

**ESTIMATES OF FEDERAL TAX
EXPENDITURES FOR
FISCAL YEARS 2005-2009**

PREPARED FOR THE
HOUSE COMMITTEE ON WAYS AND MEANS
AND THE
SENATE COMMITTEE ON FINANCE

BY THE STAFF OF THE
JOINT COMMITTEE ON TAXATION



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INTRODUCTION

This report¹ on tax expenditures for fiscal years 2005–2009 is prepared by the staff of the Joint Committee on Taxation (“Joint Committee staff”) for the House Committee on Ways and Means and the Senate Committee on Finance. The report also is submitted to the House and Senate Committees on the Budget.

As in the case of earlier reports,² the estimates of tax expenditures in this report were prepared in consultation with the staff of the Office of Tax Analysis in the Treasury Department (“the Treasury”). The Treasury published its estimates of tax expenditures for fiscal years 2003–2009 in the Administration’s budgetary statement of February 2004.³ The lists of tax expenditures in this Joint Committee staff report and the Administration’s budgetary statement overlap considerably; the differences are discussed in Part I of this report under the heading “Comparisons with Treasury.”

The Joint Committee staff has made its estimates (as shown in Table 1) based on the provisions in tax law as enacted through December 31, 2004. Expired or repealed provisions are not listed unless they have continuing revenue effects that are associated with ongoing taxpayer activity. Proposed extensions or modifications of expiring provisions are not included until they have been enacted into law. The tax expenditure estimates in this report are based on the January 2004 Congressional Budget Office revenue baseline and Joint Committee staff projections of the gross income, deductions, and expenditures of individuals and corporations for calendar years 2004–2009.

Part I of this report contains a discussion of the concept of tax expenditures. Part II is a discussion of the measurement of tax expenditures. Estimates of tax expenditures for fiscal years 2005–2009 are presented in Table 1 in Part III. Table 2 shows the distribution of tax returns by income class, and Table 3 presents distributions of selected individual tax expenditures by income class.

¹ This report may be cited as follows: Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2005–2009* (JCS–1–05), January 12, 2005.

² Joint Committee on Taxation, *Estimates of Federal Tax Expenditures*, October 4, 1972 (JCS–28–72), June 1, 1973 (JCS–20–73), July 8, 1975 (JCS–11–75), March 15, 1976 (JCS–5–76), March 15, 1977 (JCS–10–77), March 14, 1978 (JCS–9–78), March 15, 1979 (JCS–9–79), March 6, 1980 (JCS–8–80), March 16, 1981 (JCS–7–81), March 8, 1982 (JCS–4–82), March 7, 1983 (JCS–4–83), November 9, 1984 (JCS–39–84), April 12, 1985 (JCS–8–85), March 1, 1986 (JCS–7–86), February 27, 1987 (JCS–3–87), March 8, 1988 (JCS–3–88), February 28, 1989 (JCS–4–89), March 9, 1990 (JCS–7–90), March 11, 1991 (JCS–4–91), April 24, 1992 (JCS–8–92), April 22, 1993 (JCS–6–93), November 9, 1994 (JCS–6–94), September 1, 1995 (JCS–21–95), November 26, 1996 (JCS–11–96), December 15, 1997 (JCS–22–97), December 14, 1998 (JCS–7–98), December 22, 1999 (JCS–13–99), April 6, 2001 (JCS–1–01), January 17, 2002 (JCS–1–02), December 19, 2002, and December 22, 2003 (JCS–8–03).

³ Office of Management and Budget, “Tax Expenditures,” *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2005*, February 2, 2004, pp. 285–325.

I. THE CONCEPT OF TAX EXPENDITURES

Overview

"Tax expenditures" are defined under the Congressional Budget and Impoundment Control Act of 1974 ("the Budget Act") 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 tax liability."⁴ Thus, tax expenditures include any reductions in income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers.

Special income tax provisions are referred to as tax expenditures because they may be considered to be analogous to direct outlay programs, and the two can be considered as alternative means of accomplishing similar budget policy objectives. Tax expenditures are similar to those direct spending programs that are available as entitlements to those who meet the statutory criteria established for the programs.

Estimates of tax expenditures are prepared for use in budget analysis. They are a measure of the economic benefits that are provided through the tax laws to various groups of taxpayers and sectors of the economy. The estimates also may be useful in determining the relative merits of achieving specified public goals through tax benefits or direct outlays.

The legislative history of the Budget Act indicates that tax expenditures are to be defined with reference to a normal income tax structure (referred to here as "normal income tax law"). The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of income that is larger in scope than "income" as defined under general U.S. income tax principles. The Joint Committee staff has used its judgment in distinguishing between those income tax provisions (and regulations) that can be viewed as a part of normal income tax law and those special provisions that result in tax expenditures. A provision traditionally has been listed as a tax expenditure by the Joint Committee staff if there is a reasonable basis for such classification and the provision results in more than a *de minimis* revenue loss, which solely for this purpose means a total revenue loss of at least \$50 million over the five fiscal years 2005–2009. The Joint Committee staff emphasizes, however, that in the process of listing tax expenditures, no judgment is made, nor any implication intended, about the desirability of any special tax provision as a matter of public policy.

If a tax expenditure provision were eliminated, Congress might choose to continue financial assistance through other means rather than terminate all Federal assistance for the activity. If a replace-

⁴ Congressional Budget and Impoundment Control Act of 1974 (Pub. L. No. 93–344), sec. 3(3).

ment spending program were enacted, the higher revenues received as a result of the elimination of a tax expenditure might not represent a net budget gain. A replacement program could involve direct expenditures, direct loans or loan guarantees, regulatory activity, a mandate, a different form of tax expenditure, or a general reduction in tax rates. Joint Committee staff estimates of tax expenditures do not anticipate such policy responses.

The Budget Act uses the term tax expenditure to refer to the special tax provisions that are contained in the Federal income taxes on individuals and corporations.⁵ Other Federal taxes such as excise taxes, employment taxes, and estate and gift taxes may also have exceptions, exclusions, and credits, but those special tax provisions are not included in this report because they are not part of the income tax. Thus, for example, the income tax exclusion for employer-paid health insurance is included, but the Federal Insurance Contributions Act ("FICA") tax exclusion for employer-paid health insurance is not treated as a tax expenditure in this report.⁶

Some provisions in the Internal Revenue Code provide for special tax treatment that is less favorable than normal income tax law. Examples of such provisions include (1) the denial of deductions for certain lobbying expenses, (2) the denial of deductions for certain executive compensation, and (3) the two-percent floor on itemized deductions for unreimbursed employee expenses. Tax provisions that provide treatment less favorable than normal income tax law are not shown in this report because they are not included in the statutory definition of a tax expenditure.

Individual Income Tax

Under the Joint Committee staff methodology, the normal structure of the individual income tax includes the following major components: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax rate schedule, and deductions for investment and employee business expenses. Most other tax benefits to individual taxpayers can be classified as exceptions to normal income tax law.

The Joint Committee staff views the personal exemptions and the standard deduction as defining the zero-rate bracket that is a part of normal tax law. An itemized deduction that is not necessary for the generation of income is classified as a tax expenditure, but only to the extent that it, when added to a taxpayer's other itemized deductions, exceeds the standard deduction.

All employee compensation is subject to tax unless the tax code contains a specific exclusion for the income. Specific exclusions for employer-provided benefits include the following: coverage under

⁵ The Federal income tax on individuals also applies to estates and trusts, which are subject to a separate income tax rate schedule (Section 1(c) of the Internal Revenue Code of 1986, the "Code"). Estates and trusts may benefit from some of the same tax expenditure provisions that apply to individuals. In Table 1 of this report, the tax expenditures that apply to estates and trusts have been included in the estimates of tax expenditures for individual taxpayers.

⁶ Other analysts have explored applying the concept of tax expenditures to payroll and excise taxes. See, Jonathan Barry Forman, "Would a Social Security Tax Expenditure Budget Make Sense?" *Public Budgeting and Financial Management*, 5, 1993, pp. 311-335, and Bruce F. Davie, "Tax Expenditures in the Federal Excise Tax System," *National Tax Journal*, XLVII, March 1994, pp. 39-62. Prior to 2003, the President's budget contained a section that reviewed and tabulated estate and gift tax provisions that the Treasury considered tax expenditures. The Joint Committee staff considers estate and gift provisions as being outside of the normal income tax structure and thus omits them from its lists of tax expenditures.

accident and health plans,⁷ accident and disability insurance, group term life insurance, educational assistance, transportation benefits (parking, van pools, and transit passes), dependent care assistance, adoption assistance, meals and lodging furnished for the convenience of the employer, employee awards, and other miscellaneous fringe benefits (e.g., employee discounts, services provided to employees at no additional cost to employers, tuition reductions, and *de minimis* fringe benefits). Each of these exclusions is classified as a tax expenditure in this report.

Under normal income tax law, employer contributions to pension plans and income earned on pension assets would be taxable to employees as the contributions are made and as the income is earned, and employees would not receive any deduction or exclusion for their pension contributions. Under present law, employer contributions to qualified pension plans and employee contributions made at the election of the employee through salary reduction are not taxed until distributed to the employee, and income earned on pension assets is not taxed until distributed. The tax expenditure for "net exclusion of pension contributions and earnings" is computed as the income taxes forgone on current tax-excluded pension contributions and earnings less the income taxes paid on current pension distributions (including the 10-percent additional tax paid on early withdrawals from pension plans).

Under present law, social security and tier 1 railroad retirement benefits are partially excluded or fully excluded from gross income.⁸ Under normal income tax law, retirees would be entitled to an exclusion for only the portion of the retirement benefits that represents a return of the payroll taxes that they paid during their working years. Thus, the exclusion of social security and railroad retirement benefits in excess of payroll tax payments is classified as a tax expenditure.

All Medicare benefits are excluded from taxation. The value of Medicare Part A insurance generally is greater than the Health Insurance ("HI") tax contributions that enrollees made during their working years, and the value of Medicare Part B insurance generally is greater than the Part B premium that enrollees must pay. The exclusion of the value of Medicare Part A insurance in excess of HI tax contributions is classified as a tax expenditure, and the exclusion of the value of Medicare Part B insurance in excess of premiums paid also is classified as a tax expenditure.

Public assistance benefits are excluded from gross income by statute or by Internal Revenue Service regulations. Table 1 contains tax expenditure estimates for workers' compensation benefits, special benefits for disabled coal miners, and cash public assistance benefits (which include Supplemental Security Income benefits and Temporary Assistance for Needy Families benefits).

⁷ Present law contains an exclusion for employer-provided coverage under accident and health plans (Code sec. 106) and an exclusion for benefits received by employees under employer-provided accident and health plans (Code sec. 105(b)). These two exclusions are viewed as a single tax expenditure. Under normal income tax law, the value of employer-provided accident and health coverage would be includable in the income of employees, but employees would not be subject to tax on the accident and health insurance benefits (reimbursements) that they might receive.

⁸ For taxpayers with modified adjusted gross incomes above certain levels, up to 85 percent of social security and tier 1 railroad retirement benefits are includable in income.

The individual income tax does not include in gross income the imputed income that individuals receive from the services provided by owner-occupied homes and durable goods.⁹ However, the Joint Committee staff does not classify this exclusion as a tax expenditure. The measurement of imputed income for tax purposes presents administrative problems and its exclusion from taxable income may be regarded as an administrative necessity.¹⁰ Under normal income tax law, individuals would be allowed to deduct only the interest on indebtedness incurred in connection with a trade or business or an investment. Thus, the deduction for mortgage interest on a principal or second residence is classified as a tax expenditure. The Joint Committee staff assumes that, for administrative feasibility, normal income tax law would tax capital gains in full in the year the gains are realized through sale or exchange. Thus, the deferral of tax until realization is not classified as a tax expenditure, but reduced rates of tax, further deferrals of tax (beyond the year of sale or exchange), and exclusions of certain capital gains are classified as tax expenditures. It also is assumed that normal income tax law would not provide for any indexing of the basis of capital assets for changes in the general price level. Thus, under normal income tax law (as under present law), the income tax would be levied on nominal gains as opposed to real gains in asset values.

There are many types of State and local government bonds and private purpose bonds that qualify for tax-exempt status for Federal income tax purposes. Table 1 contains a separate tax expenditure listing for each type of bond.

Under the Joint Committee staff view of normal tax law, compensatory stock options would be subject to regular income tax at the time the options are exercised and employers would receive a corresponding tax deduction.¹¹ The employee's income would be equal to the difference between the purchase price of the stock and the market price on the day the option is exercised. Present law provides for special tax treatment for incentive stock options and options acquired under employee stock purchase plans. When certain requirements are satisfied, (1) the income that is received at the time the option is exercised is excluded for purposes of the regular income tax but included for purposes of the alternative minimum tax, (2) the gain from any subsequent sale of the stock is taxed as a capital gain, and (3) the employer does not receive a tax deduction with respect to the option. The special tax treatment provided to the employee is viewed as a tax expenditure by the Joint Committee staff, and an estimate of this tax expenditure is contained in Table 1. However, it should be noted that the revenue loss from the special tax treatment provided to the employee is ac-

⁹The National Income and Product Accounts include estimates of this imputed income. The accounts appear in U.S. Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, published monthly. However, a taxpayer-by-taxpayer accounting of imputed income would be necessary for a tax expenditure estimate.

¹⁰If the imputed income from owner-occupied homes were included in adjusted gross income, it would be proper to include all mortgage interest deductions and related property tax deductions as part of the normal income tax structure, since interest and property tax deductions would be allowable as a cost of producing imputed income. It also would be appropriate to allow deductions for depreciation and maintenance expenses for owner-occupied homes.

¹¹If the option has a readily ascertainable fair market value, normal law would tax the option at the time it is granted and the employer would be entitled to a deduction at that time.

complicated by a significant revenue gain from the denial of the deduction to the employer.

The individual alternative minimum tax ("AMT") and the passive activity loss rules are not viewed by the Joint Committee staff as a part of normal income tax law. Instead, they are viewed as provisions that reduce the magnitude of the tax expenditures to which they apply. For example, the AMT reduces the value of the deduction for State and local income taxes (for those taxpayers subject to the AMT) by not allowing the deductions to be claimed in the calculation of AMT liability. Similarly, the passive loss rules defer otherwise allowable deductions and credits from passive activities until a time when the taxpayer has passive income or disposes of the assets associated with the passive activity. Exceptions to the individual AMT and the passive loss rules are not classified as tax expenditures by the Joint Committee staff because the effects of the exceptions already are incorporated in the estimates of related tax expenditures.

Business Income Taxation

Regardless of the legal form of organization (sole proprietorship, partnership, or S or C corporation), the same general principles are used in the computation of taxable business income. Thus, most business tax expenditures apply equally to unincorporated and incorporated businesses.

One of the most difficult issues in defining tax expenditures for business income relates to the tax treatment of capital costs. Under present law, capital costs may be recovered under a variety of alternative methods, depending upon the nature of the costs and the status of the taxpayer. For example, investments in equipment and structures may qualify for tax credits, expensing, accelerated depreciation, or straight-line depreciation. The Joint Committee staff generally classifies as tax expenditures cost recovery allowances that are more favorable than those provided under the alternative depreciation system (sec. 168(g)), which provides for straight-line recovery over tax lives that are longer than those permitted under the accelerated system. As indicated above, the Joint Committee staff assumes that normal income tax law would not provide for any indexing of the basis of capital assets. Thus, normal income tax law would not take into account the effects of inflation on tax depreciation.

The Joint Committee staff uses several accounting standards in evaluating the provisions in the Code that govern the recognition of business receipts and expenses. Under the Joint Committee staff view, normal income tax law is assumed to require the accrual method of accounting, the standard of "economic performance" (used in the Code to test whether liabilities are deductible), and the general concept of matching income and expenses. In general, tax provisions that do not satisfy all three standards are viewed as tax expenditures. For example, the deduction for contributions to taxpayer-controlled mining reclamation reserve accounts is viewed as a tax expenditure because the contributions do not satisfy the economic performance standard. (Adherence to the standard would require that the taxpayer make an irrevocable contribution toward future reclamation, involving a trust fund or similar mechanism, as

occurs in a number of areas in the Code.) The deduction for contributions to nuclear decommissioning trust accounts is not viewed as a tax expenditure because the contributions are irrevocable (*i.e.*, they satisfy the economic performance standard). However, present law provides for a reduced rate of tax on the income of nuclear decommissioning trust accounts, and this reduced rate of tax is viewed as a tax expenditure.

The Joint Committee staff assumes that normal income tax law would provide for the carryback and carryforward of net operating losses. The staff also assumes that the general limits on the number of years that such losses may be carried back or forward were chosen for reasons of administrative convenience and compliance concerns and may be assumed to represent normal income tax law. Exceptions to the general limits on carrybacks and carryforwards are viewed as tax expenditures.

Corporate Income Tax

The income of corporations (other than S corporations) generally is subject to the corporate income tax. The corporate income tax includes a graduated tax rate schedule. The lower tax rates in the schedule are classified by the Joint Committee staff as a tax expenditure (as opposed to normal income tax law) because they are intended to provide tax benefits to small business and, unlike the graduated individual income tax rates, are unrelated to concerns about ability of individuals to pay taxes.

Exceptions to the corporate alternative minimum tax are not viewed as tax expenditures because the effects of the AMT exceptions are already incorporated in the estimates of related tax expenditures.¹²

Certain income of pass-through entities is exempt from the corporate income tax. The income of sole proprietorships, S corporations, most partnerships, and other entities (such as regulated investment companies and real estate investment trusts) is taxed only at the individual level. The special tax rules for these pass-through entities are not classified as tax expenditures because the tax benefits are available to any entity that chooses to organize itself and operate in the required manner.

Nonprofit corporations that satisfy the requirements of Code section 501 also generally are exempt from corporate income tax. The tax exemption of certain nonprofit cooperative business organizations, such as trade associations, is not treated as a tax expenditure for the same reason applicable to for-profit pass-through business entities. With respect to other nonprofit organizations, such as charities, tax-exempt status is not classified as a tax expenditure because the nonbusiness activities of such organizations generally must predominate and their unrelated business activities are subject to tax. In general, the imputed income derived from nonbusiness activities conducted by individuals or collectively by certain nonprofit organizations is outside the normal income tax base. However, the ability of donors to such nonprofit organizations to claim a charitable contribution deduction is a tax expenditure, as

¹² See discussion of individual AMT on page 6.

is the exclusion of income granted to holders of tax-exempt financing issued by charities.

Recent Legislation

The Working Families Tax Relief Act of 2004 (H.R. 1308, Pub. L. No. 108-311), enacted on October 4, 2004, modified several tax expenditures:

—The tax credit for children under age 17 was increased from \$700 to \$1,000 per child for taxable years beginning after December 31, 2004, and before December 31, 2008, and from \$800 to \$1,000 per child for taxable years beginning after December 31, 2008, and before December 31, 2009. Acceleration in refundability of the child credit from 10 percent to 15 percent of the taxpayer's earned income in excess of \$10,750 (with indexing) was made effective for taxable years beginning in 2004. For taxable years beginning after December 31, 2004, combat pay that is otherwise excluded from gross income will be counted as earned income for the purposes of computing taxable income with respect to calculating the refundable portion of the child credit. In Table 1, these changes are reflected in the tax expenditure estimate for "Earned income credit (EIC)."

—The earned income credit was modified to allow taxpayers to elect to treat combat pay that is otherwise excluded from gross income as earned income for the purposes of the earned income credit. The election was made available for taxable years beginning in 2004 and 2005. In Table 1, this change is reflected in the tax expenditure estimate for "Earned income credit (EIC)."

—A uniform definition of a qualifying child was established with respect to the following tax expenditures: the child credit, the earned income credit, and the dependent care credit. Under the uniform definition, in general, a child must satisfy each of the following tests to be defined as a qualifying child of a taxpayer: (1) the child has the same principal abode as the taxpayer for more than one half of the taxable year; (2) the child has a specified relationship to the taxpayer; and (3) the child has not yet attained a specified age. This provision is effective for taxable years beginning after December 31, 2004. In Table 1, these changes are reflected in the tax expenditure estimates for "Tax credit for children under age 17," "Earned income credit (EIC)," and "Tax credit for child and dependent care expenses."

—The phaseout of the tax credit for electric vehicles was eliminated for taxable years beginning in 2004 and 2005. (Under prior law, the phaseout began for property placed in service after December 31, 2003. The credit was reduced by 25 percent for taxable years beginning in 2004 and 50 percent for taxable years beginning in 2005.) Under present law, the credit will retain a reduction of 75 percent for taxable years beginning in 2006. No credit is available for taxable years beginning after December 31, 2006. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

The Working Families Tax Relief Act also extended a number of expired or expiring provisions:

—The tax credit for research and experimentation expenses was extended for 18 months. The provision is effective for expenditures

paid or incurred after June 30, 2004, and before January 1, 2006. The tax expenditure estimate in Table 1, "Tax credit for qualified research expenditures," is based on expenses paid or incurred prior to the expiration date and reflects unused credits that are carried forward to succeeding taxable years.

—The work opportunity tax credit was extended for two years. The credit is available for wages paid or incurred for workers beginning work after December 31, 2003, and on or before December 31, 2005. However, many employees who are hired in 2005 will earn credits for their employers in 2006 because the credit applies to wages paid during the first 12 months of employment. The tax expenditure estimate in Table 1, "Work opportunity tax credit," is based on credits attributable to wages paid or incurred to employees who begin work in 2005 and credits that were earned in prior years and carried forward to subsequent taxable years.

—The welfare-to-work tax credit was extended for two years. The credit is available for wages paid or incurred for workers beginning work after December 31, 2003, and on or before December 31, 2005. However, employees who are hired in 2004 and 2005 will earn credits for their employers in 2006 and 2007 respectively because the credit applies to wages paid during the first 24 months of employment. The tax expenditure estimate in Table 1, "Welfare-to-work tax credit," is based on credits attributable to wages paid or incurred to employees who begin work in 2004 and 2005 and credits that were earned in prior years and carried forward to subsequent taxable years.

—The authority to issue qualified zone academy bonds was extended for two years. The provision is effective for obligations issued after December 31, 2003. The authority will expire for obligations issued after December 31, 2005. Table 1 contains a tax expenditure estimate for "Tax credits for holders of qualified zone academy bonds" that is based on tax credits that will be claimed for zone academy bonds issued prior to expiration.

—The enhanced deduction for corporate contributions of computer equipment to public libraries and elementary and secondary schools was extended for two years. The deduction is available for contributions made during taxable years beginning after December 31, 2003, and before January 1, 2006. This deduction is reflected in Table 1 in the tax expenditure estimate for "Deduction for charitable contributions to educational institutions."

—The above-the-line deduction for teacher classroom expenses was extended for two years. The deduction will be available for expenses incurred in taxable years beginning in 2004 and 2005. The tax expenditure estimate in Table 1, "Above-the-line deduction for teacher classroom expenses," is based on deductions for expenses incurred in taxable years beginning before January 1, 2006.

—The expensing of environmental remediation costs ("brownfields") was extended for two years. The provision is effective for expenses paid or incurred after December 31, 2003, and before January 1, 2006. In Table 1, this change is reflected in the tax expenditure estimate for "Expensing of environmental remediation costs ("brownfields")." The negative tax expenditure estimates for fiscal years 2007 through 2009 are attributable to two factors. First, the depreciation deductions in those years are smaller than

the deductions that would have been claimed if the remediation costs in earlier years had not qualified for expensing. Second, larger capital gains taxes will be paid in those years on sales of property for which remediation costs had been incurred in prior years. The basis of the property is reduced by the amount of the expensed remediation costs, and this results in larger capital gains upon the sale of the property.

—Certain tax incentives with respect to the New York City Liberty Zone were extended. These incentives are: (1) an extension of the authority to issue Liberty Zone bonds, which will expire for obligations issued after December 31, 2009; and (2) a one-year extension of the authority for one additional advance refunding for certain bonds for facilities located in New York City, which will expire after December 31, 2005. The Act also clarified that certain bonds issued by the Municipal Assistance Corporation are eligible for one additional advanced refunding. In Table 1, these changes are reflected in the tax expenditure estimate for “New York City Liberty Zone tax incentives.”

—Tax incentives for the District of Columbia enterprise zone were extended for two years. These incentives are: (1) a wage credit for workers who live in the District and work for a qualified District of Columbia enterprise zone business, which will expire for wages incurred after December 31, 2005; (2) a capital gains exclusion for qualified tangible property that is placed in service in the District of Columbia enterprise zone, which will expire for property acquired after December 31, 2005; (3) an increase in section 179 expensing for District of Columbia enterprise zone businesses, which will expire for property placed in service after December 31, 2005; and (4) the authority to issue tax-exempt development bonds, which will expire after December 31, 2005. Also, the tax credit for first-time homebuyers in the District of Columbia was extended for two years. The credit will expire for property purchased after December 31, 2005. In Table 1, all of these tax provisions are combined in the tax expenditure estimate for “District of Columbia tax incentives.”

—The tax credit for electricity production from renewable resources was extended for two years. The provision generally is effective for facilities placed in service after December 31, 2003. Facilities placed in service prior to January 1, 2006 are eligible to claim the credit. The tax expenditure estimate in Table 1, “Tax credit for electricity production from renewable resources,” is based on tax credits earned by facilities placed in service prior to the expiration date. This provision was further modified by the American Jobs Creation Act of 2004, which is described later in this section.

—The wage credit for Indian reservation employment was extended for one year. The provision is effective January 1, 2005. The credit will expire for wages incurred after December 31, 2005. The tax expenditure estimate in Table 1, “Wage credit for Indian reservation employment,” is based on wages incurred through December 31, 2005, and credits carried forward to succeeding taxable years.

—The availability of Archer medical savings accounts (“MSAs”) was extended through December 31, 2005. After that date, no new contributions may be made to Archer MSAs except by individuals

who previously made Archer MSA contributions and by the employees of small employers with prior Archer MSA participation. The Archer MSA tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

The American Jobs Creation Act of 2004 (H.R. 4520, Pub. L. No. 108-357), enacted on October 22, 2004, eliminated the following tax expenditures:

—The exclusion of extraterritorial income (“ETI”) from gross income was eliminated. However, for transactions prior to 2005, taxpayers retain 100 percent of their ETI benefits. For transactions after 2004, the Act provides taxpayers with 80 percent of their otherwise-applicable ETI benefits for transactions during 2005 and 60 percent of their otherwise-applicable ETI benefits during 2006. ETI exclusion provisions remain in effect for transactions in the ordinary course of a trade or business if such transactions are pursuant to a binding contract in effect on September 17, 2003. The provision is effective for transactions after December 31, 2004. In Table 1, these changes are reflected in the tax expenditure estimate for “Exclusion of extraterritorial income.”

—The Act eliminated the reforestation tax credit, which provided a 10-percent credit on up to \$10,000 of qualified amortizable basis in timber property. This tax expenditure was not previously listed in Table 1 because the estimated revenue loss was below the *de minimis* amount.

The American Jobs Creation Act of 2004 also included several new tax expenditures:

—A deduction relating to income attributable to United States production activities was created. The provision allows a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to a portion of the taxpayer’s qualified production activities income. In general, qualified production activities income is equal to domestic production gross receipts minus the sum of: (1) the costs of goods sold that are allocable to such receipts; (2) other deductions, expenses, or losses that are directly allocable to such receipts; and (3) a proper share of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income. For taxable years beginning after 2009, the deduction is equal to nine percent of the lesser of (1) the qualified production activities income of the taxpayer for the taxable year, or (2) taxable income for the taxable year. For taxable years beginning in 2005 and 2006, the deduction is three percent of income, and for taxable years beginning in 2007, 2008, and 2009, the deduction is six percent of income. However, the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer during the relevant calendar year. The provision is effective for taxable years beginning after December 31, 2004. In Table 1, this provision is reflected in the tax expenditure estimate for “Production activity deduction.”

—The Act provided taxpayers the option to deduct the cost of qualifying film and television productions in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances. The provision applies only to qualifying film and television productions the aggregate cost of which does not exceed \$15 million. This threshold is increased to

\$20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress. The provision is effective for qualifying productions commencing after the date of enactment. The proposal expires for qualifying productions commencing after December 31, 2008. In Table 1, this provision is reflected in the tax expenditure estimate for "Deduction of certain film and television production costs."

—A 50-percent business tax credit is provided for qualified railroad track maintenance expenditures paid or incurred in a taxable year by eligible taxpayers. The credit is limited to the product of \$3,500 times the number of miles of railroad track owned or leased by an eligible taxpayer as of the close of its taxable year. Qualified railroad track maintenance expenditures are defined as amounts expended (whether or not chargeable to a capital account) for maintaining a railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by a Class II or Class III railroad. The taxpayer's basis in railroad track is reduced by the amount of the credit. No portion of the credit may be carried back to any taxable year beginning before January 1, 2005. The provision is effective for expenses paid or incurred during taxable years beginning after December 31, 2004, and before January 1, 2008. In Table 1, this provision is reflected in the tax expenditure estimate for "Provide a 50-percent tax credit for certain expenditures for maintaining railroad tracks."

—Corporations were permitted to elect a "tonnage tax" in lieu of the corporate income tax on taxable income from certain shipping activities. An electing corporation is only subject to tax on these activities at the maximum corporate income tax rate on their notional shipping income, which is based on the net tonnage of the corporation's qualifying vessels. The provision is effective for taxable years beginning after the date of enactment. This tax expenditure is not listed on Table 1 because the estimated revenue loss is below the *de minimis* amount.

—An income tax credit is provided for biodiesel and qualified biodiesel mixtures. The credit is the sum of the biodiesel mixture credit plus the biodiesel credit and is treated as a general business credit. The biodiesel mixture credit is 50 cents for each gallon of biodiesel used by the taxpayer in the production of qualified biodiesel. For agri-biodiesel, the credit is \$1 per gallon. The biodiesel credit is 50 cents for each gallon of biodiesel which is not in a mixture with diesel fuel and which during the taxable year is (1) used by the taxpayer as a fuel in a trade or business or (2) sold by the taxpayer at retail to a person and placed in the fuel tank of such person's vehicle. For agri-biodiesel, the credit is \$1 per gallon. The provision is effective for fuel produced, and sold or used after December 31, 2004. The provision expires December 31, 2006. In Table 1, this provision is reflected in the tax expenditure estimate for "Tax credit for biodiesel blenders."

—The Act provided a charitable deduction for certain expenses incurred in carrying out sanctioned whaling activities. The deduction is limited to \$10,000 per taxable year and is available only to an individual who is recognized by the Alaska Whaling Commis-

sion as a whaling captain charged with the responsibility for maintaining and carrying out sanctioned whaling activities. The provision is effective for contributions made after December 31, 2004. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

—The Act permitted small business refiners to expense up to 75 percent of the costs paid or incurred for the purpose of complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency (“EPA”). In addition, the Act provided that a small business refiner may claim a credit equal to five cents per gallon of low sulfur diesel fuel produced during the taxable year that is in compliance with the Highway Diesel Fuel Sulfur Control Requirements of the EPA. The total production credit claimed by the taxpayer is limited to 25 percent of the capital costs incurred to comply with the EPA diesel fuel requirements. The taxpayer’s basis in the property with respect to which the credit applies is reduced by the amount of the production credit claimed. Costs qualifying for the deduction and the credit are those costs paid or incurred with respect to any facility of a small business refiner during the period beginning January 1, 2003, and ending on the earlier of the date one year after the taxpayer must comply with the applicable EPA regulations or December 31, 2009. These new tax expenditures are listed in Table 1 as “Incentives for small refiners to comply with EPA sulfur regulations.”

—Certain dividends received by U.S. corporations from controlled foreign corporations were made eligible for an 85-percent dividends-received deduction. At the taxpayer’s election, the deduction is available for dividends received either during the taxpayer’s first taxable year beginning on or after the date of enactment of the bill or during the taxpayer’s last taxable year beginning before this date. Dividends received after the election period will be taxed in the normal manner under present law. In Table 1, this provision is reflected in the tax expenditure estimates for “Deferral of active income of controlled foreign corporations” and “Deferral of certain active financing income.” This provision has two effects on these tax expenditure estimates: (1) some conceptually forgone U.S. tax is collected on “old” deferred income, and thereby reduces the tax expenditure for “new” deferred income; and (2) technical aspects of the provision enhance foreign tax creditability in the 2005 to 2009 period for some taxpayers, regardless of whether they have employed deferral for foreign income. On net, these two changes reduce the deferral tax expenditures for 2005 and 2006 and increase the tax expenditures for the 2007 through 2009 period.

—The Act delayed the effective date for Treasury Department regulations regarding an exemption from gross income for earnings of a foreign corporation derived from the international operation of ships and aircraft if an equivalent exemption from tax is granted by the applicable foreign country to corporations organized in the United States. The Act provided that the regulations apply to taxable years of foreign corporations beginning after September 24, 2004. This tax expenditure is not listed on Table 1 because the estimated revenue loss is below the *de minimis* amount.

—A new category of exempt-facility bonds was created: the qualified green building and sustainable design project bond (“qualified

green bond"). A qualified green bond is defined as any bond issued as part of an issue that finances a project designated by the Secretary, after consultation with the Administrator of the Environmental Protection Agency, as a green building and sustainable design project that meets the following requirements: (1) at least 75 percent of the square footage of the commercial buildings that are part of the project is registered for the U.S. Green Building Council's Leadership in Energy and Environmental Design certification and is reasonably expected (at the time of designation) to meet such certification; (2) the project includes a brownfield site; (3) the project receives at least \$5 million in specific State or local resources; and (4) the project includes at least one million square feet of building or at least 20 acres of land. Under the provision, qualified green bonds are not subject to the State bond volume limitations. Rather, there is a national limitation of \$2 billion of qualified green bonds that the Secretary may allocate, in the aggregate, to qualified green building and sustainable design projects. Qualified green bonds may be currently refunded if certain conditions are met, but cannot be advanced refunded. The provision is effective for bonds issued after December 31, 2004, and before October 1, 2009. In Table 1, this provision is reflected in the tax expenditure estimate for "Exclusion of interest on State and local government bonds for qualified green building and sustainable design projects."

—To implement Federal Energy Regulatory Commission restructuring policy, the Act permitted taxpayers to elect to recognize gain from qualifying electric transmission transactions ratably over an eight-year period beginning in the year of sale if the amount realized from such sale is used to purchase exempt utility property within the applicable period. The applicable period is four years after the close of the taxable year in which the transaction occurs. If the amount realized exceeds the amount used to purchase reinvestment property, any realized gain shall be recognized as in the year of the transaction. Any remaining realized gain is recognized ratably over the eight-year period. A qualifying electric transmission transaction is the sale or other disposition of property used by the taxpayer in the trade or business of providing electric transmission services, or an ownership interest in such an entity, to an independent transmission company prior to January 1, 2007. The provision is effective for transactions occurring after the date of enactment. In Table 1, this provision is reflected in the tax expenditure estimate for "Deferral of gain from the disposition of electric transmission property to implement Federal Energy Regulatory Commission restructuring policy."

The American Jobs Creation Act of 2004 also modified several tax expenditures:

—The maximum dollar amount that may be deducted under section 179 was increased from \$25,000 to \$100,000 for property placed in service in taxable years beginning before 2008. In addition, for purposes of the phase-out of the deductible amount, the \$200,000 amount is increased to \$400,000 for property placed in service in taxable years beginning before 2008. The provision extends through 2007 the indexing for inflation of both the maximum dollar amount that may be deducted and the \$400,000 amount. Section 179 was also expanded to include off-the-shelf computer

software placed in service in taxable years before 2008. These provisions are effective for taxable years beginning after December 31, 2005. In Table 1, these changes are reflected in the tax expenditure estimate for "Expensing under section 179 of depreciable business property."

—The Act provided a 15-year recovery period for qualified leasehold improvement property placed in service after October 22, 2004, and before January 1, 2006. The provision requires that qualified leasehold improvement property be recovered using the straight-line method. The definition of qualified property was modified such that qualified property is not qualified for subsequent owners of such improvement. An exception to this rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment. In addition, a 15-year recovery period was established for qualified restaurant property placed in service after the date of enactment and before January 1, 2006. The provision requires that the qualified restaurant property be recovered using the straight-line method. In Table 1, these changes are reflected in the tax expenditure estimate for "Depreciation of buildings other than rental housing in excess of alternative depreciation system."

—The Secretary of Housing and Urban Development was authorized to add contiguous census tracts to a renewal community in the following general circumstances. First, the renewal community, including any tract to be added, must have met the renewal community eligibility requirements at the time of the community's original nomination. In addition, any tract to be added must have a poverty rate using 2000 Census data that exceeds the poverty rate of such tract using 1990 Census data. Second, a tract may be added to a renewal community even if the addition of such tract to such community would have caused the community to fail one or more eligibility requirements when originally nominated using the 1990 Census data, provided that: (1) the renewal community after the inclusion of such tract does not have a population that exceeds 200,000 using either 1990 or 2000 Census data; (2) such tract has a poverty rate of at least 20 percent using 2000 Census data; and (3) such tract has a poverty rate using 2000 Census data that exceeds the poverty rate of such tract using 1990 Census data. These provisions are effective as if included in the amendment made by section 101 of the "Community Renewal Tax Relief Act of 2000." In Table 1, these changes are reflected in the tax expenditure estimate for "Renewal community tax incentives."

—The Act extended the use of income averaging to individuals engaged in the trade or business of fishing. Under prior law income averaging was available only to farmers. An individual taxpayer engaged in a farming or fishing business may elect to compute his or her current year tax liability by averaging, over the prior 3-year period, all or a portion of his or her taxable income from the trade or business of farming. The extension of income averaging to fishermen is effective for taxable years beginning after December 31, 2003. In Table 1, this change is reflected in the tax expenditure estimate for "Income averaging for farmers and fishermen."

—The Act provided an exclusion from gross income for education loan repayments provided under the National Health Service Corps

("NHSC") Loan Repayment Program and State programs eligible for funds under the Public Health Service Act. This provision is effective for taxable years beginning after December 31, 2003. In Table 1, this change is reflected in the tax expenditure estimate for "Exclusion of income attributable to the discharge of certain student loan debt and NHSC Educational Loan repayments."

—The Act permitted on a property-by-property basis up to \$10,000 of qualified reforestation expenditures to be expensed. Qualified reforestation expenditures above \$10,000 are to be amortized over 84 months. This provision is effective for expenditures paid or incurred after the date of enactment. In Table 1, this change is reflected in the tax expenditure estimate for "Expensing of timber-growing costs."

—The alcohol fuels income tax credit was extended through December 31, 2010. In Table 1, this change is reflected in the tax expenditure estimate for "Tax credit for alcohol fuel blenders."

—The placed in service date was extended for bonus depreciation for certain non-commercial aircraft. Qualifying aircraft are eligible for the additional first-year depreciation deduction if placed in service before January 1, 2006. In order to qualify, the aircraft must: (1) be acquired by the taxpayer during the applicable time period as under prior law; (2) meet the appropriate placed-in-service date requirements; (3) not be tangible personal property used in the trade or business of transporting persons or property (except for agricultural or firefighting purposes); (4) be purchased by a purchaser who, at time of the contract for the purpose, has made a nonrefundable deposit of the lesser of ten percent of the cost or \$100,000; and (5) have an estimated production period exceeding four months and a cost exceeding \$200,000. This provision is effective as if included in the amendments made by section 101 of the "Job Creation and Worker Assistance Act of 2000." In addition, a special rule was provided with respect to bonus depreciation in the case of multiple units of property subject to the same lease. In such cases, property will qualify as placed in service on the date of sale if sold within three months after the final unit is placed in service, provided the period between the time the first unit is placed in service and the last unit is placed in service does not exceed 12 months. This provision is effective for sales after June 4, 2004. In Table 1, these changes are reflected in the tax expenditure estimate for "Depreciation of equipment in excess of the alternative depreciation system."

—The maximum allowable amount of total capital expenditures by an eligible business or a related party for the purpose of qualified small issue bond issuance was increased from \$10 million to \$20 million. This provision is effective for bonds issued after September 30, 2009. In Table 1, this change is reflected in the tax expenditure estimate for "Exclusion of interest on State and local government small-issue bonds."

—The Act repealed the subpart F rules relating to foreign base company shipping income. The Act also amended the exception from foreign personal holding company income applicable to rent or royalties derived from unrelated persons in an active trade or business by providing safe harbor for rents derived from leasing an aircraft or vessel in foreign commerce. Such rents are excluded from

foreign personal holding company income if the active leasing expenses comprise at least 10 percent of the profit on the lease. This provision is effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders within which such taxable years of such foreign corporations end. In Table 1, these changes are reflected in the tax expenditure estimate for "Deferral of active income of controlled foreign corporations."

—The Act modified the temporary exceptions from subpart F foreign personal holding company income and foreign base company services income for income derived in the active conduct of a banking, financing, or similar business. For the purposes of determining whether a controlled foreign corporation or a qualified business unit has conducted directly in its home country substantially all of the activities in connection with transactions with customers, the Act provided that an activity is treated as conducted directly by the controlled foreign corporation or qualified business unit in its home country if the activity is performed by employees of a related person and: (1) the related person is itself an eligible controlled foreign corporation the home country of which is the same as that of the controlled foreign corporation or qualified business unit; (2) the activity is performed in the home country of the related person; and (3) the related person is a compensated on an arm's length basis for the performance of the activity by its employees and such compensation is treated as earned by such person in its home country for the purposes of the tax laws of such country. This provision is effective for taxable years of foreign corporations beginning after December 31, 2004, and for taxable years of U.S. shareholders within which such taxable years of such foreign corporations end. In Table 1, these changes are reflected in the tax expenditure estimate for "Deferral of certain active financing income."

—The deduction for State and local taxes paid was modified to provide that a taxpayer may elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction provided for State and local income taxes. Taxpayers have two options with respect to the sales tax deduction amount. Taxpayers may deduct the total amount of general State and local sales taxes paid by accumulating receipts showing general sales taxes paid. Alternatively, taxpayers may use tables created by the Secretary of the Treasury. The tables are to be based on average consumption by taxpayers on a State-by-State basis taking into account filing status, number of dependents, adjusted gross income and rates of State and local general sales taxation. Taxpayers who use the tables created by the Secretary may, in addition to the table amounts, deduct eligible general sales taxes paid with respect to the purchase of motor vehicles, boats and other items specified by the Secretary. Sales taxes for items that may be added to the tables are not to be reflected in the tables themselves. This provision is effective for taxable years beginning after December 31, 2003, and before January 1, 2006. In Table 1, this change is reflected in the tax expenditure estimate for "Deduction of nonbusiness State and local government income, sales, and personal property taxes."

—The Act provided a statutory seven-year recovery period for permanent motorsports racetrack complexes. For this purpose, mo-

torsports racetrack complexes include land improvements and support facilities but do not include transportation equipment, warehouses, administrative buildings, hotels, or motels. This provision is effective for property placed in service after the date of enactment and before 2008. In Table 1, this change is reflected in the tax expenditure estimate for "Depreciation of equipment in excess of the alternative depreciation system."

—The Act established a statutory seven-year recovery period and a class life of 22 years for any Alaska natural gas pipeline. In order to qualify for the seven-year recovery period, otherwise qualifying property must be placed in service after December 13, 2013. A taxpayer who places qualifying property in service before January 1, 2014 may elect to treat the pipeline as placed in service on January 1, 2014. This change is not reflected in Table 1 because the provision affects only tax expenditure estimates beyond 2009.

—The enhanced oil recovery cost credit was extended such that expenses in connection with the construction of any qualifying natural gas processing plant capable of processing two trillion British thermal units of Alaskan natural gas into a natural gas pipeline system on a daily basis are qualified enhanced oil recovery costs eligible for the credit. The provision is effective for costs paid or incurred in taxable years beginning after December 31, 2004. This change is not reflected in Table 1 because the provision affects only tax expenditure estimates beyond 2009.

—The Act provided that qualified naval ship contracts may be accounted for using the 40/60 percentage of completion/capitalized cost method during the first five taxable years of the contract. The cumulative reduction in tax resulting from the provision over the five-year period is recaptured and included in the taxpayer's tax liability in the sixth year. This provision is effective for contracts entered into after the date of enactment. This change is reflected in the tax expenditure estimate for "Completed contract rules."

—The Act modified the income tax credit for the production of electricity from qualified wind energy, qualified closed-loop biomass, or qualified poultry waste facilities. In general, the Act defined five new qualifying resources for the production of electricity: open-loop biomass (including agricultural livestock waste nutrients), geothermal energy, solar energy, small irrigation power, and municipal solid waste. Two different qualifying facilities use municipal solid waste as a qualifying resource: landfill gas facilities and trash combustion facilities. In addition, refined coal was defined as a qualifying resource. The credit period for the new qualifying resources is five years commencing on the date the facility is placed into service. In general, for facilities placed in service prior to January 1, 2005, the credit period commences on January 1, 2005. The credit amount allowable for the new qualifying resources is defined as one-half the amount of the existing credit (1.5 cents per kilowatt-hour indexed for inflation and currently 1.8 cents per kilowatt-hour). An alternative credit was applied for the production of refined coal. A qualified refined coal facility may claim a credit at a rate of \$4.375 per ton (indexed for inflation after 1992) of refined coal sold to an unrelated person. As is the case for facilities that produce electricity, the credit a taxpayer may claim for the production of refined coal is phased out as the market price of refined coal

exceeds certain threshold levels. This provision is effective for property placed in service after the date of enactment. In Table 1, these changes are reflected in the tax expenditure estimate for "Tax credit for electricity production from renewable resources."

—The rules regarding charitable contribution donations of patents and other intellectual property were modified. If a taxpayer contributes a patent or other intellectual property (other than certain copyrights or inventory) to a charitable organization, the taxpayer's initial charitable contribution is limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property. In addition, the taxpayer is permitted to deduct, as a charitable deduction, certain additional amounts in the year of the contribution or in subsequent taxable years based on a specified percentage of the qualified donee income received or accrued by the charitable donee with respect to the contributed property. The amount of any additional deduction is calculated as a sliding-scale percentage of qualified donee income that is allocable to the contributed property of the applicable taxable year. No charitable contribution is permitted with respect to any revenues or income received or accrued by the charitable donee after the expiration of the legal life of the patent or intellectual property, or after the tenth anniversary of the date the contribution was made by the donor. The provision is effective for contributions made after June 30, 2004. In Table 1, this change is reflected in the tax expenditure estimates for "Deduction for charitable contributions to educational institutions" and "Deduction for charitable contributions for health organizations."

—The Act required increased donor reporting for certain charitable contributions of property other than cash, inventory, or publicly traded securities. The provision in general extends to all C corporations the prior law requirement that the donor must obtain a qualified appraisal of the property if the amount of the deduction claimed exceeds \$5,000. The provision is effective for contributions made after June 30, 2004. In Table 1, this change is reflected in the tax expenditure estimates for "Deduction for charitable contributions to educational institutions," "Deduction for charitable contributions for health organizations," and "Deduction for charitable contributions, other than for education and health."

—The amount of the deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeds \$500 and excluding inventory property) was made dependent upon the use of the vehicle by the donee organization. If the organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, then the amount of the deduction shall not exceed the gross proceeds received from the sale. The provision also in general imposed new substantiation requirements for contributions of vehicles for which the claimed value exceeds \$500. The provision is effective for contributions made after December 31, 2004. In Table 1, this change is reflected in the tax expenditure estimates for "Deduction for charitable contributions to educational institutions," "Deduction for charitable contributions for health organizations," and "Deduction for charitable contributions, other than for education and health."

The Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 (H.R. 4200, Pub. L. No. 108-3755), enacted on October 28, provided for the exclusion from gross income of qualified travel benefits received under the Operation Hero Miles program. Travel benefits include frequent traveler miles, credits for tickets, and tickets for air or surface transportation to facilitate the travel of: (1) an armed services member on active duty outside the United States, or (2) family members of an armed services member who is recuperating from injury sustained in the course of such duty. In Table 1, this change is reflected in the tax expenditure estimate for "Exclusion of benefits and allowances to Armed Forces personnel."

Expiring Tax Expenditure Provisions

A number of tax expenditure provisions expired in 2004 or are scheduled to expire in 2005:

—The designation of certain enterprise communities designated during 1994 expired. Code section 1391(d)(1) specifies that designation of enterprise communities ends upon the earliest of: (1) the close of the 10th calendar year on or after designation, (2) the termination date designated by the nominating State and local governments, or (3) the date the appropriate Secretary revokes the designation. The tax incentives of enterprise communities include the authority to issue tax-exempt facility bonds and residence eligibility with respect to the work opportunity tax credit, the welfare-to-work tax credit, and the Indian employment tax credit. In Table 1, this expiration is reflected in the tax expenditure estimate for "Empowerment zone tax incentives."

—The additional first-year depreciation deduction (sec. 168(k)) is scheduled to expire for property placed in service after December 31, 2004. The deduction is equal to 30 percent of the adjusted basis of qualifying MACRS property for property acquired after September 10, 2001 and before May 6, 2003, and placed in service before January 1, 2005. The deduction is equal to 50 percent of the adjusted basis of qualifying MACRS property for property acquired after May 5, 2003 and placed in service before January 1, 2005. However, the qualifying placed in service date for the 30 and 50 percent rates is January 1, 2006 for property which (1) is produced by a taxpayer and subject to uniform capitalization rules (sec. 263A), (2) has a production period greater than two years, or greater than one year and a cost exceeding \$1 million, or (3) has a MACRS recovery period of at least 10 years or is used in the trade or business of transporting persons for hire, such as commercial aircraft. The January 1, 2006 placed in service date also applies to certain noncommercial aircraft acquired by purchase. In Table 1, this expiration is reflected in the tax expenditure estimate for "Depreciation of equipment in excess of the alternative depreciation system."

—The income tax credit for the production of electricity from renewable resources, as modified by the American Jobs Creation Act of 2004, is scheduled to expire for facilities placed in service after December 31, 2005. The tax expenditure estimate in Table 1 is based on tax credits earned by facilities placed in service prior to the expiration date.

—The work opportunity credit, as extended by the Working Families Tax Relief Act of 2004, expires for employees who begin work after December 31, 2005. The tax expenditure estimate in Table 1 is based on credits attributable to wages paid or incurred to employees who begin work before December 31, 2005 and credits that are earned in prior years and are carried forward to subsequent taxable years.

—The welfare-to-work tax credit, as extended by the Working Families Tax Relief Act of 2004, expires for employees who begin work after December 31, 2005. The tax expenditure estimate in Table 1 is based on credits attributable to wages paid or incurred to employees who begin work before December 31, 2005 and credits that were earned in prior years and carried forward to subsequent taxable years.

—The above-the-line deduction for teacher classroom expenses, as extended by the Working Families Tax Relief Act of 2004, is scheduled to expire for expenses incurred in taxable years beginning after December 31, 2005. The tax expenditure estimate in Table 1 is based on deductions for expenses incurred in taxable years beginning before December 31, 2005.

—The option to deduct State and local sales taxes in lieu of State and local income taxes, as allowed by the American Jobs Creation Act of 2004, is scheduled to expire for taxable years beginning after December 31, 2005. The tax expenditure estimate “Deduction of nonbusiness State and local government income, sales, and personal property taxes” in Table 1 is based on deductions for taxes paid in taxable years beginning before December 31, 2005.

—As extended by the Working Families Tax Relief Act of 2004, the enhanced deduction for corporate contributions of computer equipment to public libraries and elementary and secondary schools is scheduled to expire for contributions made after December 31, 2005. In Table 1, this expiration is reflected in the tax expenditure estimate for “Deduction for charitable contributions to educational institutions.”

—The expensing of environmental remediation costs (“brownfields”), as extended by the Working Families Tax Relief Act of 2004, is scheduled to expire for expenses paid or incurred after December 31, 2005. In Table 1, this expiration is reflected in the tax expenditure estimate for “Expensing for environmental remediation costs (“brownfields”).”

—The availability of Archer medical savings accounts (“MSAs”), as extended by the Working Families Tax Relief Act of 2004, is scheduled to expire for contributions made after December 31, 2005. The Archer MSA tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

—The authority to issue qualified zone academy bonds, as extended by the Working Families Tax Relief Act of 2004, expires for obligations issued after December 31, 2005. Table 1 contains a tax expenditure estimate for “Tax credits for holders of qualified zone academy bonds” that is based on tax credits that will be claimed for zone academy bonds issued prior to the expiration.

—The tax incentives for the District of Columbia enterprise zone, as extended by the Working Families Tax Relief Act of 2004, scheduled to expire include (1) a wage credit for workers who live in the

District and work for a qualified District of Columbia enterprise zone business, which expires for wages incurred after December 31, 2005; (2) a capital gains exclusion for qualified tangible property that is placed in service in the District of Columbia enterprise zone, which expires for property acquired after December 31, 2005; (3) an increase in section 179 expensing for District of Columbia enterprise zone businesses, which expires for property placed in service after December 31, 2005; and (4) the authority to issue tax-exempt development bonds, which expires after December 31, 2005. In addition, the tax credit for first-time homebuyers in the District of Columbia expires for property purchased after December 31, 2005. In Table 1, all of these tax provisions are combined in the tax expenditure estimate for "District of Columbia tax incentives." The tax expenditure estimates for fiscal years 2006 through 2009 are primarily attributable to (1) the capital gains exclusion for tangible property that is placed in service prior to December 31, 2005, and sold during those fiscal years and (2) the exclusion of interest received during those fiscal years by the holders of tax-exempt bonds issued prior to December 31, 2005.

—The tax incentives for the New York City Liberty Zone include (1) an additional first-year depreciation deduction for qualified Liberty Zone property, which expires for property placed in service after December 31, 2009; (2) the authority to issue tax-exempt private activity bonds, which was extended by the Working Families Tax Relief Act of 2004 and expires after December 31, 2009; (4) the authority for one additional advance refunding for certain bonds for facilities located in New York City, which was extended by the Working Families Tax Relief Act of 2004 and expires after December 31, 2005; (5) an increase in section 179 expensing for qualified property used in the Liberty Zone, which expires for taxable years beginning after December 31, 2006; and (6) a five-year recovery period for Liberty Zone leasehold improvement property, which expires for property placed in service after December 31, 2006. In Table 1, all of these tax provisions are combined in the tax expenditure estimate for "New York City Liberty Zone tax incentives."

—The tax credit for research and experimentation expenses, which was extended by the Working Families Tax Relief Act of 2004, expires for expenses paid or incurred after December 31, 2005. The tax expenditure estimates in Table 1 are based on expenses paid or incurred prior to the expiration date and unused credits carried forward to succeeding taxable years.

—The wage credit for Indian reservation employment expires for wages incurred after December 31, 2005. The tax expenditure estimate in Table 1 is based on wages incurred through December 31, 2005, and credits carried forward to succeeding taxable years.

—The 15-year straight-line cost recovery for qualified leasehold improvement property and qualified restaurant property expires for property placed in service after December 31, 2005. In Table 1, these expirations are reflected in the tax expenditure estimate for "Depreciation of buildings other than rental housing in excess of the alternative depreciation system."

Comparisons with Treasury Department

The Joint Committee staff and Treasury lists of tax expenditures differ in three respects. First, the Treasury uses a different classification of those provisions that can be considered a part of normal income tax law under both the individual and business income taxes. In general, the Joint Committee staff methodology involves a broader definition of the normal income tax base. Thus, the Joint Committee list of tax expenditures includes some provisions that are not contained in the Treasury list. The cash method of accounting by certain businesses provides an example. The Treasury considers the cash accounting option for certain businesses to be a part of normal income tax law, but the Joint Committee staff methodology treats it as a departure from normal income tax law that constitutes a tax expenditure.

Second, the Joint Committee staff and Treasury estimates of tax expenditures span slightly different sets of years. The Treasury's estimates cover a seven-year period—the last fiscal year, the current fiscal year when the President's budget is submitted, and the next five fiscal years, *i.e.*, fiscal years 2003–2009. The Joint Committee staff estimates cover the current fiscal year and the succeeding four fiscal years, *i.e.*, fiscal years 2005–2009.

Third, the Joint Committee staff list excludes those provisions that are estimated to result in revenue losses below the *de minimis* amount, *i.e.* less than \$50 million over the five fiscal years 2005 through 2009. The Treasury rounds all yearly estimates to the nearest \$10 million and excludes those provisions with estimates that round to zero in each year, *i.e.* provisions that result in less than \$5 million in revenue loss in each of the years 2003 through 2009.

In some cases, two or more of the tax expenditure items in the Treasury list have been combined into a single item in the Joint Committee staff list, and vice versa. The Table 1 descriptions of some tax expenditures also may vary from the descriptions used by the Treasury.

The following is a list of tax provisions that are contained in the Joint Committee staff list of tax expenditures (and are shown in Table 1) but are not contained in the Treasury list:

National defense

- Deduction for overnight-travel expenses of National Guard and Reserve Members

Natural resources and environment

- Exclusion of contributions in aid of construction for water and sewer utilities
- Special rules for mining reclamation reserves
- Special tax rate for nuclear decommissioning reserve funds

Agriculture

- Exclusion of cost-sharing payments
- Cash accounting for agriculture
- Five-year carryback period for net operating losses attributable to farming

Insurance companies

- Special treatment of life insurance company reserves
- Deduction of unpaid loss reserves of property and casualty companies

Business and commerce

- Expensing of magazine circulation expenditures
- Special rules for magazine, paperback book, and record returns
- Completed contract rules
- Cash accounting, other than agriculture
- Deferral of gain on like-kind exchanges
- Exception from net operating loss limitations for corporations in bankruptcy
- Tax credit for employer-paid FICA taxes on tips

Employment

- Exclusion of miscellaneous fringe benefits
- Exclusion of employee awards
- Exclusion of income earned by voluntary employee beneficiary associations
- Deferral of taxation on spread on acquisition of stock under incentive stock option plans and employee stock purchase plans

Medicare

- Exclusion of Medicare benefits for Hospital Insurance
- Exclusion of untaxed Medicare benefits for Supplementary Medical Insurance
- Prescription drug insurance
- Exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare

The following tax provisions are not included in the Joint Committee staff list of tax expenditures or the Treasury list. However, these provisions are viewed as tax expenditures by the Joint Committee staff. These provisions are not listed in Table 1 because the estimated revenue losses for fiscal years 2005 through 2009 are below the de minimis amount (\$50 million):

Energy

- Expensing of tertiary injectants

Financial institutions

- Exclusion of investment income from structured settlement arrangements

Income security

- Exclusion of survivor annuities paid to families of public safety officers killed in the line of duty

Social services

- Exclusion of restitution payments received by victims of the Nazi regime and the victims' heirs and estates

Health

—Archer medical savings accounts

The following is a list of the tax provisions that are included in the Treasury list and are viewed as tax expenditures by the Joint Committee staff but are excluded from Table 1 because the estimated revenue losses for fiscal years 2005 through 2009 are below the de minimis amount (\$50 million):

Agriculture

—Deferral of tax on gains from the sale of stock in a qualified refiner or processor to an eligible farmer's cooperative

Financial institutions

—Bad debt reserves of financial institutions

Insurance companies

—Special alternative tax on small property and casualty insurance companies

—Tax exemption for certain small insurance companies

Business and commerce

—Exclusion of income from discharge of indebtedness incurred in connection with qualified real property

There are three additional tax expenditure provisions in the Treasury list that are not included in the Joint Committee staff list. Two of the provisions involve exceptions to the passive loss rules: the exception for working interests in oil and gas properties, and the exception for up to \$25,000 of rental losses. The Joint Committee staff does not classify these two provisions as tax expenditures; the effects of the passive loss rules (and exceptions to the rules) are included in the estimates of the tax expenditure provisions that are affected by the rules.¹³ The third tax expenditure in the Treasury list that is not included in the Joint Committee staff list is the exemption of certain income of telephone and electric cooperatives. The Joint Committee staff does not classify this provision as a tax expenditure because the special tax rules for pass-through entities are assumed to be a part of normal tax law.¹⁴

¹³ See discussion of the alternative minimum tax and passive loss rules, above on page 6.

¹⁴ See discussion on pages 7–8, above.

II. MEASUREMENT OF TAX EXPENDITURES

Tax Expenditure Estimates Generally

A tax expenditure is measured by the difference between tax liability under present law and the tax liability that would result from a recomputation of tax without benefit of the tax expenditure provision. Taxpayer behavior is assumed to remain unchanged for tax expenditure estimate purposes.¹⁵

The tax expenditure estimates in this report are based on the January 2004 Congressional Budget Office revenue baseline and Joint Committee staff projections of the gross income, deductions, and expenditures of individuals and corporations for calendar years 2004–2009. These projections are used to compute tax liabilities for the present-law revenue baseline and tax liabilities for the alternative baseline that assumes that the tax expenditure provision does not exist.

Internal Revenue Service (“IRS”) statistics from recent tax returns are used to develop projections of the tax credits, deductions, and exclusions that will be claimed under the present-law baseline. These IRS statistics show the actual usage of the various tax expenditure provisions. In the case of some tax expenditures, such as the earned income credit, there is evidence that some taxpayers are not claiming all of the benefits to which they are entitled, while others are filing claims that exceed their entitlements. The tax expenditure estimates in this report are based on projections of actual claims under the various tax provisions, not the tax benefits to which taxpayers are entitled.

Some tax expenditure estimates are based partly on statistics for income, deductions, and expenses for prior years. Accelerated depreciation is an example. Estimates for this tax expenditure are based on the difference between tax depreciation deductions under present law and the deductions that would have been claimed in the current year if investments in the current year and all prior years had been depreciated using the alternative (normal income tax law) depreciation system.

Each tax expenditure is estimated separately, under the assumption that all other tax expenditures remain in the tax code. If two or more tax expenditures were estimated simultaneously, the total change in tax liability could be smaller or larger than the sum of the amounts shown for each item separately, as a result of interactions among the tax expenditure provisions.

Year-to-year differences in the estimates for each tax expenditure reflect changes in tax law, including phaseouts of tax expenditure

¹⁵ An alternative way to measure tax expenditures is to express their values in terms of “outlay equivalents.” An outlay equivalent is the dollar size of a direct spending program that would provide taxpayers with net benefits that would equal what they now receive from a tax expenditure. The Treasury Department presents estimates of outlay equivalents in the President’s budget in addition to presenting estimates in the same manner as the Joint Committee staff.

provisions and changes that alter the definition of the normal income tax structure, such as the tax rate schedule, the personal exemption amount, and the standard deduction. Some of the estimates for this tax expenditure report may differ from estimates made in previous years because of changes in law and economic conditions, the availability of better data, and improved estimating techniques.

Tax Expenditures versus Revenue Estimates

A tax expenditure estimate is not the same as a revenue estimate for the repeal of the tax expenditure provision for three reasons. First, unlike revenue estimates, tax expenditure estimates do not incorporate the effects of the behavioral changes that are anticipated to occur in response to the repeal of a tax expenditure provision. Second, tax expenditure estimates are concerned with changes in the tax liabilities of taxpayers. Because the tax expenditure focus is on tax liabilities as opposed to Federal government tax receipts, there is no concern for the timing of tax payments. Revenue estimates are concerned with changes in Federal tax receipts that are affected by the timing of tax payments. Third, some of the tax provisions that provide an exclusion from income also apply to the FICA tax base, and the repeal of the income tax provision would automatically increase FICA tax revenues as well as income tax revenues. There may also be interactions between income tax provisions and other Federal taxes such as excise taxes and the estate and gift tax.

If a tax expenditure provision were repealed, it is likely that the repeal would be made effective for taxable years beginning after a certain date. Because most individual taxpayers have taxable years that coincide with the calendar year, the repeal of a provision affecting the individual income tax most likely would be effective for taxable years beginning after December 31 of a certain year. However, the Federal government's fiscal year begins October 1. Thus, the revenue estimate for repeal of a provision would show a smaller revenue gain in the first fiscal year than in subsequent fiscal years. This is due to the fact that the repeal would be effective after the start of the Federal government's fiscal year. The revenue estimate might also reflect some delay in the timing of the revenue gains as a result of the taxpayer tendency to postpone or forgo changes in tax withholding and estimated tax payments.

III. TAX EXPENDITURE ESTIMATES

Tax expenditures are grouped in Table 1 in the same functional categories as outlays in the Federal budget. Estimates are shown separately for individuals and corporations. Those tax expenditures that do not fit clearly into any single budget category have been placed in the most appropriate category.

Several of the tax expenditure items involve small amounts of revenue, and those estimates are indicated in Table 1 by footnote 1. For each of these items, the footnote means that the tax expenditure is less than \$50 million in the fiscal year.

Table 2 presents projections of tax return information for each of nine income classes on the number of all returns (including filing and nonfiling units), the number of taxable returns, the number of returns with itemized deductions, and the amount of tax liability.

Table 3 provides distributional estimates by income class for some of the tax expenditures that affect individual taxpayers. Not all tax expenditures that affect individuals are shown in this table because of the difficulty in making reliable estimates of the income distribution of items that do not appear on tax returns under present law.

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009

[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
National Defense											
Exclusion of benefits and allowances to Armed Forces personnel						2.9	2.9	3.0	3.1	3.1	15.0
Exclusion of military disability benefits						0.1	0.1	0.1	0.1	0.1	0.5
Deduction for overnight-travel expenses of National Guard and Reserve Members						0.1	0.1	0.1	0.1	0.1	0.4
International Affairs											
Exclusion of income earned abroad by U.S. citizens						3.6	3.8	4.0	4.2	4.4	20.1
Exclusion of certain allowances for Federal employees abroad						0.5	0.6	0.6	0.7	0.7	3.0
Exclusion of extraterritorial income	3.1	3.9	1.9	0.1	0.1	0.1	0.1	(1)	(1)	(1)	9.4
Deferral of active income of controlled foreign corporations	3.2	3.4	5.8	6.4	7.0						25.8
Inventory property sales source rule exception	5.9	6.2	6.4	6.3	6.1						30.9
Deferral of certain active financing income	1.0	1.1	1.7								3.8
General Science, Space, and Technology											
Tax credit for qualified research expenditures	4.8	3.0	1.5	1.0	0.4	0.1	0.1	(1)	(1)	(1)	11.0
Expensing of research and experimental expenditures	4.0	5.5	6.3	6.4	6.3	0.1	0.1	0.1	0.1	0.1	31.7
Energy											
Expensing of exploration and development costs:											
Oil and gas	0.5	0.4	0.4	0.5	0.5	(1)	(1)	(1)	(1)	(1)	2.4
Other fuels	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.3
Excess of percentage over cost depletion:											
Oil and gas	0.5	0.5	0.5	0.6	0.6	(1)	(1)	(1)	(1)	(1)	2.8
Other fuels	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2

Incentives for small refiners to comply with EPA sulfur regulations	(1)	(1)	(1)	(1)	(1)	.....	.....	.....	.....	.....	0.1
Tax credit for enhanced oil recovery costs	0.2	0.3	0.3	0.3	0.4	0.1	0.1	0.1	0.1	0.1	2.0
Tax credit for production of non-conventional fuels	1.0	1.1	1.3	0.5	0.1	0.2	0.3	0.3	0.1	(1)	5.1
Tax credit for alcohol fuel blenders ²	(1)	(1)	(1)	(1)	(1)	.....	.....	.....	.....	.....	0.1
Tax credit for biodiesel blenders ³	(1)	(1)	(1)	(1)	(1)	.....	.....	.....	.....	.....	(1)
Exclusion of interest on State and local government bonds for energy production facilities ..	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	1.0
Exclusion of energy conservation subsidies provided by public utilities .....	.....	.....	.....	.....	.....	(1)	(1)	(1)	(1)	(1)	0.1
Tax credit for investments in solar and geothermal energy facilities	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Tax credit for electricity production from renewable resources	0.2	0.2	0.3	0.4	0.4	0.1	0.1	0.1	0.1	0.1	2.0
Deferral of gain from the disposition of electric transmission property to implement Federal Energy Regulatory Commission restructuring policy	2.7	2.1	-0.2	-1.0	-1.0	.....	.....	.....	.....	.....	2.6
Natural Resources and Environment											
Expensing of exploration and development costs, nonfuel minerals	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.3
Excess of percentage over cost depletion, nonfuel minerals	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.9
Expensing and amortization of timber-growing costs	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	1.1
Exclusion of interest on State and local government sewage, water, and hazardous waste facilities bonds	0.2	0.2	0.2	0.2	0.2	0.5	0.5	0.6	0.6	0.6	3.8
Special rules for mining reclamation reserves ..	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Special tax rate for nuclear decommissioning reserve fund	0.4	0.5	0.6	0.7	0.8	.....	.....	.....	.....	.....	3.0
Exclusion of contributions in aid of construction for water and sewer utilities	(1)	(1)	(1)	(1)	(1)	.....	.....	.....	.....	.....	0.2

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009—Continued
[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Agriculture											
Expensing of soil and water conservation expenditures	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Expensing of fertilizer and soil conditioner costs	(1)	(1)	(1)	(1)	(1)	0.1	(1)	(1)	(1)	(1)	0.2
Expensing of the costs of raising dairy and breeding cattle	(1)	(1)	(1)	(1)	(4)	0.1	0.1	(1)	(1)	(4)	0.2
Exclusion of cost-sharing payments	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of cancellation of indebtedness income of farmers						0.1	0.1	0.1	0.1	0.1	0.4
Cash accounting for agriculture	0.1	0.1	0.1	0.1	0.1	0.5	0.6	0.6	0.6	0.6	3.1
Income averaging for farmers and fishermen ...						(1)	(1)	(1)	(1)	(1)	0.1
Five-year carryback period for net operating losses attributable to farming	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Commerce and Housing											
<i>Financial institutions:</i>											
Exemption of credit union income	1.4	1.4	1.5	1.6	1.6						7.5
<i>Insurance companies:</i>											
Exclusion of investment income on life insurance and annuity contracts	2.4	2.5	2.6	2.6	2.7	25.0	25.7	26.4	27.2	27.9	145.0
Small life insurance company taxable income adjustment	0.1	0.1	0.1	0.1	0.1						0.3
Special treatment of life insurance company reserves	1.8	1.9	2.0	2.0	2.1						9.8
Deduction of unpaid property loss reserves for property and casualty insurance companies	1.5	1.6	1.6	1.6	1.7						8.0

Special deduction for Blue Cross and Blue Shield companies	0.9	0.9	1.0	1.0	1.0	.....	.....	.....	.....	.....	4.8
<i>Housing:</i>											
Deduction for mortgage interest on owner-occupied residences						72.6	81.1	87.7	93.5	99.4	434.2
Deduction for property taxes on owner-occupied residences						19.6	15.0	13.4	13.0	13.2	74.1
Exclusion of capital gains on sales of principal residences						22.9	23.7	24.6	25.4	26.3	123.0
Exclusion of interest on State and local government bonds for owner-occupied housing	0.3	0.4	0.4	0.4	0.4	0.9	0.9	1.0	1.0	1.1	6.8
Exclusion of interest on State and local government bonds for rental housing	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	1.4
Depreciation of rental housing in excess of alternative depreciation system	0.4	0.4	0.5	0.5	0.6	3.4	3.8	4.3	4.9	5.6	24.4
Tax credit for low-income housing	3.3	3.4	3.5	3.6	3.7	1.4	1.5	1.5	1.6	1.7	25.2
Tax credit for rehabilitation of historic structures	0.2	0.3	0.3	0.3	0.3	0.1	0.1	0.1	0.1	0.1	1.7
<i>Other business and commerce:</i>											
Reduced rates of tax on dividends and long-term capital gains						57.8	64.2	69.9	78.6	86.3	356.8
Exclusion of capital gains at death						38.0	40.5	43.1	45.7	48.3	215.6
Carryover basis of capital gains on gifts						4.6	4.9	5.2	5.5	5.8	26.0
Deferral of gain on non-dealer installment sales	0.6	0.6	0.7	0.7	0.7	0.5	0.5	0.5	0.5	0.6	5.9
Deferral of gain on like-kind exchanges	1.2	1.3	1.3	1.4	1.4	0.5	0.5	0.5	0.5	0.5	9.1
Depreciation of buildings other than rental housing in excess of alternative depreciation system	1.4	0.9	1.2	1.6	2.1	1.3	0.1	0.2	0.3	0.5	9.6
Depreciation of equipment in excess of the alternative depreciation system	18.8	5.9	10.6	15.7	20.3	2.2	-2.2	-0.1	1.7	3.5	76.4
Expensing under section 179 of depreciable business property	0.5	0.7	0.6	-0.1	-0.4	2.1	3.0	2.5	(1)	-0.9	8.0
Amortization of business startup costs	(1)	(1)	(1)	(1)	(1)	0.6	0.6	0.6	0.6	0.7	3.1

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009—Continued
[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Reduced rates on first \$10,000,000 of corporate taxable income	3.6	4.6	5.1	5.2	5.2	.....	.....	.....	.....	.....	23.7
Permanent exemption from imputed interest rules	(1)	(1)	(1)	(1)	(1)	0.3	0.3	0.3	0.3	0.3	1.6
Expensing of magazine circulation expenditures	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Special rules for magazine, paperback book, and record returns	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Completed contract rules	0.3	0.3	0.3	0.4	0.4	(1)	(1)	(1)	(1)	(1)	1.8
Cash accounting, other than agriculture	(1)	(1)	(1)	(1)	(1)	0.7	0.8	0.8	0.8	0.8	3.9
Exclusion of interest on State and local government small-issue bonds	0.1	0.1	0.1	0.1	0.2	0.3	0.3	0.4	0.4	0.4	2.5
Exception from net operating loss limitations for corporations in bankruptcy proceedings	0.6	0.6	0.6	0.6	0.6	.....	.....	.....	.....	.....	3.0
Tax credit for employer-paid FICA taxes on tips	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.4	2.8
Deduction of certain film and television production costs	0.1	0.1	0.1	0.1	(1)	(1)	(1)	(1)	(1)	(1)	0.3
Production activity deduction	1.8	2.7	3.9	5.5	5.9	0.6	0.9	1.3	1.8	2.0	26.4
Transportation											
Provide a 50-percent tax credit for certain expenditures for maintaining railroad tracks ...	0.1	0.1	0.1	0.1	0.1	.....	.....	.....	.....	.....	0.4
Deferral of tax on capital construction funds of shipping companies	0.1	0.1	0.1	0.1	0.1	.....	.....	.....	.....	.....	0.4
Exclusion of employer-paid transportation benefits .....	.....	.....	.....	.....	.....	4.0	4.2	4.3	4.4	4.5	21.4
Community and Regional Development											
New York City Liberty Zone tax incentives	0.3	0.4	0.1	.....	.....	0.3	0.4	0.3	0.2	0.2	2.0

Empowerment zone tax incentives	0.3	0.4	0.4	0.4	0.5	0.4	0.4	0.5	0.5	0.5	4.2
Renewal community tax incentives	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.5	0.5	3.3
New markets tax credit	0.2	0.2	0.3	0.4	0.3	0.2	0.3	0.4	0.5	0.4	3.3
District of Columbia tax incentives	(1)	(1)	(1)	(1)	(1)	0.1	0.1	(1)	0.1	0.1	0.4
Wage credit for Indian reservation employment	0.1	(1)	(1)	(1)	.....	(1)	(1)	(1)	(1)	.....	0.1
Expensing of environmental remediation costs ("brownfields")	0.1	(1)	(4)	(4)	(4)	0.1	(1)	(4)	(4)	(4)	0.1
Exclusion of interest on State and local government bonds for qualified green building and sustainable design projects	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Tax credit for rehabilitation of structures, other than historic structures	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Exclusion of interest on State and local government bonds for private airports, docks, and mass-commuting facilities	0.3	0.3	0.3	0.3	0.3	0.6	0.7	0.7	0.7	0.8	4.9

Education, Training, Employment, and Social Services

Education and training:

Tax credits for tuition for post-secondary education .....	.....	.....	.....	.....	.....	5.2	5.3	5.3	5.4	5.4	26.6
Deduction for interest on student loans .....	.....	.....	.....	.....	.....	0.8	0.9	0.9	0.9	1.0	4.5
Deduction for higher education expenses .....	.....	.....	.....	.....	.....	2.8	0.7	.....	.....	.....	3.5
Exclusion of earnings of Coverdell education savings accounts .....	.....	.....	.....	.....	.....	0.1	0.1	0.1	0.2	0.2	0.7
Exclusion of interest on educational savings bonds .....	.....	.....	.....	.....	.....	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of earnings of qualified tuition programs .....	.....	.....	.....	.....	.....	0.5	0.6	0.7	0.8	0.9	3.4
Exclusion of scholarship and fellowship income .....	.....	.....	.....	.....	.....	1.4	1.5	1.5	1.6	1.6	7.6
Exclusion of income attributable to the discharge of certain student loan debt and NHSC Educational Loan repayments .....	.....	.....	.....	.....	.....	(1)	(1)	(1)	(1)	(1)	0.1

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009—Continued
[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Exclusion of employer-provided education assistance benefits						0.8	0.8	0.9	0.9	0.9	4.3
Parental personal exemption for students age 19 to 23						1.1	0.5	0.3	0.2	0.2	2.3
Exclusion of interest on State and local government student loan bonds	0.1	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.4	2.2
Exclusion of interest on State and local government bonds for private nonprofit and qualified public educational facilities	0.3	0.3	0.3	0.4	0.4	0.8	0.9	0.9	0.9	1.0	6.2
Tax credit for holders of qualified zone academy bonds	0.1	0.1	0.1	0.1	0.1						0.4
Deduction for charitable contributions to educational institutions	0.8	0.9	0.9	0.9	1.0	4.9	5.4	5.9	6.3	6.9	34.0
Above-the-line deduction for teacher classroom expenses						0.2	0.1				0.2
<i>Employment:</i>											
Exclusion of employee meals and lodging (other than military)						0.9	0.9	0.9	0.9	1.0	4.8
Exclusion of benefits provided under cafeteria plans ⁵						23.6	24.9	26.6	28.6	30.7	134.4
Exclusion of housing allowances for ministers						0.5	0.5	0.5	0.5	0.6	2.5
Exclusion of miscellaneous fringe benefits						6.4	6.6	6.8	7.0	7.3	34.2
Exclusion of employee awards						0.2	0.2	0.2	0.2	0.2	0.8
Exclusion of income earned by voluntary employees' beneficiary associations						3.1	3.3	3.4	3.5	3.7	17.0
Special tax provisions for employee stock ownership plans (ESOPs)	0.8	0.9	0.9	0.9	0.9	0.3	0.3	0.3	0.3	0.3	5.9

Work opportunity tax credit	0.2	0.2	0.1	(1)	(1)	0.1	(1)	(1)	(1)	(1)	0.6
Welfare-to-work tax credit	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Deferral of taxation on spread on acquisition of stock under incentive stock option plans and employee stock purchase plans ⁶						0.4	0.4	0.4	0.4	0.4	2.0
<i>Social services:</i>											
Tax credit for children under age 17 ⁷						46.6	46.5	46.4	46.4	45.8	231.7
Tax credit for child and dependent care ex- penses						3.0	2.2	1.9	1.8	1.7	10.6
Exclusion of employer-provided child care ⁸ ..						1.0	1.1	1.1	1.2	1.3	5.6
Tax credit for employer-provided dependent care	0.1	0.1	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	0.8
Exclusion of certain foster care payments						0.6	0.6	0.6	0.7	0.7	3.2
Adoption credit and employee adoption bene- fits exclusion						0.2	0.2	0.2	0.2	0.2	1.0
Deduction for charitable contributions, other than for education and health	1.8	1.9	2.0	2.1	2.1	26.0	29.4	31.9	34.2	37.7	169.3
Tax credit for disabled access expenditures ..	(1)	(1)	(1)	(1)	(1)	0.1	0.1	0.1	0.1	0.1	0.4
Health											
Exclusion of employer contributions for health care, health insurance premiums, and long- term care insurance premiums ⁹						78.6	91.2	100.2	107.8	116.0	493.7
Exclusion of medical care and CHAMPUS/ TRICARE medical insurance for military de- pendents, retirees, and retiree dependents ...						1.6	1.6	1.7	1.7	1.7	8.4
Deduction for health insurance premiums and long-term care insurance premiums by the self-employed						3.2	3.8	4.2	4.5	5.0	20.7
Deduction for medical expenses and long-term care expenses						7.7	8.2	8.9	9.5	9.9	44.1
Exclusion of workers' compensation benefits (medical benefits)						5.2	5.5	5.7	6.0	6.3	28.8
Health savings accounts						0.4	0.5	0.5	0.6	0.7	2.7

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009—Continued
[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Exclusion of interest on State and local government bonds for private nonprofit hospital facilities	0.5	0.5	0.5	0.6	0.6	1.3	1.3	1.4	1.4	1.5	9.7
Deduction for charitable contributions to health organizations	0.9	1.0	1.0	1.0	1.1	3.3	3.7	4.1	4.3	4.8	25.2
Tax credit for orphan drug research	0.2	0.2	0.2	0.3	0.3	.....	.....	.....	.....	.....	1.2
Tax credit for purchase of health insurance by certain displaced persons .....	.....	.....	.....	.....	.....	0.1	0.1	0.1	0.1	0.1	0.6
Medicare											
Exclusion of Medicare benefits:											
Hospital insurance (Part A) .....	.....	.....	.....	.....	.....	16.4	18.1	19.7	21.4	23.9	99.5
Supplementary medical insurance (Part B) ..	.....	.....	.....	.....	.....	10.9	11.8	12.8	13.9	15.7	65.1
Prescription drug insurance (Part D) .....	.....	.....	.....	.....	.....	.....	4.3	7.2	8.4	9.8	29.7
Exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare .....	.....	1.2	1.7	1.9	2.1	.....	.....	.....	.....	.....	6.8
Income Security											
Exclusion of workers' compensation benefits (disability and survivors payments) .....	.....	.....	.....	.....	.....	3.9	4.1	4.3	4.5	4.7	21.5
Exclusion of damages on account of personal physical injuries or physical sickness .....	.....	.....	.....	.....	.....	1.4	1.4	1.5	1.5	1.5	7.3
Exclusion of special benefits for disabled coal miners .....	.....	.....	.....	.....	.....	0.1	0.1	0.1	(¹)	(¹)	0.3
Exclusion of cash public assistance benefits .....	.....	.....	.....	.....	.....	2.5	2.6	2.7	2.7	2.8	13.3
Net exclusion of pension contributions and earnings:											
Employer plans .....	.....	.....	.....	.....	.....	102.8	107.9	113.3	118.9	124.8	567.8
Individual retirement plans .....	.....	.....	.....	.....	.....	11.6	14.8	16.3	18.0	19.5	80.2

Keogh plans						8.3	9.1	10.8	11.5	11.4	51.1
Tax credit for certain individuals for elective deferrals and IRA contributions						1.7	1.6	0.5			3.8
Tax credit for new retirement plan expenses of small businesses	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Exclusion of other employee benefits:											
Premiums on group term life insurance						2.5	2.5	2.6	2.6	2.7	12.9
Premiums on accident and disability insurance						2.5	2.6	2.7	2.8	2.9	13.4
Additional standard deduction for the blind and the elderly						1.8	1.8	1.7	1.8	1.9	9.1
Tax credit for the elderly and disabled						(1)	(1)	(1)	(1)	(1)	0.1
Deduction for casualty and theft losses						0.2	0.2	0.2	0.2	0.2	1.1
Earned income credit (EIC) ⁷						39.0	39.0	38.8	39.0	39.3	195.1
Social Security and Railroad Retirement											
Exclusion of certain social security and railroad retirement benefits						22.3	22.3	22.8	23.5	24.4	115.3
Veterans' Benefits and Services											
Exclusion of veterans' disability compensation						3.4	3.5	3.5	3.6	3.6	17.5
Exclusion of veterans' pensions						0.1	0.1	0.1	0.1	0.1	0.6
Exclusion of veterans' readjustment benefits						0.2	0.2	0.2	0.2	0.3	1.2
Exclusion of interest on State and local government bonds for veterans' housing	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
General Purpose Fiscal Assistance											
Exclusion of interest on public purpose State and local government debt	7.4	7.5	7.6	7.8	8.0	19.1	19.3	19.7	20.1	20.5	136.9
Deduction of nonbusiness State and local government income, sales, and personal property taxes						46.2	36.8	33.9	33.7	35.2	185.8
Tax credit for Puerto Rico and possession income, and Puerto Rico economic activity	1.2	0.3									1.5

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2005–2009—Continued
[Billions of dollars]

Function	Corporations					Individuals					Total 2005–09
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009	
Interest											
Deferral of interest on savings bonds						1.1	1.1	1.1	1.1	1.1	5.6

¹ Positive tax expenditure of less than \$50 million.

² In addition, the exemption from excise tax for alcohol fuels results in a reduction in excise tax receipts, net of income tax effect, of \$1.4 billion in each of the fiscal years 2005 through 2007 and \$1.5 billion per year in fiscal years 2008 and 2009.

³ In addition, the exemption from excise tax for biodiesel results in a reduction in excise tax receipts, net of income tax effect, of a total of \$0.1 billion over the fiscal years 2004 through 2007.

⁴ Negative tax expenditure of less than \$50 million.

⁵ Estimate includes amounts of employer-provided health insurance purchased through cafeteria plans and employer-provided child care purchased through dependent care flexible spending accounts. These amounts are also included in other line items in this table.

⁶ Tax expenditure estimate does not include offsetting denial of corporate deduction for qualified stock option compensation.

⁷ Tax expenditure estimate includes refundable amounts, amounts used to offset income taxes, and amounts used to offset other taxes. The amount of refundable child tax credit and earned income tax credit used to offset taxes other than income tax or paid out as refunds is: \$51.5 billion in 2005, \$51.9 billion in 2006, \$51.0 billion in 2007, and \$50.6 billion in 2008, and \$50.7 in 2009.

⁸ Estimate includes employer-provided child care purchased through dependent care flexible spending accounts.

⁹ Estimate includes employer-provided health insurance purchased through cafeteria plans.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

Table 2.—Distribution by Income Class of All Returns, Taxable Returns, Itemized Returns, and Tax Liability at 2004 Rates and 2004 Law and 2004 Income Levels¹

[Money amounts in millions of dollars, returns in thousands]

Income Class ²	All returns ³	Taxable returns	Itemized returns	Tax liability
Below \$10,000	25,426	589	301	— \$6,824
\$10,000 to \$20,000	22,336	6,742	896	— 13,424
\$20,000 to \$30,000	19,811	8,688	1,899	— 2,473
\$30,000 to \$40,000	16,580	10,390	3,287	12,214
\$40,000 to \$50,000	13,101	10,025	4,228	24,218
\$50,000 to \$75,000	22,875	20,129	10,721	76,832
\$75,000 to \$100,000	13,584	13,261	9,556	83,229
\$100,000 to \$200,000	14,383	14,260	12,506	195,823
\$200,000 and over	3,454	3,430	3,281	353,082
Total	151,449	87,512	46,675	\$722,676

¹ Tax law as in effect on November 1, 2004, is applied to the 2004 level and sources of income and their distribution among taxpayers.

² The income concept used to place tax returns into classes is adjusted gross income (AGI) plus: (a) tax-exempt interest, (b) employer contributions for health plans and life insurance, (c) employer share of FICA tax, (d) workers' compensation, (e) nontaxable Social Security benefits, (f) insurance value of Medicare benefits, (g) alternative minimum tax preference items, and (h) excluded income of U.S. citizens living abroad.

³ Includes filing and nonfiling units. Filing units include all taxable and nontaxable returns. Nonfiling units include individuals with income that is exempt from Federal income taxation (e.g., transfer payments, interest from tax-exempt bonds, etc.). Excludes individuals who are dependents of other taxpayers and taxpayers with negative income.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,
at 2004 Rates and 2004 Income Levels ¹**

[Money amounts in millions of dollars, returns in thousands]

Income Class ²	Medical deduction		Real estate tax deduction	
	Returns	Amount	Returns	Amount
Below \$10,000	3	(³)	29	\$2
\$10,000 to \$20,000	189	\$50	813	112
\$20,000 to \$30,000	503	188	2,141	403
\$30,000 to \$40,000	1,002	471	3,482	724
\$40,000 to \$50,000	1,096	711	4,162	1,157
\$50,000 to \$75,000	2,341	2,275	10,133	3,599
\$75,000 to \$100,000	1,290	1,512	7,575	3,908
\$100,000 to \$200,000	777	1,808	7,422	6,412
\$200,000 and over	67	621	1,428	2,995
Total	7,268	\$7,633	37,185	\$19,312

Footnotes appear at the end of the table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,
at 2004 Rates and 2004 Income Levels¹—Continued**

[Money amounts in millions of dollars, returns in thousands]

Income Class [2]	State and local income, sales, and personal property tax deduction		Charitable contribution deduction	
	Returns	Amount	Returns	Amount
Below \$10,000	61	\$6	2	\$1
\$10,000 to \$20,000	1,014	85	251	30
\$20,000 to \$30,000	2,685	386	884	135
\$30,000 to \$40,000	4,281	910	2,158	405
\$40,000 to \$50,000	4,888	1,641	3,303	794
\$50,000 to \$75,000	11,564	5,530	9,170	2,917
\$75,000 to \$100,000	8,265	6,576	8,781	3,668
\$100,000 to \$200,000	8,237	12,423	11,883	9,473
\$200,000 and over	2,227	17,703	3,152	16,997
Total	43,221	\$45,258	39,584	\$34,419

Footnotes appear at the end of the table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,
at 2004 Rates and 2004 Income Levels¹—Continued**

[Money amounts in millions of dollars, returns in thousands]

Income Class ²	Child care credit		Earned income credit ⁴	
	Returns	Amount	Returns	Amount
Below \$10,000	(5)	(3)	5,383	\$6,641
\$10,000 to \$20,000	82	\$25	6,152	15,522
\$20,000 to \$30,000	373	172	4,783	10,620
\$30,000 to \$40,000	633	361	3,471	4,605
\$40,000 to \$50,000	567	328	951	587
\$50,000 to \$75,000	1,265	640	98	73
\$75,000 to \$100,000	1,142	560	.....	.....
\$100,000 to \$200,000	1,367	710	.....	.....
\$200,000 and over	223	120	.....	.....
Total	5,641	\$2,915	20,838	\$38,048

Footnotes appear at the end of the table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,
at 2004 Rates and 2004 Income Levels ¹—Continued**

[Money amounts in millions of dollars, returns in thousands]

Income Class ²	Untaxed Social Security and Railroad Retirement benefits		Child Tax Credit ⁴	
	Returns	Amount	Returns	Amount
Below \$10,000	137	\$8	129	\$161
\$10,000 to \$20,000	3,587	760	3,331	1,893
\$20,000 to \$30,000	4,848	3,335	4,422	5,158
\$30,000 to \$40,000	3,558	4,048	4,219	6,500
\$40,000 to \$50,000	2,947	3,591	3,406	5,563
\$50,000 to \$75,000	5,743	7,895	6,851	11,646
\$75,000 to \$100,000	2,706	1,768	4,982	8,634
\$100,000 to \$200,000	2,225	710	4,654	7,236
\$200,000 and over	550	180	8	9
Total	26,301	\$22,295	32,002	\$46,799

Footnotes appear at the end of the table.

**Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items,
at 2004 Rates and 2004 Income Levels ¹—Continued**

[Money amounts in millions of dollars, returns in thousands]

Income Class ²	Mortgage interest deduction	
	Returns	Amount
Below \$10,000	65	\$22
\$10,000 to \$20,000	787	250
\$20,000 to \$30,000	2,271	1,136
\$30,000 to \$40,000	3,501	2,195
\$40,000 to \$50,000	4,140	3,738
\$50,000 to \$75,000	9,834	11,325
\$75,000 to \$100,000	7,198	12,793
\$100,000 to \$200,000	7,353	23,248
\$200,000 and over	2,141	15,457
Total	37,291	\$70,164

Footnotes for Table 3:

¹ Excludes individuals who are dependents of other taxpayers and taxpayers with negative income.

² The income concept used to place tax returns into classes is adjusted gross income (AGI) plus: (a) tax-exempt interest, (b) employer contributions for health plans and life insurance, (c) employer share of FICA tax, (d) workers' compensation, (e) nontaxable Social Security benefits, (f) insurance value of Medicare benefits, (g) alternative minimum tax preference items, and (h) excluded income of U.S. citizens living abroad.

³ Less than \$500,000.

⁴ Includes the refundable portion.

⁵ Less than 500,000 returns.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.