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ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2004–2008

PREPARED FOR THE

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AND THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This report[1] on tax expenditures for fiscal years 2004–2008 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 2002–2008 in the Administration's budgetary statement of February 2003.[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 19, 2003. Expired or repealed provisions are not listed unless they have continuing revenue effects that are associated with ongoing taxpayer activity.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.

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 2004–2008 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 2004–2008* (JCS–8–03), December 22, 2003.

[2] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures,* October 4, 1972, June 1, 1973, July 8, 1975, March 15, 1976, March 16, 1977, March 14, 1978, March 15, 1979, March 6, 1980, March 16, 1981, March 8, 1982, March 7, 1983, November 9, 1984, April 12, 1985, March 1, 1986, February 27, 1987, March 8, 1988, February 28, 1989, March 9, 1990, March 11, 1991, April 24, 1992, April 22, 1993, November 9, 1994, September 1, 1995, November 26, 1996, December 15, 1997, December 14, 1998, December 22, 1999, April 6, 2001, January 17, 2002, and December 19, 2002.

[3] Office of Management and Budget, "Tax Expenditures," *Budget of the United States Government: Analytical Perspectives, Fiscal Year 2004,* February 3, 2003, pp. 101–140.

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 2004–2008. 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 (P.L. 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. Those itemized deductions that are not necessary for the generation of income are classified as tax expenditures, but only to the extent that they exceed the standard deduction level.

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

[5] The Federal income tax on individuals also applies to estates and trusts, which are subject to a separate income tax rate schedule (Internal Revenue Code section 1(e)). 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] In its budget statement, the Treasury Department identifies tax expenditures in the unified transfer tax (the estate and gift tax and the generation-skipping transfer tax). See, Office of Management and Budget, "Tax Expenditures," February 3, 2003, pp. 101–140. Other analysts have explored applying the concept of tax expenditures to the 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.

under accident and health plans,[7] accident and disability insurance, group term life insurance, educational assistance, transportation benefits (parking, van pools, and transit passes), child care, 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).

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[7] Present law contains an exclusion for employer-provided coverage under accident and health plans (sec. 106 of the Internal Revenue Code of 1986, the "Code") 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 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-

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[9] The 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.

[10] If 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.

[11] If 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.

companied 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, and most partnerships 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 (because such contributions do not generate income to the donor), 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 Jobs and Growth Tax Relief Reconciliation Act of 2003 (H.R. 2), enacted on May 28, 2003 (P.L. 108–27), modified several tax expenditures, as follows:

—The tax credit for children under age 17 was increased from $600 to $1,000 per child for taxable years beginning in 2003 and 2004.

—The additional first-year depreciation deduction (sec. 168(k)) was increased from 30 percent to 50 percent of the adjusted basis of the qualified property, effective for property acquired after May 5, 2003, and before January 1, 2005. Property does not qualify if there was a binding written contract for the acquisition in effect before May 6, 2003. The provision is effective for taxable years ending after May 5, 2003. In Table 1, this change is reflected in the tax expenditure estimate for "Depreciation of equipment in excess of the alternative depreciation system."

—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 in 2003, 2004, and 2005. 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 in 2003, 2004, and 2005. Section 179 was also expanded to include off-the-shelf computer software placed in service in taxable years beginning in 2003, 2004, and 2005. In Table 1, these changes are reflected in the tax expenditure estimate for "Expensing of depreciable business property."

—The tax rates applicable to the adjusted net capital gains of individuals were reduced from 20 percent to 15 percent and from 10 percent to 5 percent (zero in 2008), for purposes of both the regular tax and the alternative minimum tax. These rates apply to assets held more than one year. The lower rates are effective for capital assets sold or exchanged on or after May 6, 2003, and before January 1, 2009. In addition, the tax rates applicable to dividends received by individual shareholders from domestic and qualified foreign corporations were reduced to the rates applicable to capital gains, for purposes of both the regular tax and the alternative minimum tax. The lower rates apply to dividends received in taxable years beginning after 2002 and before 2009. In Table 1, these changes are reflected in the tax expenditure estimate for "Reduced rates of tax on dividends and long-term capital gains."

The Military Family Tax Relief Act of 2003 (H.R. 3365), enacted on November 11, 2003 (P.L. 108–121), modified several tax expenditures, as follows:

—The exclusion of capital gains on sales of principal residences was modified to include special rules for members of the uniformed services and the Foreign Service of the United States. The uniformed services include the Army, Navy, Air Force, Marine Corps, and Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the Public Health Service. Under the provision, members of the uniformed services and the Foreign Service may elect to suspend for a maximum of ten years the five-year test period for ownership and use of the principal residence during certain absences due to service in the uniformed services or the Foreign Service. The modification is effective for sales or exchanges of principal residences after May 6, 1997. This is reflected in the tax expenditure estimate for "Exclusion of capital gains on sales of principal residences" which is listed under the category "Housing."

—The military death gratuity benefit was increased from $6,000 to $12,000 and the excludable portion of the death gratuity benefit was increased from $3,000 to the full amount of the benefit. These changes are effective for deaths occurring after September 10, 2001. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount of $50 million over the fiscal years 2004 through 2008.

—The exclusion for certain military benefits (section 134) was modified to clarify the exclusion of dependent care assistance provided through programs for members of the uniformed services. The modification provides that all dependent care assistance provided through programs for members of the uniformed services is excluded from gross income. The modification is effective for taxable years beginning after December 31, 2002. The modification was estimated to have no revenue effect. In Table 1, the tax expenditure estimate for "Exclusion of benefits and allowances to Armed Forces personnel" includes the effects of the exclusion for dependent care assistance provided to Armed Forces personnel. The tax expenditure estimate for "Exclusion of employer-provided dependent care" includes the effects of the exclusion for all other (non-military) dependent care programs.

—The rules governing the tax treatment of distributions from Coverdell education savings accounts and qualified tuition programs were modified to provide that the additional 10–percent tax on withdrawals not used for qualified education expenses does not apply to withdrawals made on account of attendance at the United States Military Academy, the United States Naval Academy, The United States Air Force Academy, the United States Coast Guard Academy, or the United States Merchant Marine Academy. The provision applies to taxable years beginning after December 31, 2002. In Table 1, this change is reflected in the tax expenditure estimates for "Exclusion of earnings of Coverdell education savings accounts" and "Exclusion of earnings of qualified tuition programs."

—The Victims of Terrorism Tax Relief Act of 2001 provided certain income tax relief to individuals who died as a result of certain acts of terrorism. The Military Family Tax Relief Act of 2003 extended this income tax relief to astronauts who lose their lives on a space mission (including the individuals who lost their lives in the space shuttle Columbia disaster). The provision is generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002. Some of the tax provisions that provide this income tax relief could be viewed as tax expenditures but none are listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

The Military Family Tax Relief Act of 2003 also created two new tax expenditures, as follows:

—An exclusion was provided for amounts received under the Department of Defense Homeowners Assistance Program. This program provides payments to certain employees and members of the Armed Forces to offset the adverse effects on housing values of military base realignments or closures. The exclusion may not exceed the reduction in the fair market value of the property. The exclusion is effective for payments made after the date of enactment (November 11, 2003). This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

—An above-the-line deduction was provided for the overnight transportation, meals, and lodging expenses of National Guard and Reserve members who must travel away from home more than 100 miles (and stay overnight) to attend National Guard and Reserve meetings. The amount of expenses that may be deducted may not exceed the general Federal government per diem rate applicable to that locale. The provision is effective with respect to amounts paid or incurred in taxable years beginning after December 31, 2002. This tax expenditure is listed in Table 1 as "Deduction for overnight travel expenses of National Guard and Reserve members."

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (H.R. 1), enacted on December 8, 2003 (P.L. 108–173), establishes a new voluntary Medicare Part D prescription drug insurance program. The program will begin on January 1, 2006. The program will be administered by private insurance companies and employers who will bear a part of the risk of providing the insurance, but Federal subsidies will be provided to reduce the premiums paid by enrollees. The value of the Federal subsidy will be excludable from the taxable incomes of the enrollees and the Joint Committee staff views this exclusion as a tax expenditure. It is listed in Table 1 as "Exclusion of untaxed Medicare benefits: Prescription drug insurance (Part D)."

The Medicare prescription drug program will also provide subsidies to employers who maintain certain levels of prescription drug coverage for their retirees. These employer subsidies will be excluded from taxable income. The exclusion is viewed as a tax expenditure and is listed in Table 1 as "Exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare retirees."

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 also contains a provision that creates health savings accounts ("HSAs") which provide tax-favored savings for health care expenses for individuals who are covered by health insurance plans that satisfy minimum deductible requirements. The provision is effective for taxable years beginning after December 31, 2003. This tax expenditure is listed in Table 1 as "Health savings accounts."

A number of tax expenditure provisions are scheduled to expire in 2003 or 2004:

—The tax credit for electricity production from wind, closed-loop biomass, and poultry litter expires for facilities placed in service after December 31, 2003. 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 tax credit expires for employees who begin work after December 31, 2003. However, the employees who are hired in 2003 will earn credits for their employers in 2004 because the credit applies to wages paid during the first 12 months of employment. The tax expenditure estimate in Table 1 is based on credits attributable to wages paid or incurred to employees who began working in 2003 and credits that were earned in prior years and carried forward to subsequent taxable years.

—The welfare-to-work tax credit expires for employees who begin work after December 31, 2003. However, employees who are hired in 2002 and 2003 will earn credits for their employers in 2004 because the credit applies to wages paid during the first 24 months of employment. The tax expenditure estimate in Table 1 is based on credits attributable to wages paid or incurred to employees who began working in 2002 and 2003 and credits that were earned in prior years and carried forward to subsequent taxable years.

—The authority to issue qualified zone academy bonds expires for obligations issued after December 31, 2003. 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 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, 2003. This expiration is reflected in the tax expenditure estimate for "Deduction for charitable contributions to educational institutions."

—The tax credit for electric vehicles begins a phaseout for property placed in service after December 31, 2003. The credit is reduced by 25 percent in 2004, 50 percent in 2005, and 75 percent in 2006. No credit is available after 2006. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

—The deduction for investments in clean-fuel vehicles begins a phaseout for property placed in service after December 31, 2003. The deduction is reduced by 25 percent in 2004, 50 percent in 2005, and 75 percent in 2006. No deduction is available after 2006. In Table 1, this phaseout is reflected in the tax expenditure estimate for "Deduction for clean fuel vehicles and refueling property."

—The above-the-line deduction for teacher classroom expenses is scheduled to expire for expenses incurred in taxable years beginning after December 31, 2003. The tax expenditure estimate in Table 1 is based on deductions for expenses incurred in taxable years beginning before January 1, 2004.

—The cut-off year for Archer medical savings accounts ("MSAs") is 2003. After December 31, 2003, 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 expensing of environmental remediation costs ("Brownfields") is scheduled to expire for expenses incurred after December 31, 2003. This item is listed in Table 1. The positive tax expenditure estimate for fiscal year 2004 is attributable to the expensing of costs incurred in October through December 2003. The negative tax expenditure estimates for fiscal years 2005 through 2008 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.

—The tax credit for first-time homebuyers in the District of Columbia expires for property purchased after December 31, 2003. This tax expenditure is not listed in Table 1 because the estimated revenue loss is below the *de minimis* amount.

—The tax incentives for the District of Columbia enterprise zone 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, 2003; (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, 2003; (3) an increase in section 179 expensing for District of Columbia enterprise zone businesses, which expires for property placed in service after December 31, 2003; and (4) the authority to issue tax-exempt development bonds, which expires after December 31, 2003. 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 2004 through 2008 are primarily attributable to (1) the capital gains exclusion for tangible property that is placed in service prior to December 31, 2003, 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, 2003.

—The tax incentives for the New York City Liberty Zone include (1) a work opportunity tax credit, which expires for wages incurred after December 31, 2003; (2) an additional first-year depreciation deduction for qualified Liberty Zone property, which expires for property placed in service after December 31, 2009; (3) the authority to issue $8 billion of tax-exempt private activity bonds, which expires after December 31, 2004; (4) the authority for one additional advance refunding for certain bonds for facilities located in New York City, which expires after December 31, 2004; (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 expires for expenses paid or incurred after June 30, 2004. 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, 2004. The tax expenditure estimate in Table 1 is based on wages incurred through December 31, 2004, and credits carried forward to succeeding taxable years.

—Accelerated depreciation for Indian reservation investments expires for property placed in service after December 31, 2004. The tax expenditure estimate in Table 1 is based on the difference between the accelerated tax depreciation deductions that will be claimed in 2004 through 2008 for Indian reservation property placed in service prior to December 31, 2004, and the depreciation deductions that would have been claimed had this property not qualified for the accelerated depreciation. In fiscal years 2006 through 2008, the depreciation deductions are smaller than the deductions that would have been claimed had the property not qualified for accelerated depreciation, thus the tax expenditure estimates in these years are negative.

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 narrower concept of normal income tax law. Thus, the Joint Committee list of tax expenditures includes some provisions that are not contained in the Treasury list. The cash method of accounting 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 2002–2008. The Joint Committee staff estimates cover the current fiscal year and the succeeding four fiscal years, *i.e.*, fiscal years 2004–2008.

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 2004 through 2008. 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 2002 through 2008.

For the past nine years, the President's budget has contained a section that reviews and tabulates the estate and gift tax provisions that the Treasury considers as tax expenditures. The Joint Committee staff considers estate and gift tax provisions as being outside of the normal income tax structure and thus omits them from its list of tax expenditures.

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:

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
—Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters

Employment

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

Medicare

—Exclusion of untaxed Medicare benefits for Hospital Insurance
—Exclusion of untaxed Medicare benefits for Supplementary Medical Insurance

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 2004 through 2008 are below the *de minimis* amount ($50 million):

National Defense

—Exclusion of death gratuity benefits payable to survivors of deceased members of the Armed Forces
—Exclusion of amounts received under the Department of Defense Homeowners Assistance Program

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

Transportation

—Exclusion of interest on State and local government bonds for high-speed rail

Social services

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

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 2004 through 2008 are below the *de minimis* amount ($50 million):

Energy

—Tax credit for electric vehicles
—Tax credit for small ethanol producers

Natural resources and environment

—Tax credit and seven-year amortization for reforestation expenditures

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

Social services

—Expensing of costs for removing architectural barriers

Health

—Archer medical savings accounts

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]

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[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 Congressional Budget Office and Joint Committee staff projections of the gross income, deductions, and expenditures of individuals and corporations for calendar years 2003–2008. 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 provisions and changes that alter the definition of the normal in-

[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.

come 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, tax expenditure estimates do not incorporate any changes in taxpayer behavior, whereas revenue estimates incorporate the effects of the behavioral changes that are anticipated to occur in response to the repeal of a tax 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 which 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 at the beginning of a calendar year. In this case, the revenue estimate for repeal would show a smaller revenue gain in the first fiscal year than in subsequent years, because the repeal would be occurring after the start of the 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 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 2004–2008

[Billions of dollars]

Function	Corporations					Individuals					Total 2004–08
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008	
National Defense											
Exclusion of benefits and allowances to Armed Forces personnel	...	...	...	...	...	2.7	2.8	2.8	2.9	2.9	14.2
Exclusion of military disability benefits	...	...	...	...	...	0.1	0.1	0.1	0.1	0.1	0.6
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	...	...	...	...	...	3.4	3.6	3.8	4.0	4.2	19.0
Exclusion of certain allowances for Federal employees abroad	...	...	...	...	...	0.4	0.5	0.5	0.6	0.6	2.6
Exclusion of extraterritorial income	5.2	5.5	5.9	6.1	6.3	...	...	...	...	...	29.0
Deferral of active income of controlled foreign corporations	4.6	4.8	5.0	5.2	5.4	...	...	...	...	...	25.0
Inventory property sales source rule exception	5.4	5.7	6.0	6.3	6.6	...	...	...	...	...	30.0
Deferral of certain active financing income	1.9	2.1	2.3	1.7	...	...	...	...	...	...	8.0
General Science, Space, and Technology											
Tax credit for qualified research expenditures	3.9	2.4	1.2	0.7	0.3	(1)	(1)	(1)	(1)	(1)	8.6
Expensing of research and experimental expenditures	3.5	4.9	6.0	6.5	6.9	0.1	0.1	0.1	0.1	0.1	28.5
Energy											
Expensing of exploration and development costs:											
Oil and gas	0.5	0.3	0.4	0.5	0.5	(1)	(1)	(1)	(1)	(1)	2.0
Other fuels	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.2
Excess of percentage over cost depletion:											
Oil and gas	0.4	0.4	0.5	0.5	0.5	(1)	(1)	(1)	(1)	(1)	2.4
Other fuels	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1

Tax credit for enhanced oil recovery costs	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	1.5
Tax credit for production of non-conventional fuels	0.5	0.5	0.5	0.6	0.2	0.1	0.1	0.1	0.1	0.1	2.8
Tax credit for alcohol fuel blenders [2]	(1)	(1)	(1)	(1)	(1)	....	....	....	....	....	(1)
Exclusion on interest on State and local government industrial development bonds for energy production facilities	(1)	(1)	(1)	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.9
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 wind, biomass, and poultry waste	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	1.1
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	0.8
Expensing of multiperiod timber-growing costs	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	1.0
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	0.5	0.5	0.5	3.4
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	0.3	0.3	0.4	0.4	0.4	....	....	....	....	....	1.8
Exclusion of contributions in aid of construction for water and sewer utilities	(1)	(1)	(1)	(1)	(1)	....	....	....	....	....	0.1
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	0.1	0.1	0.1	0.1	0.3
Expensing of the costs of raising dairy and breeding cattle	(1)	(1)	(1)	(1)	(1)	0.1	(1)	(1)	(1)	(1)	0.2
Exclusion of cost-sharing payments	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2004–2008—Continued

[Billions of dollars]

Function	Corporations 2004	Corporations 2005	Corporations 2006	Corporations 2007	Corporations 2008	Individuals 2004	Individuals 2005	Individuals 2006	Individuals 2007	Individuals 2008	Total 2004–08
Exclusion of cancellation of indebtedness income of farmers	....	....	....	....	....	0.1	0.1	0.1	0.1	0.1	0.4
Cash accounting for agriculture	(1)	(1)	(1)	(1)	(1)	0.3	0.3	0.3	0.3	0.3	1.9
Income averaging for farmers	....	....	....	....	....	(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											
Financial institutions:											
Exemption of credit union income	1.2	1.3	1.3	1.4	1.5	....	....	....	....	....	6.7
Insurance companies:											
Exclusion of investment income on life insurance and annuity contracts	1.4	1.4	1.5	1.5	1.5	24.7	25.4	26.0	26.7	27.3	137.5
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	1.7	1.8	1.9	2.0	2.0	....	....	....	....	....	9.4
Deduction of unpaid property loss reserves for property and casualty insurance companies	1.5	1.5	1.6	1.6	1.6	....	....	....	....	....	7.8
Special deduction for Blue Cross and Blue Shield companies	0.5	0.5	0.6	0.6	0.6	....	....	....	....	....	2.8
Housing:											
Deduction for mortgage interest on owner-occupied residences	....	....	....	....	....	61.4	69.9	75.6	80.2	85.5	372.7
Deduction for property taxes on owner-occupied residences	....	....	....	....	....	18.7	16.7	15.0	14.2	13.3	77.8
Exclusion of capital gains on sales of principal residences	....	....	....	....	....	17.9	18.0	18.3	18.5	18.7	91.4

Exclusion of interest on State and local government bonds for owner-occupied housing	0.3	0.3	0.3	0.3	0.3	0.8	0.9	0.9	0.9	0.9	6.0
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	1.3
Depreciation of rental housing in excess of alternative depreciation system	0.3	0.4	0.4	0.5	0.5	3.0	3.3	3.7	4.3	4.9	21.3
Tax credit for low-income housing	3.0	3.2	3.3	3.5	3.7	1.3	1.4	1.4	1.5	1.6	23.8
Tax credit for rehabilitation of historic structures	0.4	0.4	0.4	0.4	0.4	0.1	0.1	0.1	0.1	0.1	2.5
Other business and commerce:											
Reduced rates of tax on dividends and long-term capital gains	....	....	....	....	....	66.1	76.8	81.7	86.5	95.2	406.3
Exclusion of capital gains at death	....	....	....	....	....	35.9	37.7	40.0	42.8	46.2	202.6
Carryover basis of capital gains on gifts	....	....	....	....	....	4.3	4.6	4.9	5.2	5.5	24.5
Deferral of gain on non-dealer installment sales	0.6	0.6	0.6	0.7	0.7	0.4	0.5	0.5	0.5	0.5	5.6
Deferral of gain on like-kind exchanges	1.2	1.2	1.3	1.3	1.4	0.4	0.5	0.5	0.5	0.5	9.2
Deferral of gain on involuntary conversions resulting from Presidentially-declared disasters	....	....	....	....	....	(1)	(1)	(1)	(1)	(1)	0.1
Depreciation of buildings other than rental housing in excess of alternative depreciation system	1.8	1.4	0.9	1.2	1.6	1.9	1.3	0.1	0.2	0.3	10.7
Depreciation of equipment in excess of the alternative depreciation system	52.9	23.0	2.4	6.1	12.4	16.1	5.8	−1.6	−0.6	1.4	117.9
Expensing of depreciable business property	....	....	....	....	....	....	....	....	....	....	0.0
Amortization of business startup costs	(1)	(1)	(1)	(1)	(1)	0.6	0.6	0.6	0.6	0.7	3.1
Reduced rates on first $10,000,000 of corporate taxable income	3.3	4.1	5.1	5.6	5.8	....	....	....	....	....	23.9
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

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2004–2008—Continued

[Billions of dollars]

Function	Corporations					Individuals					Total 2004–08
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008	
Completed contract rules	0.2	0.2	0.2	0.2	0.2	(1)	(1)	(1)	(1)	(1)	1.2
Cash accounting, other than agriculture	(1)	(1)	(1)	(1)	(1)	0.7	0.7	0.8	0.8	0.8	3.8
Exclusion of interest on State and local government small-issue industrial development bonds	0.1	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.3	0.3	2.2
Exception from net operating loss limitations for corporations in bankruptcy proceedings	0.7	0.6	0.6	0.6	0.6	....	....	....	....	....	3.1
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	2.7
Transportation											
Deduction for clean fuel vehicles and refueling property	(1)	(1)	(1)	(3)	(3)	0.2	0.2	0.1	0.1	....	0.5
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	....	....	....	....	....	3.8	3.8	3.8	3.9	3.9	19.2
Community and Regional Development											
New York City Liberty Zone tax incentives	0.1	0.3	0.4	0.1	−0.1	0.2	0.3	0.3	0.2	0.2	2.4
Empowerment zone tax incentives	0.3	0.3	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.5	3.7
Renewal community tax incentives	0.1	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.5	2.9
New markets tax credit	0.1	0.2	0.2	0.3	0.4	0.2	0.2	0.3	0.4	0.5	2.8
District of Columbia tax incentives	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.3
Wage credit for Indian reservation employment	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Accelerated depreciation for Indian reservation investments	0.1	(1)	−0.1	−0.1	−0.1	0.1	(1)	−0.1	−0.1	−0.1	−0.3
Expensing of environmental remediation costs ("Brownfields")	(1)	(3)	(3)	(3)	(3)	(1)	(3)	(3)	(3)	(3)	−0.1

Tax credit for rehabilitation of structures, other than historic structures	0.1	0.1	0.1	0.1	0.1	([1])	([1])	([1])	([1])	([1])	0.4
Exclusion of interest on State and local government bonds for private airports, docks, and mass-commuting facilities	0.2	0.2	0.2	0.2	0.3	0.6	0.6	0.6	0.6	0.6	4.4
Education, Training, Employment, and Social Services											
Education and training:											
Tax credits for tuition for post-secondary education	....	....	....	....	....	4.3	4.3	4.4	4.4	4.4	21.8
Deduction for interest on student loans	....	....	....	....	....	0.7	0.8	0.8	0.9	0.9	3.9
Deduction for higher education expenses	....	....	....	....	....	2.7	2.9	0.7	....	....	6.3
Exclusion of earnings of Coverdell education savings accounts	....	....	....	....	....	0.3	0.3	0.4	0.4	0.5	2.0
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	....	....	....	....	....	1.5	1.5	1.6	1.6	1.7	7.9
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	....	....	....	....	....	1.5	1.1	0.7	0.6	0.5	4.4
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	0.3	2.0
Exclusion of interest on State and local government bonds for private nonprofit and qualified public educational facilities	0.3	0.3	0.3	0.3	0.3	0.8	0.8	0.8	0.8	0.8	5.6
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	1.1	1.1	1.1	1.2	1.2	5.2	5.3	5.5	5.6	5.8	33.1
Above the line deduction for teacher classroom expenses	....	....	....	....	....	0.1	....	....	....	....	0.1

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2004–2008—Continued

[Billions of dollars]

Function	Corporations 2004	Corporations 2005	Corporations 2006	Corporations 2007	Corporations 2008	Individuals 2004	Individuals 2005	Individuals 2006	Individuals 2007	Individuals 2008	Total 2004–08
Employment:											
Exclusion of employee meals and lodging (other than military)	....	....	....	....	....	0.9	0.9	0.9	0.9	0.9	4.7
Exclusion of benefits provided under cafeteria plans [4]	....	....	....	....	....	16.9	18.4	19.5	20.7	22.2	97.6
Exclusion of housing allowances for ministers	....	....	....	....	....	0.4	0.5	0.5	0.5	0.5	2.4
Exclusion of miscellaneous fringe benefits	....	....	....	....	....	5.8	5.9	6.0	6.2	6.4	30.3
Exclusion of employee awards	....	....	....	....	....	0.1	0.1	0.2	0.2	0.2	0.8
Exclusion of income earned by voluntary employees' beneficiary associations	....	....	....	....	....	3.2	3.4	3.5	3.7	3.9	17.7
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	0.1	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.4
Welfare-to-work tax credit	0.1	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)	0.1
Deferral of taxation on spread on acquisition of stock under incentive stock option plans and employee stock purchase plans [5]	....	....	....	....	....	0.4	0.4	0.4	0.4	0.4	2.0
Social services:											
Tax credit for children under age 17 [6]	....	....	....	....	....	44.1	35.7	31.7	31.1	30.4	173.0
Tax credit for child and dependent care expenses	....	....	....	....	....	3.1	2.6	2.2	2.1	1.9	11.9
Exclusion of employer-provided child care [7]	....	....	....	....	....	0.8	0.9	0.9	1.0	1.0	4.7
Tax credit for employer-provided dependent care	0.1	0.1	0.1	0.2	0.2	(1)	(1)	(1)	(1)	(1)	0.8
Exclusion of certain foster care payments	....	....	....	....	....	0.6	0.7	0.7	0.8	0.8	3.6
Adoption credit and employee adoption benefits exclusion	....	....	....	....	....	0.1	0.2	0.2	0.2	0.2	1.0

Deduction for charitable contributions, other than for education and health	1.8	1.9	1.9	2.0	2.1	27.9	28.8	29.6	30.5	31.4	158.0
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 [8]	....	....	....	....	....	96.0	109.4	121.5	132.2	143.6	602.7
Exclusion of medical care and CHAMPUS/TRICARE medical insurance for military dependents, retirees, and retiree dependents	....	....	....	....	....	1.7	1.8	1.8	1.8	1.9	9.0
Deduction for health insurance premiums and long-term care insurance premiums by the self-employed	....	....	....	....	....	3.3	3.6	4.0	4.3	4.6	19.8
Deduction for medical expenses and long-term care expenses	....	....	....	....	....	5.9	6.9	7.7	8.8	9.9	39.2
Exclusion of workers' compensation benefits (medical benefits)	....	....	....	....	....	3.7	3.9	4.0	4.2	4.4	20.3
Health savings accounts	....	....	....	....	....	0.3	0.4	0.5	0.5	0.6	2.4
Exclusion of interest on State and local government bonds for private nonprofit hospital facilities	0.5	0.5	0.5	0.5	0.5	1.2	1.2	1.2	1.3	1.3	8.6
Deduction for charitable contributions to health organizations	0.9	1.0	1.0	1.0	1.1	3.5	3.7	3.8	3.9	4.0	23.9
Tax credit for orphan drug research	0.2	0.2	0.2	0.2	0.3	....	....	....	....	....	1.1
Tax credit for purchase of health insurance by certain displaced persons	(1)	0.1	0.2	0.2	0.2	(1)	0.1	0.1	0.1	0.1	1.1
Medicare											
Exclusion of untaxed Medicare benefits:											
Hospital insurance (Part A)	....	....	....	....	....	16.8	19.3	21.4	23.1	25.1	105.7
Supplementary medical insurance (Part B)	....	....	....	....	....	11.0	12.6	14.1	15.6	17.3	70.6
Prescription drug insurance (Part D)	....	....	....	....	....	....	....	1.9	3.6	4.3	9.8
Exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare	....	....	1.1	1.6	1.9	....	....	....	....	....	4.7

Table 1.—Tax Expenditure Estimates By Budget Function, Fiscal Years 2004–2008—Continued

[Billions of dollars]

Function	Corporations					Individuals					Total 2004–08
	2004	2005	2006	2007	2008	2004	2005	2006	2007	2008	
Income Security											
Exclusion of workers' compensation benefits (disability and survivors payments)	....	....	....	....	....	4.8	4.9	5.0	5.3	5.6	25.6
Exclusion of damages on account of personal physical injuries or physical sickness	....	....	....	....	....	1.4	1.4	1.4	1.5	1.5	7.2
Exclusion of special benefits for disabled coal miners	....	....	....	....	....	0.1	0.1	0.1	0.1	(1)	0.3
Exclusion of cash public assistance benefits	....	....	....	....	....	3.2	3.3	3.5	3.6	3.6	17.2
Net exclusion of pension contributions and earnings:											
Employer plans	....	....	....	....	....	94.6	99.3	104.2	109.4	114.8	522.1
Individual retirement plans	....	....	....	....	....	13.0	15.5	17.2	18.7	20.5	84.9
Keogh plans	....	....	....	....	....	6.2	6.5	6.8	7.2	7.6	34.3
Tax credit for certain individuals for elective deferrals and IRA contributions	....	....	....	....	....	2.5	2.3	2.1	0.6	....	7.6
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	....	....	....	....	....	2.4	2.5	2.6	2.7	2.8	13.0
Premiums on accident and disability insurance	....	....	....	....	....	2.4	2.5	2.7	2.8	2.9	13.3
Additional standard deduction for the blind and the elderly	....	....	....	....	....	2.0	2.1	2.3	2.2	2.2	10.8
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	1.0
Earned income credit (EIC)[6]	....	....	....	....	....	34.1	35.4	36.1	36.6	37.4	179.7

Social Security and Railroad Retirement											
Exclusion of untaxed social security and railroad retirement benefits	....	....	....	....	....	20.0	20.8	21.5	22.3	22.9	107.5
Veterans' Benefits and Services											
Exclusion of veterans' disability compensation	....	....	....	....	....	3.1	3.3	3.4	3.5	3.4	16.6
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	0.2	1.1
Exclusion of interest on State and local government bonds for veteran's 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	7.1	7.2	7.3	7.5	7.6	18.2	18.4	18.8	19.2	19.6	130.9
Deduction of nonbusiness State and local government income and personal property taxes	....	....	....	....	....	44.3	40.9	37.9	36.7	35.4	195.2
Tax credit for Puerto Rico and possession income, and Puerto Rico economic activity	1.4	1.2	0.3	....	....	....	....	....	....	....	2.9
Interest											
Deferral of interest on savings bonds	....	....	....	....	....	1.7	1.7	1.7	1.7	1.7	9.0

[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 $1.1 billion in each of the fiscal years 2004 through 2006, and $1.2 billion per year in fiscal years 2007 and 2008.

[3] Negative tax expenditure of less than $50 million.

[4] 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.

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

[6] 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: $44.3 billion in 2004, $44.8 billion in 2005, $42.6 billion in 2006, $42.7 billion in 2007, and $42.9 billion in 2008.

[7] Estimate includes employer-provided child care purchased through dependent care flexible spending accounts.

[8] 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 2003 Rates and 2003 Law and 2003 Income Levels [1]

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

Income Class [2]	All returns [3]	Taxable returns	Itemized returns	Tax liability
Below $10,000	21,365	957	280	−$6,813
$10,000 to $20,000	25,881	8,340	1,027	−10,358
$20,000 to $30,000	21,135	10,251	2,108	1,110
$30,000 to $40,000	17,274	11,866	3,137	17,003
$40,000 to $50,000	12,776	10,007	3,620	24,438
$50,000 to $75,000	23,139	20,868	9,904	82,140
$75,000 to $100,000	13,575	13,337	8,953	86,609
$100,000 to $200,000	13,241	13,185	11,080	190,989
$200,000 and over	3,490	3,485	3,281	369,055
Total	**151,876**	**92,296**	**43,390**	**$754,173**

[1] Tax law as in effect on June 1, 2003, is applied to the 2003 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 2003 Rates and 2003 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	11	$1	62	$2
$10,000 to $20,000	279	45	1,010	99
$20,000 to $30,000	882	181	2,135	366
$30,000 to $40,000	1,307	337	2,873	619
$40,000 to $50,000	1,325	487	3,520	988
$50,000 to $75,000	2,573	1,472	9,361	3,402
$75,000 to $100,000	1,388	1,017	7,049	3,695
$100,000 to $200,000	822	1,470	6,815	5,839
$200,000 and over	80	425	1,714	3,161
Total	**8,670**	**$5,436**	**34,539**	**$18,171**

Footnotes at end of table.

Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items, at 2003 Rates and 2003 Income Levels [1]—Continued

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

Income Class [2]	State and local income and personal property tax deduction		Charitable contributions deduction	
	Returns	Amount	Returns	Amount
Below $10,000	63	$1	45	$2
$10,000 to $20,000	1,048	60	537	52
$20,000 to $30,000	2,441	275	1,243	191
$30,000 to $40,000	3,218	645	2,299	492
$40,000 to $50,000	3,779	1,295	2,865	859
$50,000 to $75,000	9,775	4,921	8,353	3,422
$75,000 to $100,000	7,115	6,069	8,178	4,249
$100,000 to $200,000	7,066	11,554	11,167	10,114
$200,000 and over	2,212	18,244	3,373	17,531
Total	**36,716**	**$43,064**	**38,060**	**$36,912**

Footnotes at end of table.

Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items, at 2003 Rates and 2003 Income Levels[1]—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	....	....	5,490	$6,760
$10,000 to $20,000	28	$5	5,536	13,437
$20,000 to $30,000	410	188	4,534	9,486
$30,000 to $40,000	611	350	2,986	3,366
$40,000 to $50,000	710	408	598	370
$50,000 to $75,000	1,557	753	37	36
$75,000 to $100,000	1,232	648	....	....
$100,000 to $200,000	1,278	685	....	....
$200,000 and over	232	126	....	....
Total	**6,057**	**$3,162**	**19,186**	**$33,457**

Footnotes at end of table.

Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items, at 2003 Rates and 2003 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	53	$4	77	$57
$10,000 to $20,000	1,540	385	2,922	1,253
$20,000 to $30,000	5,228	2,987	4,189	4,006
$30,000 to $40,000	3,809	4,682	3,943	5,414
$40,000 to $50,000	2,763	3,328	3,487	5,670
$50,000 to $75,000	5,324	6,064	7,288	12,526
$75,000 to $100,000	2,602	1,312	4,965	8,724
$100,000 to $200,000	2,229	546	4,101	6,379
$200,000 and over	554	185	7	3
Total	**24,102**	**$19,493**	**30,979**	**$44,032**

Footnotes at end of table.

Table 3.—Distribution by Income Class of Selected Individual Tax Expenditure Items, at 2003 Rates and 2003 Income Levels [1]—Continued

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

Income Class [2]	Mortgage interest deduction	
	Returns	Amount
Below $10,000	80	$10
$10,000 to $20,000	918	226
$20,000 to $30,000	1,900	898
$30,000 to $40,000	2,772	1,681
$40,000 to $50,000	3,352	2,919
$50,000 to $75,000	9,038	9,829
$75,000 to $100,000	6,734	11,091
$100,000 to $200,000	6,557	18,818
$200,000 and over	2,143	13,512
Total	**33,494**	**$58,984**

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 returns.

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

Source: Joint Committee on Taxation.