earned or withdrawn.

139. ***Individual Retirement Accounts.***—Individual taxpayers can take advantage of several different Individual Retirement Accounts (IRAs): deductible IRAs, non-deductible IRAs, and Roth IRAs. The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit is $4,000 in 2006 and 2007, and $5,000 in 2008 (indexed thereafter) and allows taxpayers over age 50 to make additional "catch-up" contributions of $1,000.

Taxpayers whose AGI is below $83,000 ($62,000 for non-joint filers) in 2007 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $83,000 to $103,000 in 2007. Taxpayers whose AGI is above the phase-out range can also claim a deduction for their IRA contributions depending on whether they (or their spouse) are an active participant in an employer-provided retirement plan. The tax on the investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

Taxpayers with incomes below $166,000 ($114,000 for nonjoint filers) can make contributions to Roth IRAs. The maximum contribution to a Roth IRA is phased out for taxpayers with AGI between $156,000 and $166,000 ($99,000 and $114,000 for singles). Investment income of a Roth IRA is not taxed when earned nor when withdrawn. Withdrawals from a Roth IRA are penalty free if: (1) the Roth IRA was opened at least 5 years before the withdrawal, and (2) the taxpayer either (a) is at least 591/2, (b) dies, (c) is disabled, or (d) purchases a first-time house.

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

140. ***Low and moderate-income savers' credit.***—The Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to $2,000. This credit is in addition to any deduction or exclusion. The credit is completely phased out by $52,000 for joint filers and $26,000 for single filers.

141. ***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 $45,000 in 2007. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

142. ***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, but only to the extent that the employer's share of the total costs does not exceed the cost of $50,000 of such insurance.

143. ***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.

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

145. ***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.

146. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,300 standard deduction if single, or $1,050 if married in 2007.

147. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,300 standard deduction if single, or $1,050 if married in 2007.

148. ***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.

149. ***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.

150. ***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 $8,080 of earned income in 2007. The credit is 40 percent of the first $11,790 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $15,390 at the rate of 15.98 percent (21.06 percent if two or more qualifying children are present). It is completely phased out when the taxpayer's modified adjusted gross income reaches $33,241 ($37,783 if two or more qualifying children are present), $35,241 (or $39,783) for those married.

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 2007, the credit is 7.65 percent of the first $5,590 of earned income. When the taxpayer's income exceeds $7,000 (9,000 if married), the credit is phased out at the rate of 7.65 percent. It is completely phased out at $12,590 ($14,590 for married) of modified adjusted gross income.

For workers with or without children, the income levels at which the credit begins to phase-out and the maximum amounts of income on which the credit can be taken are adjusted for inflation. For married taxpayers filing a joint return, the base amount for the phase-out increases by $2,000 in 2006 through 2007, and $3,000 in 2008 (indexed thereafter).

Earned income tax credits in excess of tax liabilities owed through the individual income tax system are refundable to individuals. This portion of the credit is shown as an outlay, while the amount that offsets tax liabilities is shown as a tax expenditure.

151. ***Additional exemption for housing Hurricane Katrina displaced individuals.***—This provision, introduced by the Katrina Emergency Tax Relief Act of 2005, provides an additional exemption of $500 for each Hurricane Katrina displaced individual for whom the taxpayer is providing shelter in his or her home, for a maximum additional exemption amount is $2,000.

Social Security

152. ***Social Security benefits for retired workers.***—The non-taxation of Social Security benefits that exceed the beneficiary's contributions out of taxed income 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.

153. ***Social Security benefits for the disabled.***—Benefit payments from the Social Security Trust Fund for disability are partially excluded from a beneficiary's gross incomes.

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

Veterans Benefits and Services

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

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

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

158. ***Tax-exempt mortgage bonds for veteran.***—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

159. ***Public purpose State and local bonds.***—Interest earned on State and local government bonds issued to finance public-purpose construction (e.g., schools, roads, sewers), equipment acquisition, and other public purposes is tax-exempt. Interest on bonds issued by Indian tribal governments for essential governmental purposes is also tax-exempt.

160. ***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. The deductibility of state and local sales taxes is set to expire at the end of 2007.

Interest

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

Appendix A

TREASURY REVIEW OF THE TAX EXPENDITURE PRESENTATION

This appendix provides a presentation of the Treasury Department's continuing review of the tax expenditure budget. The review focuses on three issues: (1) using comprehensive income as a baseline tax system; (2) using a consumption tax as a baseline tax system; and (3) defining negative tax expenditures (provisions that cause taxpayers to pay too much tax).

The first section of this appendix compares major tax expenditures in the current budget to those implied by a comprehensive income baseline. This comparison includes a discussion of negative tax expenditures. The second section compares the major tax expenditures in the current budget to those implied by a consumption tax baseline, and also discusses negative tax expenditures. The final section addresses concerns that have been raised over the measurement of some current tax expenditures by describing new estimates of the tax expenditure caused by accelerated depreciation and by the tax exemption of the return earned on owner-occupied housing, and an alternative estimate of the tax expenditure for the preferential treatment of capital gains. The final section also provides an estimate of the negative tax expenditure caused by the double tax on corporate profits.

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND THOSE BASED ON COMPREHENSIVE INCOME

As discussed in the main body of the chapter, tax expenditures are measured relative to normal law or reference law baselines that deviate from a comprehensive concept of income. Consequently, tax expenditures identified in the Budget can differ from those that would be identified under a comprehensive income tax baseline. This appendix compares major tax expenditures listed in the tax expenditure budget with those implied by a comprehensive income baseline.

Current budgetary practice excludes from the list of tax expenditures those provisions that over-tax certain items of income because the original motivation for the analysis was to identify tax provisions that substitute for direct Government spending programs. However, this treatment gives a one-sided picture of how current law deviates from the baseline tax system. Relative to comprehensive income, a number of current tax provisions would be negative tax expenditures. Some of these also might be negative tax expenditures under the reference law or normal law baselines, expanded to admit negative tax expenditures.

Major Tax Expenditures from the Traditional Budget under a Comprehensive Income Tax Baseline

Comprehensive income, also called Haig-Simons income, is the real, inflation-adjusted accretion to one's economic power arising between two points in time, e.g., the beginning and ending of the year. It includes all accretions to wealth, whether or not realized, whether or not related to a market transaction, and whether a return to capital or labor. Inflation-adjusted capital gains (and losses) would be included in comprehensive income as they accrue. Business investment and casualty losses, including losses caused by depreciation, would be deducted. Implicit returns, such as those accruing to homeowners, also would be included in comprehensive income. A comprehensive income tax baseline would tax all sources of income once and only once. Thus, it would not levy a separate tax on corporate income leading to the double taxation of corporate profits.

Comprehensive income is widely held to be the idealized base for an income tax even though it is not a perfectly defined concept.[5] It suffers from conceptual ambiguities, some of which are discussed below, as well as practical problems in measurement and tax administration, e.g., how to implement a practicable deduction for economic depreciation or include in income the return earned on consumer durable goods such as housing, automobiles, and major appliances.

Furthermore, comprehensive income does not necessarily represent an ideal tax base; economic efficiency would be improved by deviating from comprehensive income as a tax base by reducing the tax on capital income to spur economic growth further or by subsidizing certain types of activities to correct for market failures. In addition, some elements of comprehensive income would be difficult or impossible to include in a tax system that is administrable.

Classifying individual tax provisions relative to a comprehensive income baseline is difficult in part because of the ambiguity of the baseline. It also is difficult because of interactions between tax provisions (or their absence). These interactions mean that it may not always be appropriate to consider each provision in isolation. Nonetheless, Appendix Table 1 attempts such a classification for each of thirty illustrative large tax expenditures from the Budget.

Table 1 classifies fifteen of the thirty items as tax expenditures under a comprehensive tax base (those in panel A). Most of these give preferential tax treatment to the return on certain types of savings or investment. They reflect the hybrid nature of the existing tax system and arise out of policy decisions to reduce the high tax rate on capital income that would otherwise arise. Even these relatively clear-cut items, how-

[5] See, e.g., David F. Bradford, Untangling the Income Tax (Cambridge, MA: Harvard University Press, 1986), pp. 15–31, and Richard Goode, "The Economic Definition of Income" in Joseph Pechman, ed., Comprehensive Income Taxation (Washington, D.C.: The Brookings Institution, 1977), pp. 1–29.

ever, can raise ambiguities in light of the absence of integration of the corporate and individual tax systems. For example, the reduction or elimination of individual level tax on income from investment in corporate equities might not be a tax expenditure relative to a comprehensive income baseline because the income is taxed first at the corporate level. A similar line of reasoning suggests that in the case of corporations, expensing[6] of R&E or accelerated depreciation are not tax expenditures because they offset the corporate tax penalty.

Because net rental income (gross rents minus depreciation, interest, taxes, and other expenses) would be in the homeowner's tax base under a comprehensive income tax baseline, this item would continue to be a tax expenditure relative to a comprehensive income baseline.

The exclusion of worker's compensation benefits also would be a tax expenditure under comprehensive income tax principles; if the worker were to buy the insurance himself, he would be able to deduct the premium (since it represents a reduction in net worth) but should include in income the benefits when paid (since it represents an increase in net worth).[7] If the employer pays the premium, the proper treatment would allow the employer a deduction and allow the employee to disregard the premium, but he would take any proceeds into income. Current law allows the employer to deduct the premium and excludes both the premium and the benefits from the employee's tax base.

Panel B displays items that probably are tax expenditures, but that raise additional issues. Current law, for instance, allows deductions for home mortgage interest and for property taxes on owner-occupied housing. The tax expenditure budget includes both of these provisions. A comprehensive tax base would allow both deductions, but it would also include imputed gross rental income. Current law does not include gross rental income, however, and so on this basis the home mortgage interest deduction and the deduction for property taxes on owner-occupied housing are properly tax expenditures under a comprehensive income tax base.[8] Indeed, the sum of the tax expenditure for these two deductions, plus the tax expenditure for the failure to include net rental income, sums to the tax expenditure for owner-occupied housing relative to a comprehensive income tax base.

The deduction of nonbusiness State and local taxes other than on owner-occupied homes also is included in Panel B. The justification for this tax expenditure is that 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.[9] The difficulty is that this presumes that one's consumption of State and local services relates directly to the amount of State and local taxes paid. Such a presumption is difficult to sustain when taxes are levied inconsistently across taxpayers.[10]

In contrast to the view in the official Budget, however, the deduction for State and local taxes might not be a tax expenditure if the baseline were comprehensive income. Properly measured comprehensive income would include the value of State and local government benefits received, but would allow a deduction for State and local taxes paid.[11] Thus, in this sense the deductibility of State and local taxes is consistent with comprehensive income tax principles; it should not be a tax expenditure. Nonetheless, imputing the value of State and local services is difficult and is not done under current law. Consequently, a deduction for taxes might sensibly be viewed as a (roughly measured) tax expenditure relative to a comprehensive income baseline.[12]

The comprehensive income tax base is an objective measure of income. Traditionally, this measure is modified to reflect a subjective or social economic policy concern regarding the financial ability of an individual to pay tax. Absent this modification, provisions such as the personal exemption and the child tax credit would be treated as tax expenditures. However, once the definition of income is modified to reflect the ability of an individual to pay tax, then these and similar provisions are typically dropped from the list of tax expenditures.

The step-up of basis at death lowers the tax on capital gains for those who inherit assets. From that perspective it would be a tax expenditure under a comprehensive income baseline. Nonetheless, there are ambiguities. Under a comprehensive income baseline, all inflation-adjusted gains would be taxed as accrued, so there would be no deferred unrealized gains on assets held at death.

The partial exclusion of Social Security benefits from tax is also listed in panel B. To the extent Social Security is viewed as a pension, comprehensive income would include all contributions to Social Security retirement funds (payroll taxes) and tax accretions to value as they arise.[13] Benefits paid out of contributions and the inside build-up in value, however, would not be

[6] Expensing means immediate deduction. Proper income tax treatment requires capitalization followed by annual depreciation allowances reflecting the decay in value of the associated R&E spending.

[7] Suppose a taxpayer buys a one year term unemployment insurance policy at the beginning of the year. At that time he exchanges one asset, cash, for another, the insurance policy, so there is no change in net worth. But, at the end of the year, the policy expires and so is worthless, hence the taxpayer has a reduction in net worth equal to the premium. If the policy pays off during the year (i.e., the taxpayer has a work related injury), then the taxpayer would include the proceeds in income because they represent an increase in his net worth.

[8] If there were no deduction for interest and property taxes, the tax expenditure base (i.e., the proper tax base minus the actual tax base) for owner-occupied housing would equal the homeowner's net rental income: gross rents minus(depreciation+interest+property taxes+other expenses). With the deduction for interest and property taxes, the tax expenditure base rises to gross rents minus (depreciation+other expenses).

[9] Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

[10] Property taxes on owner-occupied housing also might serve as a proxy for the value of untaxed local services provided to homeowners. As such, they would be listed in the tax expenditure budget (as configured, i.e., building on the estimate for the failure to tax net rents) twice, once because current law does not tax rental income and again as a proxy for government services received. Property taxes on other consumer durables such as automobiles also might be included twice, owing to current law's exclusion from income of the associated service flow.

[11] U.S. Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[12] Under the normal tax method employed by the Joint Committee on Taxation, the value of some public assistance benefits provided by State Governments is included as a tax expenditure, thereby raising a potential double counting issue.

[13] As a practical matter, this may be impossible to do. Valuing claims subject to future contingencies is very difficult, as discussed in Bradford, Untangling the Income Tax, pp. 23–24.

included because the fall in the value of the individual's Social Security account would be offset by an increase in cash. In contrast, to the extent that Social Security is viewed as a transfer program, all contributions should be deductible from income and all benefits received should be included.

In contrast to any of these treatments, current law excludes one-half of Social Security contributions (employer-paid payroll taxes) from the base of the income tax, makes no attempt to tax accretions, and subjects some, but not all, benefits to taxation. The difference between current law's treatment of Social Security benefits and their treatment under a comprehensive income tax would qualify as a tax expenditure, but such a tax expenditure differs in concept from that included in the official Budget.

The tax expenditures in the official Budget[14] reflect exemptions for lower-income beneficiaries from the tax on 85 percent of Social Security benefits.[15] Historically, payroll taxes paid by the employee represented no more than 15 percent of the expected value of the retirement benefits received by a lower-earning Social Security beneficiary. The 85 percent inclusion rate is intended to tax upon distribution the remaining amount of the retirement benefit payment—the portion arising from the payroll tax contributions made by employers and the implicit return on the employee and employer contributions. Thus, the tax expenditure conceived and measured in the current budget is not intended to capture the deviation from a comprehensive income baseline, which would additionally account for the deferral of tax on the employer's contributions and on the rate of return (less an inflation adjustment attributable to the employee's payroll tax contributions). Rather, it is intended to approximate the taxation of private pensions with employee contributions made from after-tax income.[16] Hence, the tax expenditure budget understates the tax advantage accorded Social Security retirement benefits relative to a comprehensive income baseline.

The deduction for U.S. production activities also raises problems. To the extent it is viewed as a tax break for certain qualifying businesses ("manufacturers"), it would be a tax expenditure. In contrast, the deduction may prove to be so broad that it is available to most U.S. businesses, in which case it might not be seen as a tax expenditure. Rather, it would then represent a feature of the baseline tax rate system because the deduction is equivalent to a lower tax rate. In addition, it might not be a tax expenditure to the extent it is viewed as providing relief from the double tax on corporate profits.

[14] This includes the tax expenditure for benefits paid to workers, that for benefits paid to survivors and dependents, and that for benefits paid to dependents.

[15] The current Budget does not include as a tax expenditure the absence of income taxation on the employer's contributions (payroll taxes) to Social Security retirement at the time these contributions are made.

[16] Private pensions allow the employee to defer tax on all inside build-up. They also allow the employee to defer tax on contributions made by the employer, but not on contributions made directly by the employee. Applying these tax rules to Social Security would require the employee to include in his taxable income benefits paid out of inside build-up and out of the employer's contributions, but would allow the employee to exclude from his taxable income benefits paid out of his own contributions.

The next category (panel C) includes items whose treatment is less certain. The proper treatment of some of these items under a comprehensive income tax is ambiguous, while others may serve as proxies for provisions that would be a tax expenditure under a comprehensive income base.[17]

For example, under existing law charitable contributions are deductible, and this deduction is considered on its face a tax expenditure in the current budget.[18] The treatment of charitable donations, however, is ambiguous under a comprehensive income tax. If charitable contributions are a consumption item for the giver, then they are properly included in his taxable income and a deduction for contributions would be a tax expenditure under a comprehensive income tax base. In contrast, charitable contributions could represent a transfer of purchasing power from the giver to the receiver. As such, they would represent a reduction in the giver's net worth, not an item of consumption, and so properly would be deductible, implying that the charitable deduction is not a tax expenditure. At the same time, however, the value of the charitable benefits received is income to the recipient. Under current law, such income is not taxed.[19]

Medical expenditures may or may not be an element of income. These expenditures may be viewed as a reduction of net worth (e.g. cost of earning income) rather than as discretionary spending, and so are not really consumption and should be excluded from the tax base. However, expenditures for medical care may be considered as indistinguishable from other consumption items which are not excluded from a comprehensive income base.

The exemption of full taxation of Social Security benefits paid to the disabled also raises issues. Social Security benefits for the disabled most closely resemble either Government transfers or insurance. From either perspective, a comprehensive income tax would require that the benefit be included in income and would allow a deduction for associated Social Security taxes. If viewed as insurance, an equivalent treatment would allow the taxpayer to include the premium (i.e., tax) and exclude the benefit. The deviation between either of these treatments and current law's treatment (described above) would be a tax expenditure under a comprehensive income baseline.

In contrast, as described above, the tax expenditure budget displays the benefit of exempting low-income beneficiaries from the tax on 85 percent of Social Security benefits. This measurement does not correspond closely to that required under a comprehensive income base. If the payment of the benefit is viewed as a transfer and divorced from the treatment of Social Security taxes, then the current tax expenditure understates the tax expenditure measured relative to a comprehensive

[17] See, for example, Goode, The Economic Definition of Income, pp. 16–17, and Bradford, Untangling the Income Tax, pp. 19–21, and pp.30–31.

[18] The item also includes gifts of appreciated property, at least part of which represents a tax expenditure relative to an ideal income tax, even if one assumes that charitable donations are not consumption.

[19] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates.

income baseline. If the payment of the benefit is viewed as a transfer but the inability to deduct the employee's share of the Social Security tax is simultaneously considered, then it is less likely that the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline, and in some cases it may generate a negative tax expenditure. If the benefit is viewed as insurance and the tax as a premium, then the current tax expenditure overstates the tax expenditure relative to a comprehensive income baseline. Indeed, in the insurance model, the ability to exclude from tax only half of the premium might suggest that half of the payout should be taxed, so that the current tax rules impose a greater tax burden than that implied by a comprehensive income tax, i.e., a negative tax expenditure.

The final category (panel D) includes items that would not be tax expenditures under a comprehensive income tax base. A tax based on comprehensive income would allow all losses to be deducted. Hence, the exception from the passive loss rules would not be a tax expenditure.[20]

Major Tax Expenditures under a Comprehensive Income Tax That Are Excluded from the Current Budget

While most of the major tax expenditures in the current budget also would be tax expenditures under a comprehensive income base, there also are tax expenditures relative to a comprehensive income base that are not found on the existing tax expenditure list. These additional tax expenditures include the imputed return from certain consumer durables (e.g., automobiles), the difference between capital gains (and losses) as they accrue and capital gains as they are realized, private gifts and inheritances received, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, the value of payouts from insurance policies,[21] and benefits received from private charities. Under some theories of comprehensive income, the value of leisure and of household production of goods and services also would be included as tax expenditures. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule. The foreign tax credit also might be a tax expenditure since a deduction for foreign taxes, rather than a credit, might measure the income of U.S. residents properly.

Negative Tax Expenditures

The passive loss rules, restrictions on the deductibility of capital losses, and net operating loss (NOL) carry-forward requirements each would generate a negative tax expenditure, since a comprehensive income tax would allow full deductibility of losses.

Human capital is generally considered a productive asset, and so its cost (e.g., certain education and training expenses, including perhaps the cost of college and professional school) should be amortizable under a comprehensive income tax, but it is not under current law.[22]

Some restricted deductions under the individual AMT might be negative tax expenditures as might the phase-out of personal exemptions and of itemized deductions. The inability to deduct consumer interest also might be a negative tax expenditure, as an interest deduction may be required to measure income properly, as seen by the equivalence between borrowing and reduced lending.[23] As discussed above, the current treatment of Social Security payments to the disabled also might represent a negative tax expenditure if viewed as payments on an insurance policy.

Current tax law also fails to index for inflation interest receipts, capital gains, depreciation, and inventories. This failure leads to negative tax expenditures because comprehensive income would be indexed for inflation. Current law, however, also fails to index for inflation the deduction for interest payments and so this represents a (positive) tax expenditure.

The issue of indexing also highlights that even if one wished to focus only on tax policies that are similar to spending programs, accounting for some negative tax expenditures may be required. For example, the net subsidy created by accelerated depreciation is properly measured by the difference between depreciation allowances specified under existing tax law and economic depreciation, which is indexed for inflation.[24]

DIFFERENCES BETWEEN OFFICIAL TAX EXPENDITURES AND TAX EXPENDITURES RELATIVE TO A CONSUMPTION TAX BASE

This section compares tax expenditures listed in the tax expenditure budget with those implied by a comprehensive consumption tax baseline. It first discusses some of the difficulties encountered in contemplating current tax provisions as part of a comprehensive consumption tax. Next, it assesses which of thirty large income tax expenditures would be tax expenditures under the consumption tax baseline, concluding that about half would remain under a consumption tax baseline. Most that fall off the list are incentives for saving and investment.

The section next discusses some major differences between current law and a comprehensive consumption tax baseline. These differences include the consumption

[20] In contrast, the passive loss rules themselves, which restrict the deduction of losses, would be a negative tax expenditure when compared to a comprehensive tax base.

[21] To the extent that premiums are deductible.

[22] Current law offers favorable treatment to some education costs, thereby creating (positive) tax expenditures. Current law allows expensing of that part of the cost of education and career training that is related to foregone earnings and this would be a tax expenditure under a comprehensive income baseline.

[23] See Bradford, Untangling the Income Tax, p. 41.

[24] Accelerated depreciation can be described as the equivalent of an interest free loan from the Government to the taxpayer. Under federal budget accounting principles, such a loan would be treated as an outlay equal to the present value of the foregone interest.

value of owner-occupied housing and other consumer durables, benefits from in-kind Government transfers, and gifts. It concludes with a discussion of negative tax expenditures relative to a consumption tax baseline.

Ambiguities in Determining Tax Expenditures Relative to a Consumption Baseline

A broad-based consumption tax can be viewed as a combination of an income tax plus a deduction for net saving. This follows from the definition of comprehensive income as consumption plus the change in net worth. It therefore seems straightforward to say that current law's deviations from a consumption base are the sum of (a) tax expenditures on an income base associated with exemptions and deductions for certain types of income, plus (b) overpayments of tax, or negative tax expenditures, to the extent net saving is not deductible from the tax base. In reality, however, the situation is more complicated. Some issues arise which are also problems in defining a comprehensive income tax, but seem more severe, or at least only more obvious, for the consumption tax baseline.

It is not always clear how to treat certain items under a consumption tax. One problem discussed earlier in the context of the comprehensive income tax is determining whether a particular expenditure, such as spending on medical care and charitable donations, is an item of consumption.

Also, there may be more than one way to treat various items under a consumption tax. For example, a consumption tax might ignore borrowing and lending by excluding from the borrower's tax base the proceeds from loans, denying the borrower a deduction for payments of interest and principal, and excluding interest and principal payments received from the lender's tax base. On the other hand, a consumption tax might include borrowing and lending in the tax base by requiring the borrower to add the proceeds from loans in his tax base, allowing the lender to deduct loans from his tax base, allowing the borrower to deduct payments of principal and interest, and requiring the lender to include receipt of principal and interest payments. In present value terms, the two approaches are equivalent for both the borrower and the lender; in particular both allow the tax base to measure consumption and both impose a zero effective tax rate on interest income. But which approach is taken obviously has different implications (at least on an annual flow basis) for the treatment of many important items of income and expense such as the home mortgage interest deduction. The classification below suggests that the deduction for home mortgage interest could well be a tax expenditure, but takes note of alternative views.

Some exclusions of income are equivalent in many respects to consumption tax treatment that immediately deducts the cost of an investment while taxing the future cash flow. For example, exempting an investment's income (or yield) is equivalent to consumption tax treatment with respect to the normal rate of return on new investment; expensing generates a tax reduction that offsets in present value terms the tax paid on the investment's future normal returns. Because of this equivalence, in the context of consumption taxes, a yield exemption approach is sometimes called a tax prepayment approach. That is, tax is paid on an asset's purchase price rather than on the consumption flow that it generates.

However, a yield exemption approach differs from a pure consumption tax with respect to the distribution of income and Government revenue. Pure profits in excess of the normal rate of return would be taxed under a consumption tax because pure profits are an element of cash flow; however, pure profits would not be taxed under a yield exemption tax system. The question arises whether an exemption of certain kinds of investment income, and certain investment tax credits, should be regarded as the equivalent of consumption tax treatment. The classification that follows takes a fairly broad view of this equivalence and considers many tax provisions that reduce or eliminate the tax on capital income to be roughly consistent with a broad-based consumption tax.

Considering provisions individually can be misleading. The hybrid character of the existing tax system reflects many provisions that might be good policy in the context of a consumption tax, but that generate inefficiencies because of the problem of the "uneven playing field" when evaluated within the context of the existing tax rules. It is not clear how these should be classified. For example, many saving incentives are targeted to specific tax-favored sources of capital income. The inability to save on a similar tax-favored basis irrespective of the ultimate purpose to which the saving is applied potentially distorts economic choices in ways that would not occur under a broad-based consumption tax.

In addition, provisions can interact even once an appropriate treatment is determined. For example, if financial flows are excluded from the tax base, then the deduction for home mortgage interest would be a tax expenditure except that current law generally taxes interest income. When combined with the mortgage interest deduction, this offsets the inclusion of the interest flow, consistent with consumption tax treatment.

Capital gains would not be a part of a comprehensive consumption tax base. Proceeds from asset sales and sometimes borrowing would be part of the cash-flow tax base, but, for transactions between domestic investors at a flat tax rate, the effects of these transactions would cancel out in the economy as a whole. The classification below generally views available capital gains tax relief as consistent with a broad-based consumption tax because they lower tax rate on capital income is consistent with a consumption-based tax.

Such considerations suggest that, as with an income tax, computing the current tax's deviations from "the" base of a consumption tax is difficult because deviations cannot always be uniquely determined, making it problematic to do a consistent accounting of the differences between the current tax base and a consumption tax base. Nonetheless, Appendix Table 2 attempts a classification based on the judgments outlined above.

Treatment of Major Tax Expenditures under a Comprehensive Consumption Baseline

As noted above, the major difference between a comprehensive consumption tax and a comprehensive income tax is in the treatment of saving, or in the taxation of capital income. Consequently, many current tax expenditures related to preferential taxation of capital income would not be tax expenditures under a consumption tax. However, preferential treatment of items of income that is unrelated to saving or investment incentives would remain tax expenditures under a consumption baseline. In addition, several official tax expenditures relating to items of income and expense are difficult to classify properly, while others may serve as proxies for properly measured tax expenditures.

Appendix Table 2 shows thirty large tax expenditures from the Budget classified according to whether they would be considered a tax expenditure under a consumption tax. One of the thirty items clearly would be a tax expenditure (shown in panel A) under a consumption tax, while an additional six (those in panel B) probably would be tax expenditures.

Exclusion of workers' compensation benefits allows an exclusion from income that is unrelated to investment, and so should be included in the base of a comprehensive consumption tax.

In one respect the deductibility of home mortgage interest is a strong candidate for inclusion as a tax expenditure. A consumption tax would seek to tax the entire value of the flow of services from housing, and so would not allow a deduction for home mortgage interest. This would be the case regardless of whether the tax base included the annual flow of housing services, or instead used a tax-prepayment or yield exemption approach (discussed more completely below) to taxing housing services. A deduction for interest would be allowed under a consumption tax applied to both real and financial cash flows, but current law does not require the homeowner to take into income the proceeds of a home loan, nor does it allow a deduction for principal repayments.

From another perspective, however, the home mortgage interest deduction would not be a tax expenditure under a consumption tax. Under a consumption tax, the interest income accruing to the mortgage lender generally would not be taxed (at least in present value terms). As interest income is subject to tax under current law, the homeowner's mortgage interest deduction could be viewed as counterbalancing the lender's inclusion, eliminating interest flows from the tax base, as would be appropriate under many types of consumption taxes.[25]

The deductibility of property taxes on owner-occupied housing also is a strong candidate for inclusion as a tax expenditure under a consumption tax baseline, although there is a bit of ambiguity. Property taxes would be deducted under a consumption tax under which the base allowed expensing of the cost of the house and included the rental value of the house in the annual tax base. But, as discussed above in the income tax section, this deduction nonetheless is a strong candidate for inclusion as a tax expenditure because the current tax system does not impute the consumption value of housing services to the homeowner's tax base.

Under a consumption tax based on the yield exemption or tax prepayment approach to housing, property taxes would not be deducted by the homeowner because the cash flows (positive and negative) related to the investment are simply ignored for tax purposes—they are outside the tax base. Their deduction under current law would represent a tax expenditure. As discussed below, current law's taxation of housing approximates a yield exemption approach; no deduction of the purchase price of the house, no tax on the house's service flow. Consequently, the deduction for property taxes probably would be a tax expenditure relative to a consumption base.

As discussed in the section on comprehensive income, whether the deduction for State and local income taxes gives rise to a tax expenditure under a consumption tax depends on whether the services paid for with these taxes constitute consumption value to the taxpayer. If there is not a firm relationship between the taxes paid and the services received, then the deduction may not be viewed as a tax expenditure.

Property taxes on assets other than housing would seem to be best thought of using the model discussed above for housing. These taxes typically are paid on assets, such as automobiles and boats, yielding a stream of services that current federal tax law fails to impute to income.

The tax expenditures for Social Security benefits discussed in the section on comprehensive income measure a tax benefit relative to a baseline that is somewhere between a comprehensive income tax and a consumption tax. The properly measured tax expenditure relative to a consumption tax baseline would include only those Social Security benefits that are accorded treatment more favorable than that implied by a consumption tax, which would correspond to including 50 percent of Social Security benefits in the recipient's tax base.[26] Thus, the existing tax expenditure is correct conceptually, but is not measured properly relative to a comprehensive income tax. A similar analysis would

[25] One must guard against double counting here, however, to the extent that current law's general taxation of capital income is calculated elsewhere in the tax expenditure budget as a negative tax expenditure.

[26] The current tax expenditure estimates reflect exceptions for low-income taxpayers from the general rule that 85 percent of Social Security benefits are included in the recipient's tax base. The 85 percent inclusion is intended as a simplified mechanism for taxing Social Security benefits as if the Social Security program were a private pension with employee contributions made from after-tax income. Under these tax rules, income earned on contributions made by both employers and employees benefits from tax deferral, but employer contributions also benefit because the employee may exclude them from his taxable income, while the employee's own contributions are included in his taxable income. These tax rules give the equivalent of consumption tax treatment, a zero effective tax rate on the return, to the extent that the original pension contributions are made by the employer, but give less generous treatment to the extent that the original contributions are made by the employee. Income earned on employee contributions is taxed at a low, but positive, effective tax rate. Based on historical calculations, the 85 percent inclusion reflects roughly the outcome of applying these tax rules to a lower-income earner when one-half of the contributions are from the employer and one-half from the employee.

apply to the exclusion of Social Security benefits of dependents and retirees.

There is a strong case for viewing the child tax credit and the earned income tax credit as social welfare programs (transfers). As such, they would be tax expenditures relative to a consumption baseline. These credits could alternatively be viewed as relieving tax on "non-discretionary" consumption, and so not properly considered a tax expenditure.

The treatment of the items in panel C is less uncertain. Several of these items relate to the costs of medical care or to charitable contributions. As discussed in the previous section of the appendix, there is disagreement within the tax policy community over the extent to which medical care and charitable giving represent consumption items.

There also is the issue of how to tax medical insurance premiums. Under current law, employees may exclude insurance premiums paid for by employers from their income. The self-employed also may exclude (via a deduction) medical insurance premiums from their taxable income. From some perspectives, these premiums should be included in the tax base because they represent consumption. Yet an alternative perspective would support excluding the premium from the tax base as long as the value of any medical services paid for by the insurance policy were included. But even from this alternative perspective, the official tax expenditure might continue to be a tax expenditure under a consumption tax baseline because current law excludes the value of medical services paid with insurance benefits from the employee's taxable income.

Current law does not tax the annual rental value of owner-occupied housing. In contrast, the annual rental value of the housing would be taxed under a consumption tax. Hence, from one perspective, the exclusion of the net annual rental value of owner-occupied housing would be a tax expenditure relative to a consumption tax baseline.

However, a consumption tax that included in its base the annual rental value of housing also would allow the homeowner a deduction for the price of the house in the year it was purchased; the investment in housing would be expensed. Current law fails to allow such a deduction, raising doubt about classifying as a tax expenditure the exclusion of net rental income from owner-occupied housing. Indeed, it is possible to interpret current law as applying the tax pre-payment or yield exemption method to housing, so it is not clear whether the failure to tax the rental income from housing represents a tax expenditure.

The taxation of Social Security benefits for the disabled also is difficult to classify. As discussed in this appendix above, these benefits generally ought to be taxed because they represent purchasing power. However, the associated Social Security taxes ought to be fully deductible, but they are not. Hence the proper treatment is unclear. Moreover, if the insurance model is applied, the taxation of Social Security benefits might be a negative tax expenditure.

The credit for low-income housing acts to lower the tax burden on qualified investment, and so from one perspective would not be a tax expenditure under a consumption tax baseline. However, in some cases the credit is too generous; it can give a negative tax on income from qualified investment rather than the zero tax called for under consumption tax principles. In addition, the credit is very narrowly targeted. Consequently, it could be considered a tax expenditure relative to a consumption tax baseline.

The final panel (D) shows items that are not tax expenditures under a consumption base. Most of these relate to tax provisions that eliminate or reduce the tax on various types of capital income because a zero tax on capital income is consistent with consumption tax principles.

The deduction for U.S. production activities is not classified as a tax expenditure. This reflects the view that it represents a widespread reduction in taxes on capital income or an offset to the corporate income tax. The exception from the passive loss rules probably would not be a tax expenditure because proper measurement of income, and hence of consumption, requires full deduction of losses.

Major Tax Expenditures under a Consumption Tax That Are Excluded from the Current Budget

Several differences between current law and a consumption tax are left off the official tax expenditure list. Additional possible tax expenditures include benefits paid by insurance policies, in-kind benefits from such Government programs as food-stamps, Medicaid, and public housing, and benefits received from charities. Under some theories of a comprehensive consumption tax, the value of leisure and of household production of goods and services would be included as a tax expenditure.

A consumption tax implemented as a tax on gross cash flows would tax all proceeds from sales of capital assets when consumed, rather than just capital gains; because of expensing, taxpayers effectively would have a zero basis. The proceeds from borrowing would be in the base of a consumption tax that also allowed a deduction for repayment of principal and interest, but are excluded from the current tax base. The deduction of business interest expense might be a tax expenditure, since under some forms of consumption taxation interest is neither deducted from the borrower's tax base nor included in the lender's tax base. The personal exemption and standard deduction also might be considered tax expenditures, although they can be viewed differently, e.g., as elements of the basic tax rate schedule.

Negative Tax Expenditures

Importantly, current law also deviates from a consumption tax norm in ways that increase, rather than decrease, tax liability. These provisions are called negative tax expenditures.

A large item on this list would be the inclusion of capital income in the current individual income tax base, including the income earned on inside-build up in Social Security accounts. The revenue from the corporate income tax, or more generally a measure of the double tax on corporate profits, also would be a negative tax expenditure. Depreciation allowances, even if accelerated, would be a negative tax expenditure since consumption tax treatment generally requires expensing. Depending on the treatment of loans, the borrower's inability to deduct payments of principal and the lender's inability to deduct loans might be a negative tax expenditure. The passive loss rules and net operating loss carry-forward provisions also might generate negative tax expenditures, because the change in net worth requires a deduction for losses (consumption = income—the change in net worth). Human capital is a productive asset, and so its cost (e.g., certain education and training expenses, including perhaps costs of college and professional school) should be expensed, but it is not under current law. Certain restrictions under the individual Alternative Minimum Tax as well as the phase-out of personal exemptions and of itemized deductions also might be considered negative tax expenditures. Under some views, the current tax treatment of Social Security benefits paid to the disabled would be a negative tax expenditure.

REVISED ESTIMATES OF SELECTED TAX EXPENDITURES

Accelerated Depreciation

Under the reference tax law baseline no tax expenditures arise from accelerated depreciation. In the past, tax expenditure estimates of accelerated depreciation under the normal tax law baseline compared tax allowances based on the historic cost of an asset with allowances calculated using the straight-line method over relatively long recovery periods. Normal law allowances also were determined by the historical cost of the asset and so did not adjust for inflation, although such an adjustment is required when measuring economic depreciation, the age related fall in the real value of the asset.

Beginning with the 2004 Budget, the tax expenditures for accelerated depreciation under the normal law concept have been recalculated using as a baseline depreciation rates and replacement cost indexes from the National Income and Product Accounts. [27] The revised estimates are intended to approximate the degree of acceleration provided by current law over a baseline determined by real, inflation adjusted, and economic depreciation. Current law depreciation allowances for machinery and equipment include the benefits of a temporary expensing provision. [28] The estimates are shown in tables in the body of the main text, e.g., Table 19–1.

Owner-Occupied Housing

A homeowner receives a flow of housing services equal in gross value to the rent that could have been earned had the owner chosen to rent the house to others. Comprehensive income would include in the homeowner's tax base this gross rental flow, and would allow the homeowner a deduction for expenses such as interest, depreciation, property taxes, and other costs associated with earning the rental income. Thus, a comprehensive tax base would include in its base the homeowner's implicit net rental income (gross income minus deductions) earned on investment in owner-occupied housing.

In contrast to a comprehensive income tax, current law makes no imputation for gross rental income and allows no deduction for depreciation or for other expenses, such as utilities and maintenance. Current law does, however, allow a deduction for home mortgage interest and for property taxes. Consequently, relative to a comprehensive income baseline, the total tax expenditure for owner-occupied housing is the sum of tax on net rental income plus the tax saving from the deduction for property taxes and for home mortgage interest. [29]

Prior to 2006, the official list of tax expenditures did not include the exclusion of net implicit rental income on owner-occupied housing. Instead, it included as tax expenditures deductions for home mortgage interest and for property taxes. While these deductions are legitimately considered tax expenditures, given current law's failure to impute rental income, they are highly flawed as estimates of the total income tax advantage to housing; they overlook the additional exclusion of implicit net rental income. To the extent a homeowner owns his house outright, unencumbered by a mortgage, he would have no home mortgage interest deduction, yet he still would enjoy the benefits of receiving tax free the implicit rental income earned on his house. On the other hand, a homeowner with a mortgage approximately matching the value of the house might make interest payments that exceed the implicit rental income. The treatment of owner-occupied housing has been revised beginning in the 2006 budget, which now includes an item for the exclusion of net rental income of homeowners. [30]

[27] See Barbara Fraumeni, "The Measurement of Depreciation in the U.S. National Income and Product Accounts," in Survey of Current Business 77 No. 7 (Washington, D.C.: Department of Commerce, Bureau of Economic Analysis, July, 1997), pp. 7–42, and the National Income and Product Accounts of the United States, Table 7.6, "Chain-type Quantity and Price Indexes for Private Fixed Investment by Type," U.S. Department of Commerce, Bureau of Economic Analysis.

[28] The temporary provision allows 30 percent of the cost of a qualifying investment to be deducted immediately rather than capitalized and depreciated over time. It is generally effective for qualifying investments made after September 10, 2001 and before September 11, 2004. The Jobs and Growth Tax Relief Reconciliation Act of 2003 raised the deduction to 50 percent depreciation (up from 30 percent) of the cost new equipment purchased after May 5, 2003 and placed into service before January 1, 2005. Qualifying investments generally are limited to tangible property with depreciation recovery periods of 20 years or less, certain software, and leasehold improvements, but this set of assets corresponds closely to machinery and equipment.

[29] The homeowner's tax base under a comprehensive income tax is net rents. Under current law, the homeowner's tax base is -(interest + property taxes). The tax expenditure base is the difference between the comprehensive income base and current law's tax base, which for homeowners is the sum of net rents plus interest plus property taxes.

[30] This estimate combines the positive tax expenditure for the failure to impute rental income with the negative tax expenditure for the failure to allow a deduction for depreciation and other costs.

Appendix Table 3, as well as the tables in the body of the main text, e.g., Tables 19–1 and 19–2, show estimates of the tax expenditure caused by the exclusion of implicit net rental income from investment in owner-occupied housing. This estimate starts with the NIPA calculated value of gross rent on owner-occupied housing, and subtracts interest, taxes, economic depreciation, and other costs in arriving at an estimate of net-rental income from owner-occupied housing.[31]

Accrued Capital Gains

Under a comprehensive income baseline, all real gains would be taxed as accrued. These gains would be taxed as ordinary income rather than at preferential rates. There would be no deferred unrealized gains on assets held at death, nor gains carried over on gifts, or other preferential treatments. Indeed, all of the provisions related to capitals gains listed in the tax expenditure budget would be dropped. Instead, in their place the difference between the ordinary tax on real gains accrued and the actual tax paid would be calculated. For 1999, for instance, the tax on real accrued gains on corporate equity is estimated at $594 billion. This compares to an estimated tax on realized gains of $62 billion, for forgone revenues of $562 billion. However, this forgone revenue may easily turn into a revenue gain given the limits on capital losses. For 2000, for instance, real accrued losses in corporate equity amounted to $1.4 trillion. Yet, taxpayers paid an estimated $70 billion in capital gains taxes. This roughly translates into an overpayment of taxes to the tune of $464 billion.

Double Tax on Corporate Profits

A comprehensive income tax would tax all sources of income once. Taxes would not vary by type or source of income.

[31] National Income and Production Accounts, Table 2.4.

In contrast to this benchmark, current law taxes income that shareholders earn on investment in corporate stocks at least twice, and at combined rates that generally are higher than those imposed on other sources of income. Corporate profits are taxed once at the company level under the corporation income tax. They are taxed again at the shareholder level when received as a dividend or recognized as a capital gain. Corporate profits can be taxed more then twice when they pass through multiple corporations before being distributed to noncorporate shareholders. Corporate level taxes cascade because corporations are taxed on capital gains they realize on the sale of stock shares and on some dividend income received. Compared to a comprehensive income tax, current law's double (or more) tax on corporate profits is an example of a negative tax expenditure because it subjects income to a larger tax burden than implied by a comprehensive income baseline.

Appendix A Table 3 provides an estimate of the negative tax expenditure caused by the multiple levels of tax on corporate profits. This negative tax expenditure is measured as the shareholder level tax on dividends paid and capital gains realized out of earnings that have been fully taxed at the corporate level. It also includes the corporate tax paid on inter-corporate dividends and on corporate capital gains attributable to the sale of stock shares. The estimate includes the reduction in the dividends and capital gains tax rates enacted in JGTRRA.

The negative tax expenditure is large in magnitude; it exceeds $41 billion in the years 2007 through 2013. It is comparable in size (but opposite in sign) to all but the largest official tax expenditures. JGTRRA reduced but did not eliminate the double tax on corporate profits.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX [1]

Description	Revenue Effect 2009
A. Tax Expenditure Under a Comprehensive Income Tax	
Capital gains (except agriculture, timber, iron ore, and coal)	55,940
Net exclusion of pension contributions and earnings: 401(k) plans	51,000
Net exclusion of pension contributions and earnings: Employer plans	45,670
Accelerated depreciation of machinery and equipment (normal tax method)	44,120
Capital gains exclusion on home sales	34,710
Exclusion of interest on public purpose State and local bonds	25,900
Exclusion of interest on life insurance savings	23,500
Deferral of income from controlled foreign corporations (normal tax method)	13,780
Net exclusion of pension contributions and earnings: Keogh plans	13,000
Accelerated depreciation on rental housing (normal tax method)	11,760
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	11,700
Exclusion of net imputed rental income on owner-occupied housing	7,550
Exclusion of workers' compensation benefits	5,920
Credit for low-income housing investments	5,780
Expensing of research and experimentation expenditures (normal tax method)	4,990
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Deductibility of mortgage interest on owner-occupied homes	100,810
Step-up basis of capital gains at death	36,750
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	33,200
Child credit	29,950
Exclusion of Social Security benefits for retired workers	18,640
Deductibility of State and local property tax on owner-occupied homes	16,640
Deduction for U.S. production activities	15,330
Earned income tax credit	5,440
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	168,460
Deductibility of charitable contributions, other than education and health	46,980
Deductibility of medical expenses	5,920
Social Security benefits for the disabled	5,810
Deductibility of charitable contributions, health	5,300
Deductibility of charitable contributions, education	5,270
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Exception from passive loss rules for $25,000 of rental loss	8,840

[1] The measurement of certain tax expenditures under a comprehensive income tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX[1]

Description	Revenue Effect 2009
A. Tax Expenditure Under a Consumption Base	
Exclusion of workers' compensation benefits	5,920
B. Probably a Tax Expenditure Under a Consumption Base	
Deductibility of mortgage interest on owner-occupied homes	100,810
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	33,200
Child credit	29,950
Exclusion of Social Security benefits for retired workers	18,640
Deductibility of State and local property tax on owner-occupied homes	16,640
Earned income tax credit	5,440
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	168,460
Deductibility of charitable contributions, other than education and health	46,980
Exclusion of net imputed rental income on owner-occupied housing	7,550
Deductibility of medical expenses	5,920
Social Security benefits for disabled	5,810
Credit for low-income housing investments	5,780
Deductibility of charitable contributions, health	5,300
Deductibility of charitable contributions, education	5,270
D. Not a Tax Expenditure Under a Consumption Base	
Capital gains (except agriculture, timber, iron ore, and coal)	55,940
Net exclusion of pension contributions and earnings: 401(k) plans	51,000
Net exclusion of pension contributions and earnings: Employer plans	45,670
Accelerated depreciation of machinery and equipment (normal tax method)	44,120
Step-up basis of capital gains at death	36,750
Capital gains exclusion on home sales	34,710
Exclusion of interest on public purpose State and local bonds	25,900
Exclusion of interest on life insurance savings	23,500
Deduction for U.S. production activities	15,330
Deferral of income from controlled foreign corporations (normal tax method)	13,780
Net exclusion of pension contributions and earnings: Keogh plans	13,000
Accelerated depreciation on rental housing (normal tax method)	11,760
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	11,700
Exception from passive loss rules for $25,000 of rental loss	8,840
Expensing of research and experimentation expenditures (normal tax method)	4,990

[1] The measurement of certain tax expenditures under a consumption tax baseline may differ from the official budget estimate even when the provision would be a tax expenditure under both baselines.Source: Table 19–2, Tax Expenditure Budget.

Appendix Table 3. REVISED TAX EXPENDITURE ESTIMATES[1]

Provision	Revenue Loss						
	2007	2008	2009	2010	2011	2012	2013
Imputed Rent On Owner-Occupied Housing	3,890	5,440	7,550	10,480	14,540	20,180	28,010
Double Tax on corporate profit[2]	–41,230	–44,340	–46,860	–49,520	–52,340	–55,310	–58,460

[1] Calculations described in the appendix text.
[2] This is a negative tax expenditure, a tax provision that overtaxes income relative to the treatment specified by the baseline tax system.

Appendix B

PERFORMANCE MEASURES AND THE ECONOMIC EFFECTS OF TAX EXPENDITURES

The Government Performance and Results Act of 1993 (GPRA) directs Federal agencies to develop annual and strategic plans for their programs and activities. These plans set out performance objectives to be achieved over a specific time period. Most of these objectives will be achieved through direct expenditure programs. Tax expenditures, however, may also contribute to achieving these goals. This Appendix responds to the report of the Senate Governmental Affairs Committee on GPRA4[32] calling on the Executive Branch to undertake a series of analyses to assess the effect

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

of specific tax expenditures on the achievement of agencies' performance objectives.

Comparison of tax expenditure, spending, and regulatory policies. Tax expenditures by definition work through the tax system and, particularly, the income tax. Thus, they may be relatively advantageous policy approaches when the benefit or incentive is related to income and is intended to be widely available.[33] Because there is an existing public administrative and private compliance structure for the tax system, the incremental administrative and compliance costs for a tax expenditure may be low in many cases. In addition, some tax expenditures actually simplify the operation of the tax system, (for example, the exclusion for up to $500,000 of capital gains on home sales). Tax expenditures also implicitly subsidize certain activities. Spending, regulatory or tax-disincentive policies can also modify behavior, but may have different economic effects. Finally, a variety of tax expenditure tools can be used e.g., deductions, credits, exemptions, deferrals, floors, ceilings; phase-ins; phase-outs; dependent on income, expenses, or demographic characteristics (age, number of family members, etc.). This wide range of policy instruments means that tax expenditures can be flexible and can have very different economic effects.

Tax expenditures also have limitations. In many cases they add to the complexity of the tax system, which raises both administrative and compliance costs. For example, personal exemptions, deductions, credits, and phase-outs can complicate filing and decision-making. The income tax system may have little or no contact with persons who have no or very low incomes, and does not require information on certain characteristics of individuals used in some spending programs, such as wealth. These features may reduce the effectiveness of tax expenditures for addressing certain income-transfer objectives. Tax expenditures also generally do not enable the same degree of agency discretion as an outlay program. For example, grant or direct Federal service delivery programs can prioritize activities to be addressed with specific resources in a way that is difficult to emulate with tax expenditures.

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

Regulations have more direct and immediate effects than outlay and tax-expenditure programs because regulations apply directly and immediately to the regulated party (i.e., the intended actor) generally in the private sector. Regulations can also be fine-tuned more quickly than tax expenditures because they can often be changed as needed by the Executive Branch without legislation. Like tax expenditures, regulations often rely largely on voluntary compliance, rather than detailed inspections and policing. As such, the public administrative costs tend to be modest relative to the private resource costs associated with modifying activities. Historically, regulations have tended to rely on proscriptive measures, as opposed to economic incentives. This reliance can diminish their economic efficiency, although this feature can also promote full compliance where (as in certain safety-related cases) policymakers believe that trade-offs with economic considerations are not of paramount importance. Also, regulations generally do not directly affect Federal outlays or receipts. Thus, like tax expenditures, they may escape the degree of scrutiny that outlay programs receive. However, major regulations are subjected to a formal regulatory analysis that goes well beyond the analysis required for outlays and tax-expenditures. To some extent, the GPRA requirement for performance evaluation will address this lack of formal analysis.

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

Tax expenditures, like spending and regulatory programs, have a variety of objectives and effects. When measured against a comprehensive income tax, for example, these include: encouraging certain types of activities (e.g., saving for retirement or investing in certain sectors); increasing certain types of after-tax income (e.g., favorable tax treatment of Social Security income); reducing private compliance costs and Government administrative costs (e.g., the exclusion for up to $500,000 of capital gains on home sales); and promoting tax neutrality (e.g., accelerated depreciation in the presence of inflation). Some of these objectives are well suited to quantitative measurement, while others are less well suited. Also, many tax expenditures, including those cited above, may have more than one objective. For example, accelerated depreciation may

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

encourage investment. In addition, the economic effects of particular provisions can extend beyond their intended objectives (e.g., a provision intended to promote an activity or raise certain incomes may have positive or negative effects on tax neutrality).

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

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

An Overview of Evaluation Issues by Budget Function. The discussion below considers the types of measures that might be useful for some major programmatic groups of tax expenditures. The discussion is intended to be illustrative and not all encompassing. However, it is premised on the assumption that the data needed to perform the analysis are available or can be developed. In practice, data availability is likely to be a major challenge, and data constraints may limit the assessment of the effectiveness of many provisions. In addition, such assessments can raise significant challenges in economic modeling.

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

International affairs. Tax expenditures are also aimed at goals such as tax neutrality. These include the exclusion for income earned abroad by nongovernmental employees and exclusions for income of U.S.-controlled foreign corporations. Measuring the effectiveness of these provisions raises challenging issues.

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

Housing investment also benefits from tax expenditures. The imputed net rental income from owner-occupied housing is excluded from the tax base. The mortgage interest deduction and property tax deduction on personal residences also are reported as tax expenditures because the value of owner-occupied housing services is not included in a taxpayer's taxable income. Taxpayers also may exclude up to $500,000 of the capital gains from the sale of personal residences. Measures of the effectiveness of these provisions could include their effects on increasing the extent of home ownership and the quality of housing. Similarly, analysis of the extent of accumulated inflationary gains is likely to be relevant to evaluation of the capital gains for home sales. Deductibility of State and local property taxes assists with making housing more affordable as well as easing the cost of providing community services through these taxes. Provisions intended to promote investment in rental housing could be evaluated for their effects on making such housing more available and affordable. These provisions should then be compared with alternative programs that address housing supply and demand.

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

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

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

Health. Individuals also benefit from favorable treatment of employer-provided health insurance. Measures of these benefits could include increased coverage and pooling of risks. The effects of insurance coverage on final outcome measures of actual health (e.g., infant mortality, days of work lost due to illness, or life expectancy) or intermediate outcomes (e.g., use of preventive health care or health care costs) could also be investigated.

Income security, Social Security, and veterans benefits and services. Major tax expenditures in the income security function benefit retirement savings, through employer-provided pensions, individual retirement accounts, and Keogh plans. These provisions might be evaluated in terms of their effects on boosting retirement incomes, private savings, and national savings (which would include the effect on private savings as well as public savings or deficits). Interactions with other programs, including Social Security, also may merit analysis. As in the case of employer-provided health insurance, analysis of employer-provided pension programs requires imputing the value of benefits funded at the firm level to individuals.

Other provisions principally affect the incomes of members of certain groups, rather than affecting incentives. For example, tax-favored treatment of Social Security benefits, certain veterans' benefits, and deductions for the blind and elderly provide increased incomes to eligible parties. The earned-income tax credit, in contrast, should be evaluated for its effects on labor force participation as well as the income it provides lower-income workers.

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

The above illustrative discussion, although broad, is nevertheless incomplete, omitting important details both for the provisions mentioned and the many that are not explicitly cited. Developing a framework that is sufficiently comprehensive, accurate, and flexible to reflect the objectives and effects of the wide range of tax expenditures will be a significant challenge. OMB, Treasury, and other agencies will work together, as appropriate, to address this challenge. As indicated above, over the next few years the Executive Branch's focus will be on the availability of the data needed to assess the effects of the tax expenditures designed to increase savings.