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TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982-1986

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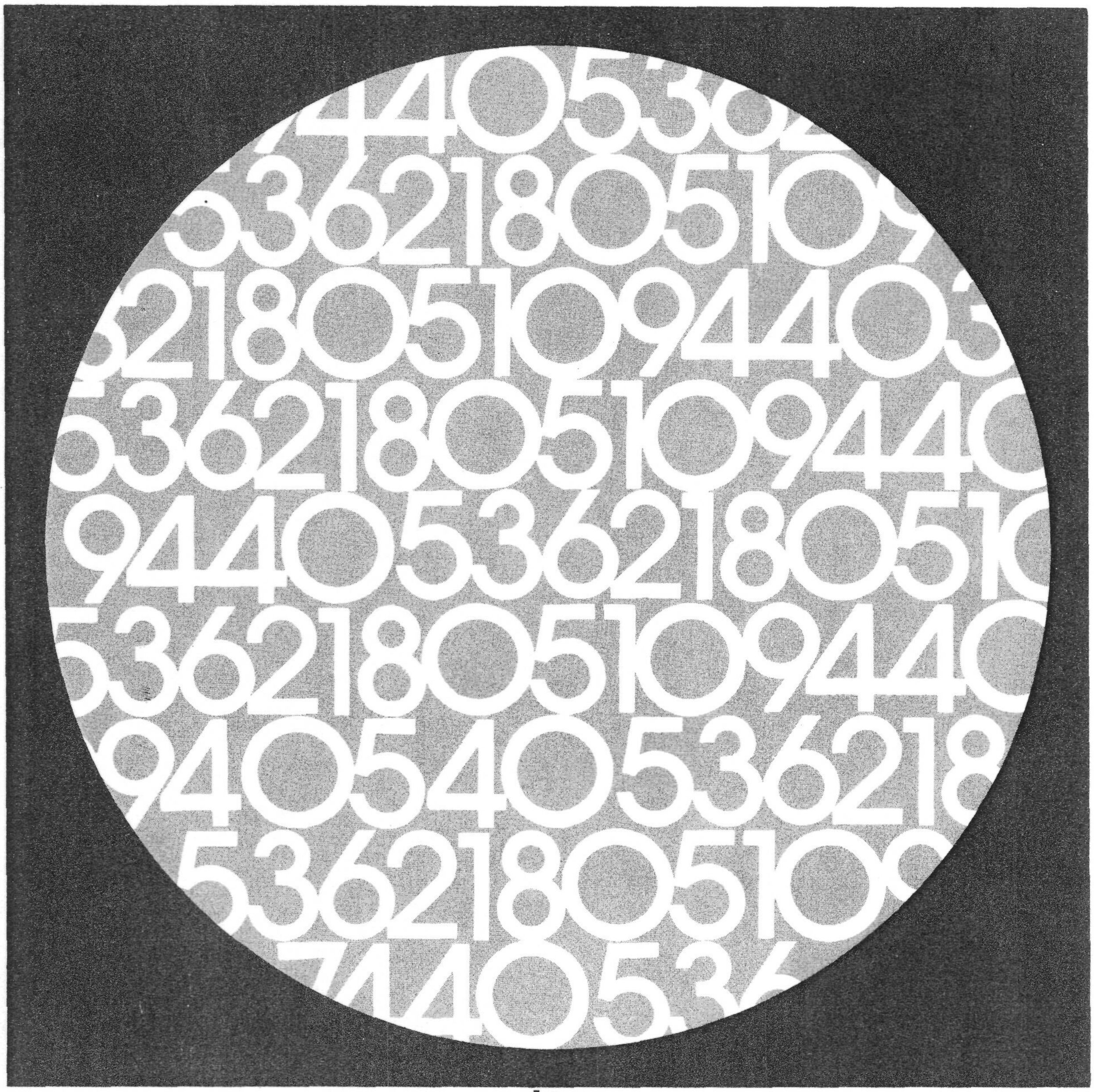

CONGRESS OF THE UNITED STATES

CONGRESSIONAL BUDGET OFFICE

TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982-1986

The Congress of the United States
Congressional Budget Office

ERRATUM

TAX EXPENDITURES: CURRENT ISSUES AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1982-1986

Page 72: Table 7 should include the capital cost recovery provisions of the Economic Recovery Tax Act of 1981 under "Increases in Tax Expenditures." These provisions will reduce revenues by $1,503 million in 1981, $9,569 million in 1982, $16,796 million in 1983, $26,250 million in 1984, $37,285 million in 1985, and $52,797 million in 1986.

PREFACE

The Congressional Budget Office is required by section 308(c) of the Congressional Budget Act of 1974 to issue a report each year that projects tax expenditures for each of the next five fiscal years. This report fulfills that statutory requirement for fiscal years 1982 to 1986. It is a companion to Baseline Budget Projections: Fiscal Years 1982-1986 (July 1981), which gives CBO's projections of budget authority, outlays, and revenues for the same period.

This report also discusses a number of definitional and measurement issues that have arisen with respect to tax expenditures, and reviews some of the economic, jurisdictional, budgetary, and administrative considerations in choosing among tax expenditure subsidies, general tax cuts, and direct expenditure subsidies. It also reviews briefly the legislation affecting tax expenditures enacted in calendar years 1980 and 1981, including the Economic Recovery Tax Act of 1981. The five-year projections of revenue losses from tax expenditures in Appendix A do not include the effects of that act, however; they reflect the law in effect on January 1, 1981.

The report was prepared by James M. Verdier of the Tax Analysis Division, with assistance from Ralph Rector, Willie Bradford, and Martha Campbell. All members of the Tax Analysis Division provided valuable comments and suggestions. A number of others both inside and outside of the CBO made detailed comments on earlier drafts, including Henry Aaron, Albert Buckberg, Sheldon S. Cohen, Seymour Fiekowsky, Alfred B. Fitt, Jerome Kurtz, Paul R. McDaniel, Joseph A. Pechman, Allen Schick, Mark Steitz, Emil M. Sunley, Stanley S. Surrey, and Paul Van de Water. Patricia H. Johnston edited the manuscript, and Linda Brockman typed it.

Alice M. Rivlin
Director

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SUMMARY

Tax expenditures are revenue losses that result from provisions of the federal tax code that give special or selective tax relief to certain groups of taxpayers. Like federal spending and loan programs, tax expenditures serve to channel resources from some sectors of the economy to others. The investment tax credit, for example, encourages investment in business plant and equipment by allowing those who make such investments to pay less tax than they otherwise would, while the extra personal exemption for the blind gives special tax relief to this class of taxpayers.

There is occasional uncertainty about whether a particular provision should be treated as a tax expenditure or not. The general rule is that provisions that are part of the normal structure of the income tax--general rate schedules and exemption levels, deductions for the costs of earning taxable income, and the like--are not tax expenditures; only special provisions that have some purpose beyond simply defining taxable net income fall into this category.

MEASUREMENT

Since tax expenditures represent revenue the federal government does not collect, measuring them presents some special conceptual and practical problems. The amount of revenue that would be collected under some different law can never be directly observed. A tax system without tax expenditures is simply an abstraction; it cannot be measured with the same precision that actual outlays and tax collections can.

In addition to this conceptual problem, practical difficulties arise because of the interaction of the revenue loss estimates of tax expenditures with the standard deduction (zero bracket amount), marginal tax rates, and other provisions of the tax code. The estimates for each tax expenditure are made by assuming that the provision is repealed, that all other provisions of the tax code are unchanged, and that economic behavior is not affected by the tax expenditure change. While this is a convenient and useful approach for estimating the cost of a single tax expenditure, since

it corresponds roughly to the estimates for individual spending programs, it becomes less realistic as more and more simultaneous changes in tax expenditures are included in the estimate. The arithmetic total of all tax expenditure revenue losses thus has only limited value. Nonetheless, the estimates of the revenue loss from each individual tax expenditure serve well the major purpose of the tax expenditure budget, which is to compare the costs and benefits of alternative ways of channeling resources to particular groups or activities.

TAX EXPENDITURE SUBSIDIES, GENERAL TAX CUTS, AND DIRECT EXPENDITURE SUBSIDIES

Since the effects of tax expenditures are very similar to those of federal spending and loan programs, it is useful analytically to consider tax expenditures as alternatives to spending programs. In practice, however, the choice is frequently between changes in tax expenditures and more general tax cuts. Changes in tax expenditures are normally considered in the context of tax legislation, and committee jurisdictional constraints generally limit the extent to which trade-offs between tax expenditures and direct spending programs can be made. Trade-offs between tax expenditures and general tax cuts are more feasible. The size of a general tax cut may be reduced to make room for new or increased tax expenditures, while revenue raised from reducing existing tax expenditures can be used to finance a larger general tax cut.

Tax Expenditures Versus General Tax Cuts

In deciding between tax expenditures and general tax cuts, the choice is generally between relatively large per-taxpayer savings for a narrowly defined group of taxpayers and relatively small per-taxpayer savings for large numbers of taxpayers. More specifically, the choice may turn on the possible effects of alternatives on taxpayer behavior and marginal tax rates.

Proponents of tax expenditures that encourage or reward a certain kind of behavior--targeted savings incentives, for example--frequently argue that such provisions will have greater effects on taxpayer behavior than broad across-the-board tax cuts of the same overall dollar amount. While tax subsidies or incentives that favor a particular kind of economic activity will result in more resources being devoted to that activity, this usually represents a reallocation of existing resources rather than any overall increase in resources. The effects on overall economic activity are likely to be about the same as from a general tax cut of the same size.

Tax expenditures can be viewed as both a cause and an effect of high marginal tax rates. Because tax expenditures remove a large share of income from the tax base, tax rates must be higher on the taxable income that is left to raise the same amount of revenue. And because marginal tax rates often reach quite high levels, there is continual pressure for tax expenditures to shield income from those high rates.

Tax Expenditures Versus Direct Expenditures

Tax subsidies can also serve as alternatives to spending or loan programs. Almost any feature that is included in a spending or loan program can be duplicated in a tax subsidy. There are some practical differences between tax and direct expenditure subsidies, however, that may lead the Congress to choose one rather than another.

Nontaxpayers. It can be difficult to extend tax subsidies to individuals and businesses that do not pay taxes. The most straightforward way of doing so is through the use of "refundable" tax credits--credits that are paid directly in cash to the recipients if they do not have tax liability as large as the credit. The only tax expenditure that is currently refundable is the earned income credit for low-income workers with dependents, but it has frequently been suggested that the investment tax credit and other business tax credits be refundable as well. Another way of extending tax subsidies to nontaxpaying businesses is through leasing arrangements, whereby a business with little or no tax liability leases equipment from a business with enough taxes to use the subsidy. The rules for this arrangement were considerably liberalized in the Economic Recovery Tax Act of 1981.

Experience with the earned income credit suggests that nontaxpaying individuals, especially those with low incomes, can be more difficult to deal with through the tax system than nontaxpaying businesses. The IRS may have no record of the existence of nontaxpaying individuals, and thus cannot easily inform them of their possible eligibility. Many low-income individuals are fearful of the IRS, and may be reluctant to have any association with it. Even if they overcome their reluctance, they may have difficulty with the forms and paperwork necessary to establish their eligibility, and the IRS has relatively few resources to provide them with assistance.

Committee Jurisdictions. Tax expenditures come under the jurisdiction of the tax-writing committees, while most spending programs that might be considered as alternatives come under the jurisdiction of other committees. Although this can make it difficult for the Congress to consider directly trade-offs between tax subsidies and spending programs, the problem can be eased by provisions in both Houses for the joint referral of legislation to two or more committees.

The tax committees sometimes lack expertise in program areas in which tax subsidies are provided. These committees do have jurisdiction over a wide range of health, welfare, Social Security, and unemployment compensation programs, however, and have dealt extensively in recent years with energy issues. Joint referral can also help to make up for a lack of tax committee expertise.

Budgetary Control. Tax expenditures are subject to less precise control in the budget process than are most spending programs. The budget resolutions do not set targets for tax expenditures by budget functional categories, as they do for direct spending programs. Nor are the tax committees allocated target ceilings for tax expenditures, as all committees are in the case of spending programs under their jurisdiction.

Revenue floors -- The budget process does impose one very important constraint on tax expenditures, however. Once an overall revenue floor is established by the second budget resolution, any legislation that would reduce total revenues below the floor is subject to a point of order. This requires that any increases in tax expenditures compete with all other revenue-losing provisions for the limited amount of tax reduction that is permitted. This is not very different from the discipline that applies to spending programs. While the second budget resolution does include limits on spending by major functional category, it is only the overall spending totals that are binding, just as it is only the overall revenue floor that limits tax expenditures.

Visibility -- Each bill increasing or reducing tax expenditures is accompanied by a report giving an estimate of the five-year loss or gain from the change, just as spending bills are accompanied by five-year cost estimates. Changes in tax expenditures have the same effect on the federal deficit as do any other tax or spending changes, and thus receive whatever attention and scrutiny that entails.

Periodic review -- Tax subsidies are not regularly reviewed in the way that spending programs subject to annual appropriations or periodic reauthorizations are. With the growth in recent years of entitlement programs, however, only about half of federal spending is subject to discretionary annual appropriations, and programs that are periodically reauthorized may not receive detailed scrutiny each time. In addition, tax expenditures often come up for review when the Congress considers major tax legislation, which it has done often over the last decade. Some new tax expenditures in recent years have also included scheduled expiration dates and/or required studies of their effectiveness, thereby encouraging periodic review.

Administration

The ease of administration of any subsidy program depends mainly on the eligibility rules and how they are enforced. If the rules are clear and simple, if the information needed to verify eligibility can be easily obtained, and if no significant exercise of judgment is required to apply the rules, administration of the subsidy is easy. The more a program departs from these conditions, the harder it is to administer. Tax subsidies are not different from other subsidies in this respect.

For programs that fall into the easy-to-administer category, there are some advantages in using the IRS as a subsidy distribution mechanism. It is a well-run bureaucracy that deals annually with nearly 100 million taxpayers. It already has much of the information on income, family size, and other characteristics that may be used to determine eligibility, and it can make spot checks through its system of audits.

Only about 2 percent of returns are audited, however, and many subsidy programs have eligibility rules that rely on information that tax auditors rarely check. If, therefore, the Congress wants to keep fairly close watch on eligibility for a subsidy program, providing the subsidy through the tax system may not be the best approach. But if the Congress determines that the costs of detailed eligibility checks for a particular program are likely to be greater than the losses from payments to ineligible recipients, the tax system may be preferable to setting up a new or expanded bureaucracy to administer a direct spending subsidy.

A major drawback to using the IRS as a subsidy distribution agency is that it can impose a significant burden of extra complexity on both taxpayers and the IRS. With IRS resources already severely strained by frequent changes in tax legislation, expanding tax shelter activities, and apparently widespread tax evasion in the so-called "underground economy," the extra burden of running multiple subsidy programs could lead to administrative breakdowns.

Another consideration in having the IRS administer a subsidy program is that the IRS is not likely to be as sympathetic to the goals of the program as an agency with jurisdiction over analogous direct spending programs might be. When the IRS is assigned the task of administering subsidies for housing, employment, home insulation, preservation of historic buildings, local economic development, and the like, the usual response is to treat the subsidies as if they were normal tax provisions rather than subsidy programs. Eligibility is restricted as narrowly as possible, consistent with the provisions of the statute, in order to minimize the loss of revenue. Little attempt is made to publicize the availability of the subsidy or to promote its use. Attempts to overcome these problems by having tax subsidies jointly administered by the IRS and the agencies responsible for comparable spending programs are often bogged down by interagency conflicts over eligibility rules and administrative procedures.

Beneficiary Perceptions and Preferences

The beneficiaries of a tax subsidy usually prefer not to think of the tax savings they receive as a subsidy, but rather as something that results from a normal feature of the tax code. If there is likely to be subtantial reluctance to take advantage of a subsidy--as seems to be the case with the present targeted jobs tax credit--having it work as much like a normal provision of the tax code as possible could encourage more widespread use.

Beneficiaries may also prefer receiving subsidies through the tax code because they may believe that the subsidies will be more stable and predictable than direct spending subsidies. While it is generally true that tax subsidies are less subject to changes, cutbacks, and delays in funding than federal spending programs, they are not immune from this kind of unpredictability. The legislative and administrative rules for various tax shelter and tax-exempt bond subsidies, for example, have been continually changed and tightened in recent years.

CHAPTER I. INTRODUCTION

DEFINITION

Tax expenditures are revenue losses that arise from provisions of the tax code that give special or selective tax relief to certain groups of taxpayers. They are defined in the Budget Act as:

> . . . those 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.[1]

There are certain features in an income tax that are an integral part of the normal structure of the tax, including general rate schedules and exemption levels, general rules on who is subject to tax and what accounting periods should be used, and deductions for the costs of earning taxable income. These normal features of an income tax are not considered tax expenditures. Only special provisions of the tax code that have some purpose beyond simply defining taxable net income fall into this category.

These special provisions are usually designed to encourage some desired activity or to provide aid to certain categories of taxpayers and are, thus, similar to many federal spending and loan programs. The investment tax credit, for example, is intended to encourage investment in business machinery and equipment, while the extra personal exemption for the blind gives special tax relief to these handicapped taxpayers.

There are sometimes difficulties in distinguishing between tax expenditures and provisions that are part of the normal structure of the tax code. The just-enacted deduction for two-earner married couples, for example, is treated as a tax expenditure. But if the Congress had adopted a broader approach and allowed married couples to be taxed separately at the lower rates applicable to single

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1. The Congressional Budget Act of 1974, Sec. 3(a)(3)).

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persons, the change would probably have been regarded as a modification of the basic tax structure rather than as a tax expenditure. While there are always borderline definitional issues, there has been general Congressional and Executive branch agreement over the years on which provisions of the tax code are "special" enough to be termed tax expenditures.

VARIOUS INTERPRETATIONS

The identification of a provision of the tax code as a tax expenditure does not imply a judgment about the merits of the provision. Tax expenditures are simply one of the ways in which the federal government seeks to allocate resources or influence behavior in the private sector. Just as with federal spending or loan programs, evaluation of the provision depends on the purposes being served and the cost and effectiveness of the provision compared to other ways of promoting the same objective.

Nonetheless, listing the revenue losses from special-purpose provisions of the tax code in a "tax expenditure budget" has been viewed by many as a way of identifying "tax loopholes" that are ripe for abolition or reform. Many of the items in the tax expenditure budget are, in fact, cited frequently as potential revenue-raising tax reforms, but there are others that few would want to disturb and many want to expand.

Some have objected to the whole concept of tax expenditures on the ground that it implies that the federal government is entitled to 100 percent of everyone's income, and that any portion of it taxpayers are allowed to keep is theirs only by special sufferance. The base against which tax expenditures are measured is not all income, however; it is the amount of tax that would be collected by a normal tax system that allowed no special exceptions for nontax purposes. Tax expenditures are departures from the normal tax structure, which falls far short of taxing one hundred percent of all income.

It is frequently stated or implied in analyses of particular tax expenditures that a differently structured spending program would be better than the tax expenditure on equity, efficiency, or other grounds. The alternative to a tax expenditure need not be a spending program, however. The revenue gained from eliminating a tax expenditure might well be used to reduce the federal deficit or returned to taxpayers in the form of a more general tax cut.

Converting a tax expenditure into a more general tax cut is one way of reducing federal influence over the private sector. Instead of providing a tax saving only to those in special circumstances, or who arrange their affairs in special ways, tax savings could be extended more broadly, with no strings attached. This would give taxpayers greater freedom to decide for themselves how to use their money, with less attempt by the federal government to guide their decisions.

ALTERNATIVE TERMS

Tax expenditures are not exactly the same as direct expenditures in all respects. As the next chapter points out, measuring the cost of tax expenditures for budgetary purposes presents problems that do not arise for most spending programs. In addition, tax expenditures that involve a deferral of tax liability are more like loan programs than direct grant programs. There is also concern that the term "tax expenditure" has acquired an unduly negative connotation.

A variety of alternative terms has thus been suggested: tax incentive, tax advantage, tax benefit, tax concession, tax relief, tax subsidy, and so on. There is probably little to be gained by seeking a consensus on nomenclature. This report frequently uses the term "tax subsidy," but other synonyms may creep in from time to time.

OUTLINE OF THE REPORT

Chapter II describes some of the problems and issues involved in measuring tax expenditures and accounting for them in a way that is similar in budgetary terms to the treatment of spending programs. Chapter III analyzes some of the jurisdictional, budgetary, and administrative considerations in choosing among tax subsidies, direct expenditure subsidies, and general tax cuts. Chapter IV describes the new changes in tax expenditures enacted in 1980 and 1981, including those in the Economic Recovery Tax Act of 1981. The fiscal year 1982-1986 projections of tax expenditure revenue losses appears in Appendix A. These projections reflect the law in effect on January 1, 1981. Finally, there is an appendix listing tax expenditures under the committees that have jurisdiction over analogous direct expenditure programs.

CHAPTER II. MEASUREMENT OF TAX EXPENDITURES

Conceptually, tax expenditures are revenue the federal government does not collect, so measuring them presents some special practical problems. The amount of revenue the government has collected under existing law can be directly observed; so can the amount being spent. But the amount of revenue that would be collected under some different law must be estimated; it can never be directly observed. (The future effects of tax laws and spending programs must also be estimated, of course, but ultimately there are actual tax collections and outlays against which to test the estimates.) A tax system without tax expenditures is simply an abstraction; it exists in the mind, and can never be measured with the same precision that actual outlays and tax collections can.

Tax expenditure estimates are based on samples of tax returns from past years and other economic and demographic data. The specific techniques used to measure the different types of tax expenditures are as follows:

- Tax Credits. The amount of the expenditure is equal to the amount of the credits claimed by taxpayers.

- Preferential Rates. The expenditure is calculated by multiplying the amount of income to which the special rate is applied by the difference between the regular tax rate and the preferential tax rate.

- Special Exclusions and Deductions. The expenditure is calculated by adding the amount excluded or deducted from taxable income back into the taxpayer's income, and then computing a new tax liability on that income; the tax expenditure is equal to the difference between the hypothetical tax liability so computed and the liability incurred under current law.[1]

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1. In some cases, removal of a particular provision would reduce the total of a person's itemized deductions beneath the stan-

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- o Deferrals of Liability. The expenditure is calculated as the difference between taxes paid under current law and those that would have been paid had the deferral never been allowed.

The revenue loss from each tax expenditure is estimated by comparing the revenue raised under current law with the revenue that would be raised if the provision had never existed, but both taxpayer behavior and all other tax provisions remained the same as they are under current law. This is not an estimate of the amount of revenue that would be gained if the provision were repealed, since repeal of the provision would likely change taxpayer behavior in ways that would generally reduce the revenue gain. It is also not an estimate of the revenue that would be gained if two or more tax expenditures were repealed simultaneously, since interactions among different tax expenditures and other tax provisions could make the revenue gain either more or less than if the tax expenditures were repealed separately.

Tax expenditures are similar in these respects to direct outlay programs in the federal budget. The outlay figures for a particular program do not represent the amount by which the deficit would be reduced if the program were eliminated, since elimination would usually lead to partly offsetting cost increases in other programs and reductions in tax receipts. Similarly, the budgetary saving from abolishing two spending programs simultaneously might not be the same as the sum of the saving from eliminating each separately.

In the case of both outlays and tax expenditures, the budgetary cost should be considered separately from the net effect on the federal deficit or surplus if the provision was eliminated. The net effect from elimination is almost always less than the direct cost, since all tax and spending changes have "reflow" or "feedback" effects that partially offset the direct effects of the change. Tax cuts, for example, may stimulate economic activity, which reduces some federal spending and increases tax collections, thereby offsetting some of the initial budgetary effects of the tax

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dard deduction or zero bracket amount, and the person would no longer itemize. In those cases, the tax expenditure is figured by taking the excess of his total itemized deductions over the zero bracket amount and multiplying that excess by the appropriate marginal rate.

cut. Spending cuts may reduce economic activity, leading to partially offsetting federal spending increases and reductions in tax collections.

Because the estimates of individual tax expenditures are generally consistent methodologically with those of individual spending programs, subsidies of both kinds can readily be compared. A further refinement, discussed below under "outlay equivalents," would make this comparison even more precise. The tax expenditure budget thus highlights some of the possible choices and trade-offs in allocating scarce resources. By accounting for the federal resources devoted to specific purposes through the tax code, it permits consideration of alternative uses of those resources for other purposes, or for the same purposes through a different mechanism. In 1981, for example, the Congress had a number of options for dealing with the $200/400 interest and dividend exclusion. The provision could have been continued at its existing level, or the $3 billion in revenue that it cost each year could have been used to finance a 1 percentage point across-the-board reduction in tax rates, an expansion of Individual Retirement Accounts (IRAs) and Keogh plans, direct federal assistance for the savings and loan industry, a reduction in the federal deficit, or increases in other spending programs. In the end, the Congress decided to eliminate the interest exclusion after 1981, and use the savings to fund a temporary new program of one-year $1,000 tax-exempt savings certificates, to be followed in 1985 by a new 15 percent net interest exclusion for the first $3000 of net interest.

LIMITATIONS OF TAX EXPENDITURE ESTIMATES

Arithmetic Totals

While the estimates of individual tax expenditures permit useful comparisons with the outlays for similar programs, the arithmetic total of all the tax expenditure estimates has significant limitations. As was noted earlier, the cost of each tax expenditure is estimated by determining how much additional revenue would be collected if the provision did not exist. This presents some special problems when more than one tax expenditure is involved. If three or four tax expenditures that take the form of personal deductions did not exist, for example, more people would use the standard deduction (zero bracket amount), and the net cost would be less than if each deduction was considered separately. The standard deduction would absorb part of the cost that would otherwise be assigned to the tax expenditures. On the other hand, if three or four tax expenditures that took the form of exclusions from income no longer existed, more income would be taxed at higher marginal tax rates, so that the cost would be more than if each exclusion were considered separately.

It is difficult to say which of these effects predominates in the tax expenditure budget as a whole. It is possible to deal with the problem by calculating the total amount of revenue that would be collected under an ideal or "normal" tax system with no tax expenditures, and subtracting from that the amount that is collected under the present tax system. The difference would represent the total revenue loss from all tax expenditures with all interactions taken into account. Such calculations have been made, but they require a large number of assumptions about the components of the alternative tax system and the economic conditions that would accompany it.[2] Using different assumptions would produce very different results.

In addition, the revenue loss estimates for the various tax expenditures would vary widely, depending on the other components of the system and the order in which each tax expenditure was entered into the estimating model. The resulting uncertainty and variation in the individual tax expenditure estimates could significantly lessen their usefulness for program analysis purposes. Since the main purpose of the tax expenditure budget is to make it possible to compare the costs of individual tax expenditures with alternative uses of the same resources, only limited efforts have been made to prepare internally consistent estimates of the totals.[3]

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2. For an example, see Joseph A. Pechman, ed., Comprehensive Income Taxation (The Brookings Institution, 1977), pp. 277-298. Revenues under the comprehensive income tax outlined in the Pechman book range from 43.5 percent to 71.5 percent above then-current law, depending on the level of personal deductions allowed.

3. For some examples, see Budget of the U.S. Government, Fiscal Year 1982, Special Analyses, pp. 212 and 218 (showing the revenue losses from all tax expenditures that take the form of itemized deductions to be $62.3 billion in fiscal year 1982,

(Continued)

Year-To-Year Comparisons. Despite the limitations of the arithmetic totals, it can be useful to look at the pattern of growth in the totals over time, since the revenue loss estimates have been made in roughly the same way each year. As is shown in Table 1, the number of the items in the tax expenditure budget has grown from 50 in calendar year 1967, the first year for which the budget was compiled, to 104 in fiscal year 1982. The arithmetic total of the revenue loss estimates has grown from $36.6 billion in 1967 to $266.3 billion in 1982.

To some extent, as indicated in Table 2, the growth in the number of items is the result of definitional changes: some items not previously considered tax expenditures were added to the list, and some items have been subdivided. Part of the growth in the revenue loss totals occurred because more income has been taxed at higher marginal tax rates in recent years because of inflation-induced "bracket creep" in the individual income tax and real growth in incomes. Since the revenue loss from special deductions and exclusions is measured by multiplying the amount of the deduction or exclusion by the tax rate, higher losses result when income is taxed at higher rates. Nonetheless, a significant share of the growth in both the number of items and the revenue loss totals is due to the addition of new tax expenditures by legislative action. Table 2 shows the number of tax expenditures added and eliminated by legislative action for each year from 1967 to 1986.

While general, order-of-magnitude comparisons of the arithmetic totals over time can be useful, the comparisons should not be carried too far. The estimates done in different years generally use different economic, demographic, and other assumptions. And unlike budget outlay and revenue estimates, the estimates never become actuals. In addition, as better information on specific provisions becomes available and as estimating techniques are improved, significant changes may be made in the estimates from one year to the next. The fiscal year 1981 revenue loss from tax-exempt industrial development bonds, for example, was estimated at $695 million in 1979. By 1981, however, new information on previously unreported bond issues led to a new revenue loss estimate for fiscal year 1981 of $1.23 billion. The estimates made in

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compared to an arithmetic total of the separate items of $81.8 billion, and the loss from the home mortgage interest and property tax deductions to be $35.5 billion together and $36.2 billion when calculated separately).

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TABLE 1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION, CALENDAR YEARS 1967-1973 AND FISCAL YEARS 1974-1986 (In millions of dollars)[a]

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
050 NATIONAL DEFENSE										
051 <u>Department of Defense - Military</u>										
Exclusion of benefits and allowances to Armed Forces personnel	500	550	550	500	650	700	700	650	650	650
Exclusion of military disability pensions	---	---	---	---	---	---	---	65	70	80
150 INTERNATIONAL AFFAIRS										
155 <u>International Finance Programs</u>										
Exclusion of income earned abroad by U.S. citizens	40	45	45	40	50	50	50	90	130	145
Deferral of income of domestic international sales corporations (DISC)	---	---	---	---	---	100	170	870	1,130	1,340
Deferral of income of controlled foreign corporations	150	165	170	165	165	325	350	620	590	525
Exclusion of gross-up on dividends of less developed country corporations	50	55	55	55	55	60	70	55	55	55
Special rate for Western Hemisphere Trade Corporations	50	55	55	50	75	50	75	50	50	50

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
050 NATIONAL DEFENSE										
051 Department of Defense - Military										
Exclusion of benefits and allowances to Armed Forces personnel	1,095	1,260	1,370	1,470	1,585	1,715	1,850	2,000	2,160	2,335
Exclusion of military disability pensions	105	115	120	125	170	200	245	285	325	370
150 INTERNATIONAL AFFAIRS										
155 International Finance Programs										
Exclusion of income earned abroad by U.S. citizens	120	360	530	555	640	665	720	775	840	905
Deferral of income of domestic international sales corporations (DISC)	1,030	1,135	1,170	1,400	1,600	1,630	1,730	1,810	1,870	1,930
Deferral of income of controlled foreign corporations	410	615	530	445	480	520	560	605	650	705
Exclusion of gross-up on dividends of less developed country corporations	---	---	---	---	---	---	---	---	---	---
Special rate for Western Hemisphere Trade Corporations	35	25	15	5	---	---	---	---	---	---

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
250 GENERAL SCIENCE, SPACE, AND TECHNOLOGY										
251 General Science and Basic Research										
Expensing of research and development expenditures	500	550	565	540	545	570	580	605	635	660
270 ENERGY										
271 Energy Supply										
Expensing of exploration and development costs										
Oil and gas	300	330	340	325	325	650	750	830	620	805
Other fuels	---	---	---	---	---	---	---	---	---	---
Excess of percentage over cost depletion										
Oil and gas	1,300	1,430	1,470	980	985	1,700	1,900	2,120	2,475	1,580
Other fuels	---	---	---	---	---	---	---	---	---	---
Capital gains treatment of royalties on coal[c]	5	5	5	5	5	5	5	5	50	60
Alternative fuel production credit	---	---	---	---	---	---	---	---	---	---
Alcohol fuel credit	---	---	---	---	---	---	---	---	---	---
Exclusion of interest on state and local government industrial development bonds for energy production facilities	---	---	---	---	---	---	---	---	---	---
Residential energy credits										
Supply incentives	---	---	---	---	---	---	---	---	---	---

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
250 GENERAL SCIENCE, SPACE, AND TECHNOLOGY										
251 General Science and Basic Research										
Expensing of research and development expenditures	1,425	1,480	1,580	1,795	2,030	2,280	2,550	2,845	3,170	3,525
270 ENERGY										
271 Energy Supply										
Expensing of exploration and development costs										
Oil and gas	715	1,185	1,490	2,190	2,735	2,945	3,460	4,075	4,635	5,120
Other fuels	---	---	---	---	25	25	30	30	35	35
Excess of percentage over cost depletion										
Oil and gas	1,310	1,460	1,625	2,130	2,125	2,260	2,270	2,285	2,755	3,260
Other fuels	---	---	---	---	550	565	630	695	765	840
Capital gains treatment of royalties on coal[c]	65	65	75	85	90	100	120	135	150	170
Alternative fuel production credit	---	---	---	---	25	55	50	20	10	---
Alcohol fuel credit	---	---	---	---	b	15	25	40	65	85
Exclusion of interest on state and local government industrial development bonds for energy production facilities	---	---	---	---	b	5	15	20	30	30
Residential energy credits										
Supply incentives	---	---	715	460	115	190	275	360	520	650

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
271 Energy Supply (continued)										
Alternative conservation and new technology credits										
Supply incentives	---	---	---	---	---	---	---	---	---	---
272 Energy Conservation										
Residential energy credits										
Conservation incentives	---	---	---	---	---	---	---	---	---	---
Alternative conservation and new technology credits										
Conservation incentives	---	---	---	---	---	---	---	---	---	---
Energy credit for intercity buses	---	---	---	---	---	---	---	---	---	---
300 NATURAL RESOURCES AND ENVIRONMENT										
302 Conservation and Land Management										
Capital gains treatment of certain timber income	130	140	140	130	175	175	240	185	205	215
Investment credit and seven-year amortization for reforestation expenditures	---	---	---	---	---	---	---	---	---	---
303 Recreational Resources										
Tax incentives for preservation of historic structures	---	---	---	---	---	---	---	---	---	---
304 Pollution Control and Abatement										
Exclusion of interest on state and local government pollution control bonds	---	---	---	---	---	---	---	---	110	160

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
271 Energy Supply (continued)										
Alternative conservation and new technology credits										
Supply incentives	---	---	220	390	225	315	645	980	1,055	820
272 Energy Conservation										
Residential energy credits										
Conservation incentives	---	---	---	---	425	420	420	435	445	385
Alternative conservation and new technology credits										
Conservation incentives	---	---	---	---	295	375	320	175	80	25
Energy credit for intercity buses	---	---	---	---	5	5	5	5	5	5
300 NATURAL RESOURCES AND ENVIRONMENT										
302 Conservation and Land Management										
Capital gains treatment of certain timber income	395	265	405	540	605	685	670	865	975	1,095
Investment credit and seven-year amortization for reforestation expenditures	---	---	---	---	5	5	5	10	10	10
303 Recreational Resources										
Tax incentives for preservation of historic structures	b	b	10	35	65	100	140	170	160	125
304 Pollution Control and Abatement										
Exclusion of interest on state and local government pollution control bonds	245	330	415	460	720	755	815	860	895	915

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
304 Pollution Control and Abatement (continued)										
Five-year amortization on pollution control facilities	---	---	15	15	15	25	35	35	30	20
Exclusion of payments in aid of construction of water, sewage, gas and electric utilities	---	---	---	---	---	---	---	---	---	---
306 Other Natural Resources										
Expensing of exploration and development costs, nonfuel minerals	---	---	---	---	---	---	---	---	---	---
Excess of percentage over cost depletion, nonfuel materials	---	---	---	---	---	---	---	---	---	---
Capital gains treatment of iron ore[d]	---	---	---	---	---	---	---	---	---	---
350 AGRICULTURE										
351 Farm Income Stabilization										
Expensing of certain capital outlays	800	860	880	820	840	900	1,100	750	610	460
Capital gains treatment of certain ordinary income	---	---	---	---	---	---	---	550	485	520
Deductibility of patronage dividends and certain other items of cooperatives	---	---	---	---	---	---	---	---	395	410
Exclusion of certain cost-sharing payments	---	---	---	---	---	---	---	---	---	---

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
304 Pollution Control and Abatement (continued)										
Five-year amortization on pollution control facilities	-80	-130	-25	-10	35	65	95	110	115	115
Exclusion of payments in aid of construction of water, sewage, gas and electric utilities	15	10	10	60	110	115	115	120	125	130
306 Other Natural Resources										
Expensing of exploration and development costs, nonfuel minerals	---	---	---	---	25	25	30	30	35	35
Excess of percentage over cost depletion, nonfuel materials	---	---	---	---	405	395	435	470	500	610
Capital gains treatment of iron ore[d]	---	10	20	20	20	20	20	20	20	20
350 AGRICULTURE										
351 Farm Income Stabilization										
Expensing of certain capital outlays	450	515	520	505	530	565	590	610	635	655
Capital gains treatment of certain ordinary income	340	360	375	405	430	450	470	500	520	550
Deductibility of patronage dividends and certain other items of cooperatives	290	315	335	365	400	430	460	480	520	565
Exclusion of certain cost-sharing payments	---	---	b	30	75	80	80	75	80	80

(Continued)

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TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
370 COMMERCE AND HOUSING CREDIT										
371 Mortgage Credit and Thrift Insurance										
Excess bad debt reserves of financial institutions	600	660	680	380	400	400	380	1,000	880	815
Deductibility of mortgage interest on owner-occupied homes	1,900	2,200	2,600	2,800	2,400	3,500	4,000	4,870	5,405	4,545
Deductibility of property tax on owner-occupied homes	1,800	2,350	2,800	2,900	2,700	3,250	3,500	4,060	4,510	3,690
Exclusion of interest on state and local housing bonds for owner-occupied housing	---	---	---	---	---	---	---	---	---	---
Deferral of capital gains on homes sales	---	---	---	---	---	---	---	255	805	845
Exclusion of capital gains on home sales for persons age 55 and over	---	---	---	---	---	---	---	10	40	45
Credit for purchase of new homes	---	---	---	---	---	---	---	---	---	625
376 Other Advancement and Regulation of Commerce										
Dividend and interest exclusion	225	260	290	280	300	300	325	320	315	335
Exclusion of interest on state and local industrial development bonds	---	---	---	---	---	---	---	---	175	225

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
370 COMMERCE AND HOUSING CREDIT										
371 Mortgage Credit and Thrift Insurance										
Excess bad debt reserves of financial institutions	560	705	780	855	340	470	525	620	750	895
Deductibility of mortgage interest on owner-occupied homes	5,435	4,985	8,225	12,505	19,805	25,295	31,115	37,960	46,310	56,500
Deductibility of property tax on owner-occupied homes	4,500	4,665	5,920	7,740	8,915	10,705	12,740	15,160	18,040	21,465
Exclusion of interest on state and local housing bonds for owner-occupied housing	---	---	540	665	840	1,220	1,600	1,855	1,890	1,810
Deferral of capital gains on home sales	890	935	1,125	1,010	1,100	1,220	1,345	1,480	1,630	1,790
Exclusion of capital gains on home sales for persons age 55 and over	40	70	300	535	590	650	710	785	860	950
Credit for purchase of new homes	100	---	---	---	---	---	---	---	---	---
376 Other Advancement and Regulation of Commerce										
Dividend and interest exclusion	410	475	450	490	1,325	3,170	2,340	700	770	850
Exclusion of interest on state and local industrial development bonds	285	350	495	745	1,230	1,550	1,980	2,410	2,855	3,310

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
376 Other Advancement and Regulation of Commerce (continued)										
Exemption of credit union income	40	45	45	40	40	90	100	105	115	125
Exclusion of interest on life insurance savings	900	1,000	1,050	1,050	1,100	1,200	1,300	1,420	1,545	1,695
Deductibility of interest on consumer credit	1,300	1,600	1,700	1,700	1,800	1,100	1,250	2,435	1,185	1,040
Expensing of construction period interest and taxes	---	---	---	---	---	---	---	---	1,510	1,565
Excess first-year depreciation	---	---	---	---	---	---	---	---	275	225
Depreciation on rental housing in excess of straight line	250	250	275	255	500	600	600	480	520	550
Depreciation on buildings (other than rental housing) in excess of straight line	500	550	550	500	480	500	530	505	440	490
Asset depreciation range	---	---	---	---	700	860	1,250	1,260	1,405	1,590
Amortization of business start-up costs	---	---	---	---	---	---	---	---	---	---
Capital gains other than agriculture, timber, iron ore, and coal	500	525	525	425	5,980	7,400	5,880	6,895	5,785	6,215
Capital gains at death	---	---	---	---	---	---	---	5,000	6,450	6,720
Corporate surtax exemption	1,800	2,000	2,300	2,000	2,300	2,500	3,100	3,270	3,345	5,020
Reduced rates on the first $100,000 of corporate income	---	---	---	---	---	---	---	---	---	---
Investment credit, other than for ESOP's, rehabilitation of structures, and energy	2,300	3,000	2,630	910	1,800	3,800	4,300	4,570	5,810	8,260

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
376 Other Advancement and Regulation of Commerce (continued)										
Exemption of credit union income	165	80	90	110	115	125	140	155	170	190
Exclusion of interest on life insurance savings	1,815	2,025	2,475	3,365	4,080	4,770	5,570	6,500	7,585	8,845
Deductibility of interest on consumer credit	2,310	2,120	2,585	3,595	5,260	6,040	7,050	7,965	9,005	10,175
Expensing of construction period interest and taxes	625	640	615	695	760	875	915	990	1,065	1,140
Excess first-year depreciation	180	190	185	185	195	205	215	230	245	250
Depreciation on rental housing in excess of straight line	505	370	360	350	400	425	455	495	535	580
Depreciation on buildings (other than rental housing) in excess of straight line	395	265	255	255	265	285	315	350	395	450
Asset depreciation range	1,805	2,360	2,590	3,030	3,765	4,110	4,555	4,510	4,200	4,035
Amortization of business start-up costs	---	---	---	---	20	75	115	180	255	315
Capital gains other than agriculture, timber, iron ore, and coal	7,585	7,970	8,075	14,570	17,170	20,010	22,220	24,655	27,360	30,350
Capital gains at death	7,280	8,120	9,015	4,750	5,085	5,440	5,820	6,225	6,660	7,130
Corporate surtax exemption	4,650	3,885	3,070	115	---	---	---	---	---	---
Reduced rates on the first $100,000 of corporate income	---	---	3,270	7,555	7,395	7,590	8,495	9,485	10,520	11,650
Investment credit, other than for ESOP's, rehabilitation of structures, and energy	10,610	13,125	16,070	18,615	19,525	20,765	23,080	25,445	28,000	30,915

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
400 TRANSPORTATION										
401 Ground Transportation										
Five-year amortization on railroad rolling stock	---	---	---	105	45	80	40	70	55	30
Deductibility of nonbusiness state gasoline taxes	---	---	---	---	---	---	---	865	820	575
403 Water Transportation										
Deferral of tax on shipping companies	10	10	10	10	10	30	40	35	70	105
450 COMMUNITY AND REGIONAL DEVELOPMENT										
451 Community Development										
Five-year amortization for rehabilitation of housing	---	---	---	---	25	40	50	85	105	90
Investment credit for rehabilitation of structures	---	---	---	---	---	---	---	---	---	---
500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES										
502 Higher Education										
Exclusion of scholarship and fellowship income	50	60	60	60	110	125	140	195	200	210
Employer educational assistance	---	---	---	---	---	---	---	---	---	---
Exclusion of interest on state and local student loan bonds	---	---	---	---	---	---	---	---	---	---

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
400 TRANSPORTATION										
401 Ground Transportation										
Five-year amortization on railroad rolling stock	-35	-40	-40	-40	-40	-40	-35	-20	---	---
Deductibility of nonbusiness state gasoline taxes	795	760	350	---	---	---	---	---	---	---
403 Water Transportation										
Deferral of tax on shipping companies	90	105	75	70	75	75	80	90	95	105
450 COMMUNITY AND REGIONAL DEVELOPMENT										
451 Community Development										
Five-year amortization for rehabilitation of housing	30	15	15	15	25	35	35	35	25	10
Investment credit for rehabilitation of structures	---	---	65	180	295	335	385	425	460	495
500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES										
502 Higher Education										
Exclusion of scholarship and fellowship income	250	295	355	375	410	490	565	655	765	885
Employer educational assistance	---	---	20	30	35	40	45	25	---	---
Exclusion of interest on state and local student loan bonds	---	---	---	---	80	125	170	215	260	300

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
502 Higher Education (continued)										
Parental personal exemption for students age 19 or over	500	500	525	500	550	640	675	655	670	690
Deductibility of charitable contributions (education)	170	200	200	200	275	275	300	510	645	665
504 Training and Employment										
Maximum tax on personal service income	---	---	---	---	---	---	---	330	400	480
Credit for child and dependent care expenses	25	25	25	25	30	180	180	230	295	330
Deduction/credit for employment of AFDC recipients and public assistance recipients under work incentive programs	---	---	---	---	---	5	5	5	10	10
General jobs credit	---	---	---	---	---	---	---	---	---	---
Targeted jobs credit	---	---	---	---	---	---	---	---	---	---
Five-year amortization of child care facilities	---	---	---	---	---	5	5	5	5	5
505 Other Labor Services										
Exclusion of employee meals and lodging (other than military)	150	165	170	170	170	170	170	175	265	285
Investment credit for ESOP's	---	---	---	---	---	---	---	---	---	---
506 Social Services										
Deductibility of charitable contributions, other than education and health[e]	2,200	3,000	3,450	3,550	3,200	3,100	3,400	4,110	3,725	3,285
Exclusion of contributions to prepaid legal services plans	---	---	---	---	---	---	---	---	---	---

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
502 Higher Education (continued)										
Parental personal exemption for students age 19 or over	750	770	935	1,030	1,045	1,055	1,065	1,075	1,085	1,095
Deductibility of charitable contributions (education)	755	840	1,030	1,110	1,260	1,460	1,740	2,060	2,460	2,930
504 Training and Employment										
Maximum tax on personal service income	730	665	1,335	1,265	1,655	2,105	2,640	3,270	4,085	5,110
Credit for child and dependent care expenses	840	525	610	820	1,025	1,175	1,350	1,555	1,785	2,055
Deduction/credit for employment of AFDC recipients and public assistance recipients under work incentive programs	15	15	60	50	60	60	65	70	70	75
General jobs credit	---	2,460	1,895	190	85	25	15	10	10	---
Targeted jobs credit	---	---	140	125	275	180	20	b	---	---
Five-year amortization of child care facilities	b	---	---	---	---	---	---	---	---	---
505 Other Labor Services										
Exclusion of employee meals and lodging (other than military)	330	300	325	350	380	410	445	485	525	570
Investment credit for ESOP's	245	255	385	700	770	820	895	580	195	115
506 Social Services										
Deductibility of charitable contributions, other than education and health[e]	4,255	4,685	5,715	6,155	7,520	9,015	10,825	13,055	15,755	19,020
Exclusion of contributions to prepaid legal services plans	5	10	15	20	35	10	---	---	---	---

(Continued)

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TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
550 HEALTH										
551 <u>Health Care Services</u>										
Exclusion of employer contributions for medical insurance premiums and medical care	1,100	1,400	1,450	1,450	2,000	2,500	3,000	2,940	3,275	3,665
Deductibility of medical expenses	1,500	1,600	1,700	1,700	1,900	1,900	2,100	2,125	2,315	2,020
Exclusion of interest on state and local hospital bonds	---	---	---	---	---	---	---	---	---	---
Deductibility of charitable contributions (health)[f]	---	---	---	---	---	---	---	---	1,045	930
554 <u>Consumer and Occupational Health and Safety</u>										
Expensing of removal of barriers to the handicapped	---	---	---	---	---	---	---	---	---	---
600 INCOME SECURITY										
601 <u>General Retirement and Disability Insurance</u>										
Exclusion of social security benefits[g]										
Disability insurance benefits	---	100	120	130	155	175	200	235	275	315
OASI benefits for retired workers	2,300	2,700	2,800	2,950	3,250	3,550	4,700	2,530	2,740	3,045
Benefits for dependents and survivors	---	---	---	---	---	---	---	410	450	495

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
550 HEALTH										
551 Health Care Services										
Exclusion of employer contributions for medical insurance premiums and medical care	5,195	6,340	8,255	12,965	14,165	16,610	19,485	22,855	26,810	31,445
Deductibility of medical expenses	2,585	2,435	2,890	3,585	3,580	4,080	4,650	5,305	6,045	6,610
Exclusion of interest on state and local hospital bonds	---	---	---	---	580	670	785	880	980	1,070
Deductibility of charitable contributions (health)[f]	1,050	1,035	1,260	1,355	1,620	1,915	2,185	2,765	3,320	3,985
554 Consumer and Occupational Health and Safety										
Expensing of removal of barriers to the handicapped	5	10	10	b	---	---	---	---	---	---
600 INCOME SECURITY										
601 General Retirement and Disability Insurance										
Exclusion of social security benefits[g]										
Disability insurance benefits	380	550	615	685	815	955	1,055	1,185	1,350	1,575
OASI benefits for retired workers	3,125	4,210	5,455	6,880	9,020	11,265	13,260	15,605	18,320	21,435
Benefits for dependents and survivors	730	950	825	990	1,250	1,480	1,695	1,945	2,225	2,535

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
601 General Retirement and Disability Insurance (continued)										
Exclusion of railroad retirement system benefits	---	---	---	---	---	---	---	160	170	185
Exclusion of workmen's compensation benefits	150	180	210	210	320	375	400	520	505	555
Exclusion of special benefits for disabled coal miners	---	---	---	---	---	---	---	---	50	50
Exclusion of sick and disability pay	85	95	105	105	120	225	240	255	315	330
Net exclusion of pension contributions and earnings										
Employer plans	3,000	4,000	3,150	3,075	3,650	4,000	4,400	4,790	5,225	5,745
Plans for self-employed and others	60	135	160	175	250	200	200	230	390	770
Exclusion of other employee benefits										
Premiums on group term life insurance	400	400	440	440	500	550	600	680	740	805
Premiums on accident and disability insurance	25	25	25	25	30	35	40	40	50	55
Additional exemption for the blind	10	10	10	10	10	10	10	15	10	20
Additional exemption for the elderly	---	---	---	---	---	---	---	1,150	1,100	1,155
Tax credit for the elderly	---	---	---	---	---	---	---	100	130	120
603 Unemployment Compensation										
Exclusion of other employee benefits										
Income of trusts to finance supplementary unemployment benefits	25	15	15	20	5	5	5	5	5	5

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
601 General Retirement and Disability Insurance (continued)										
Exclusion of railroad retirement system benefits	200	265	275	330	380	435	500	570	655	750
Exclusion of workmen's compensation benefits	705	835	1,035	1,165	2,675	3,260	3,965	4,825	5,870	7,145
Exclusion of special benefits for disabled coal miners	50	50	50	50	100	105	110	120	130	140
Exclusion of sick and disability pay	50	75	140	185	170	170	170	170	170	170
Net exclusion of pension contributions and earnings										
Employer plans	8,715	9,940	11,325	12,925	23,605	27,905	32,930	38,855	45,850	54,100
Plans for self-employed and others	1,305	1,650	1,920	2,125	2,105	2,305	2,525	2,770	3,040	3,345
Exclusion of other employee benefits										
Premiums on group term life insurance	800	905	875	1,485	1,855	2,055	2,275	2,520	2,790	3,090
Premiums on accident and disability insurance	70	75	75	90	100	105	110	120	130	140
Additional exemption for the blind	20	20	30	40	30	30	30	30	30	30
Additional exemption for the elderly	1,220	1,155	1,670	1,970	2,260	2,505	2,800	3,015	3,485	3,885
Tax credit for the elderly	495	250	160	135	125	120	115	110	105	100
603 Unemployment Compensation										
Exclusion of other employee benefits										
Income of trusts to finance supplementary unemployment benefits	10	10	10	10	20	20	25	30	30	35

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
603 Unemployment Compensation (continued)										
Exclusion of untaxed unemployment insurance benefits	300	325	350	400	800	700	550	1,050	2,300	3,305
604 Housing Assistance										
Exclusion of interest on state and local housing bonds for rental housing	---	---	---	---	---	---	---	---	---	---
609 Other Income Security										
Exclusion of public assistance benefits	50	50	50	50	65	65	70	75	105	115
Deductibility of casualty and theft losses	70	80	80	80	165	150	150	255	280	300
Earned income credit[h]	---	---	---	---	---	---	---	---	---	290
Excess of percentage standard deduction over minimum standard deduction	3,200	3,600	3,800	3,000	700	1,040	1,170	1,260	1,385	1,465
700 VETERANS' BENEFITS AND SERVICES										
701 Income Security for Veterans										
Exclusion of veterans' disability compensation[i]	550	600	600	650	700	480	500	485	540	590
Exclusion of veterans' pensions	---	---	---	---	---	---	---	25	25	30
702 Veterans' Education, Training and Rehabilitation										
Exclusion of GI bill benefits	---	---	---	---	---	---	---	290	255	330

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
603 Unemployment Compensation (continued)										
Exclusion of untaxed unemployment insurance benefits	2,745	1,200	1,780	2,495	5,275	4,530	4,440	4,335	4,460	4,610
604 Housing Assistance										
Exclusion of interest on state and local housing bonds for rental housing	---	---	---	---	430	555	680	800	940	1,095
609 Other Income Security										
Exclusion of public assistance benefits	100	345	355	395	465	510	580	665	755	860
Deductibility of casualty and theft losses	345	360	435	590	715	895	1,015	1,195	1,410	1,665
Earned income credit[h]	395	285	265	415	635	575	525	475	460	425
Excess of percentage standard deduction over minimum standard deduction	1,285	---	---	---	---	---	---	---	---	---
700 VETERANS' BENEFITS AND SERVICES										
701 Income Security for Veterans										
Exclusion of veterans' disability compensation[i]	655	840	905	1,050	1,300	1,575	1,860	2,135	2,460	2,825
Exclusion of veterans' pensions	30	40	45	50	85	95	105	120	130	145
702 Veterans' Education, Training and Rehabilitation										
Exclusion of GI bill benefits	255	200	195	160	180	160	130	110	90	75

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
800 GENERAL GOVERNMENT										
806 Other General Government										
Credits for political contributions	---	---	---	---	---	100	100	10	40	40
850 GENERAL PURPOSE FISCAL ASSISTANCE										
851 General Revenue Sharing										
Exclusion of interest on general purpose state and local debt	1,800	2,000	2,200	2,300	2,600	2,900	3,300	3,865	3,805	4,170
Deductibility of non-business state and local taxes (other than on owner-occupied homes)	2,800	4,150	5,100	5,600	5,600	5,300	6,000	6,955	8,490	6,505
852 Other General Purpose Fiscal Assistance										
Tax credit for corporations receiving income from doing business in United States possessions	70	80	85	80	80	80	80	355	245	240
Exclusion of income earned by individuals in United States possessions	10	10	10	10	10	10	10	---	---	---
900 INTEREST										
901 Interest on the Public Debt										
Deferral of interest on savings bonds	---	---	---	---	---	---	---	---	525	605

(Continued)

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TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
800 GENERAL GOVERNMENT										
806 Other General Government										
Credits for political contributions	40	60	80	100	100	80	80	80	100	80
850 GENERAL PURPOSE FISCAL ASSISTANCE										
851 General Revenue Sharing										
Exclusion of interest on general purpose state and local debt	4,785	5,395	5,365	5,880	5,930	6,480	7,305	7,980	8,560	9,045
Deductibility of non-business business state and local taxes (other than on owner-occupied homes)	8,095	8,505	10,935	14,665	18,405	23,060	28,060	33,670	40,405	48,485
852 Other General Purpose Fiscal Assistance										
Tax credit for corporations receiving income from doing business in United States possessions	285	485	685	780	1,005	1,095	1,200	1,320	1,455	1,600
Exclusion of income earned by individuals in United States possessions	---	---	---	---	---	---	---	---	---	---
900 INTEREST										
901 Interest on the Public Debt										
Deferral of interest on savings bonds	565	625	615	290	-75	335	335	335	335	335

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
TOTAL										
Revenue Losses	36,550	44,140	46,635	43,945	51,710	59,810	65,370	82,015	92,855	97,365
Number of Items	50	51	52	53	55	59	59	71	78	80

(Continued)

TABLE 1. (Continued)

Function and Subfunction	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
TOTAL										
Revenue Losses	113,455	123,470	149,815	181,480	228,620	266,280	306,435	350,530	403,725	465,290
Number of Items	85	84	92	92	104	104	103	103	100	98

SOURCES: Estimates of Federal Tax Expenditures, prepared by the Staffs of the Treasury Department and Joint Committee on Taxation (June 1, 1973, July 8, 1975, March 15, 1976, March 15, 1977, March 14, 1978, March 15, 1979, March 6, 1980, March 16, 1981); and Tax Analysts and Advocates, Tax Notes (April 15, 1974).

NOTE: The estimates were prepared only on a calendar year basis until 1973. The estimates for calendar years 1967 to 1973 correspond roughly to fiscal years 1968 to 1974.

a. All estimates are based on the tax law in effect at the time the estimates were made. Individual and corporate tax expenditures for each year are combined.

b. Less than $2.5 million.

c. Includes capital gains from iron ore for years 1967 to 1977.

d. Included with capital gains from coal for years 1967 to 1977.

e. Includes charitable contributions for health for years 1967 to 1974.

f. Included with other charitable contributions for years 1967 to 1974.

g. Dependents and survivors benefits, additional exemption for the elderly and the tax credit for the elderly included with OASI benefits for retired workers for years 1967 to 1973.

h. The figures in the table indicate the effect of the earned income credit on receipts. The effect on outlays is $1,165 million in 1976, $1,015 million in 1977; $945 million in 1978; $840 million in 1979; $1,695 million in 1980; $1,205 million in 1981; $1,115 million in 1982; $1,030 million in 1983; $955 million in 1984; $855 million in 1985; and $815 million in 1986.

i. Includes veterans' pensions and exclusion of GI bill benefits for years 1967 to 1973.

TABLE 2. CHANGES IN THE TAX EXPENDITURE BUDGET, FISCAL YEARS 1967 TO 1986

	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
Total Number of Tax Expenditures	50	51	52	53	55	59	59	71	78	80
Number Added Because Of										
Definitional Changes										
Items previously in the tax code but not included in the budget								11	4	
Subdivision of items previously in the budget		1						1	3	
Legislative Action			1	1	2	4		1	1	2
Number Subtracted Because Of										
Definitional Changes										
Items still in the tax code but no longer included in the budget								1		
Combination of previously separate items										
Legislative Action									1	

(Continued)

TABLE 2. (Continued)

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Total Number of Tax Expenditures	85	84	92	92	104	104	103	103	100	98
Number Added Because Of										
Definitional Changes										
Items previously in the tax code but not included in the budget			1							
Subdivision of items previously in the budget		1	1	1	10					
Legislative Action	5	1	6		5					
Number Subtracted Because Of										
Definitional Changes										
Items still in the tax code but no longer included in the budget					2					
Combination of previously separate items										
Legislative Action		3		1	1		1		3	2

SOURCE: Table 1.

earlier years are not formally revised to reflect these changes, except for the most recent year or two in which the old and new estimates overlap.

Changes in Other Tax Provisions. Estimates of tax expenditures may change when tax rates or other basic structural features of the tax code are changed, even if there are no explicit modifications in the tax expenditure provisions themselves. If tax rates are reduced across the board, for example, the measured revenue loss from tax expenditures will also be reduced, since special deductions and exclusions will be measured against lower rates.[4] Similarly, increases in the standard deduction (zero bracket amount) will reduce the revenue loss from tax expenditures that take the form of itemized deductions.

OUTLAY EQUIVALENTS

In order to make precise comparisons between tax expenditures and direct outlays programs for program analysis purposes, some adjustments in the tax expenditure estimates can be useful. If the government is trying to decide between a tax expenditure and a direct outlay subsidy program, for example, it may want to look at alternatives that provide the same after-tax benefits to recipients. The purpose of most subsidies is to influence behavior, and for this purpose the net amount of the subsidy after taxes is usually most important. But if the subsidy is taxable in one form but not in the other, the subsidies are not equivalent. The taxable subsidy is less valuable to the recipient because some portion of it is returned to the government in taxes, while its net cost to the government is less for the same reason.

The 10 percent investment tax credit, for example, is worth more to businesses than a taxable direct grant of the same amount would be, since businesses do not have to pay any tax on the amount of the credit. Accordingly, if the government were to substitute a taxable direct grant program for the investment tax credit, and wanted to keep the after-tax benefit to the recipients the same,

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4. There may also be a separate behavioral response from changes in tax rates, since the incentive for taxpayers to use special deductions or exclusions is reduced if they are worth less in tax savings. This effect may or may not be explicitly taken into account in the estimates, depending on how reliably the behavioral response can be estimated.

the total outlay cost--the "outlay equivalent"--would have to be larger than the revenue loss from the investment tax credit to cover the tax on the grant.

Some tax subsidies are, in effect, taxable. Businesses that use the targeted jobs tax credit, for example, must subtract the amount of the credit from the deduction for wages they would otherwise be allowed for tax purposes. This "basis adjustment" is equivalent to including the amount of the credit in income and

TABLE 3. HOUSING AND ENERGY TAX EXPENDITURES AND OUTLAY EQUIVALENTS, FISCAL YEARS 1980-1982 (In millions of dollars)

	1980	1981	1982
Housing			
Owner-occupied housing			
Tax expenditures	25,335	31,565	39,725
Outlay equivalents	26,840	33,170	41,655
Rental Housing			
Tax expenditures	890	1,030	1,195
Outlay equivalents	1,965	2,155	2,410
Total			
Tax expenditures	26,225	32,595	40,920
Outlay equivalents	28,805	35,325	44,065
Energy			
Conservation[a]			
Tax expenditures	660	785	850
Outlay equivalents	720	825	895
Supply[b]			
Tax expenditures	4,500	6,020	6,635
Outlay equivalents	7,715	9,520	10,875
Total			
Tax expenditures	5,160	6,805	7,485
Outlay equivalents	8,435	10,345	11,770

a. Includes exemption from excise tax for buses and bus parts.
b. Includes exemption from excise tax for alcohol fuels.

subjecting it to tax. The cost in outlays of an equivalent taxable direct grant program would thus be the same as the revenue loss from the credit, with no extra amount for the tax.

Special Analysis G in the fiscal year 1982 budget contains a more systematic illustration of this approach. In a section prepared by the Treasury Department, the outlay equivalents of the tax expenditures for energy and housing are estimated, and then compared with direct budget outlays for those purposes.[5] As indicated in Table 3, which has been adapted from information in Special Analysis G, the outlay equivalents of tax expenditures are significantly higher than the tax expenditures themselves. Since the tax expenditure subsidies are tax free, an equivalent outlay would usually have to be higher to be worth the same amount to the recipient, and the budget cost of the equivalent outlay would also be higher.

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5. Budget of the United States Government, Fiscal Year 1982, Special Analyses, pp. 234-38 (January 1981).

CHAPTER III. TAX EXPENDITURE SUBSIDIES, GENERAL TAX CUTS, AND DIRECT EXPENDITURE SUBSIDIES

Tax expenditure subsidies can be viewed as alternatives or supplements to federal spending, loan, or regulatory programs with similar goals. The targeted jobs tax credit, for example, is aimed in large measure at providing jobs for hard-core unemployed youths, a goal shared by the Job Corps program and the proposed subminimum wage for teenagers. There are tax credits, grants, and loans for residential energy conservation. Both the Export-Import Bank and the Domestic International Sales Corporation (DISC) tax provisions subsidize U.S. exports.

But tax expenditures can also be viewed as alternatives to more general tax cuts. Whenever the Congress faces a decision on cutting taxes, it has a choice between general across-the-board cuts--reductions in rates, bracket widening, increases in the zero bracket amount (standard deduction), increases in personal exemptions, and the like--and more narrowly targeted cuts that frequently take the form of tax expenditures.

This chapter reviews some of the considerations that may be relevant in choosing between tax expenditures and general tax cuts, and between tax expenditures and other forms of federal subsidies.

TAX EXPENDITURES AND GENERAL TAX CUTS

The effects of tax expenditures are very similar to those of federal spending and loan programs, so it is useful analytically to consider tax expenditures as alternatives to spending programs. In terms of actual legislative decisions, however, changes in tax expenditures are normally considered in the context of tax legislation rather than spending legislation, since committee jurisdictional problems can make it difficult to work out direct trade-offs between tax and spending programs. The choice is thus frequently between tax expenditures and more general tax cuts. Whenever the Congress is considering a large tax cut, for example, it must determine how much of the tax cut to devote to relatively broad general cuts and how much to devote to new or expanded tax expenditure provisions. If repeal or reduction of existing tax expenditures is being considered, one possible use of the additional revenue would be to return it to taxpayers in the form of an across-the-board tax cut.

The choice between general tax cuts and tax expenditures has been on the Congressional agenda frequently during the past decade. Because of the interaction of inflation with the graduated rate structure of the individual income tax, regular tax cuts have been necessary to hold taxes relatively constant as a percentage of personal income. Starting with the Tax Reform Act of 1969, large personal and business tax cuts were approved in 1971, 1975, 1976, 1977, 1978, and 1981. The Economic Recovery Tax Act of 1981 may signal a significant break in that pattern, however. The act provides for an across-the-board reduction in individual income tax rates of 23 percent over the 1981 to 1984 period, followed by indexing of the individual income tax for inflation starting in 1985. In addition, the act provides for very large reductions in business taxes over the next five years, as more generous business depreciation allowances are phased in.

The Congress has thus chosen to provide large general tax cuts, but it has not yet fully determined how those cuts are to be financed. The 1981 tax act will reduce taxes by an estimated $268 billion below the level they would otherwise have reached in fiscal year 1986, well in excess of the spending reductions that have been enacted thus far. Further reductions in spending will, therefore, be necessary if the goal of a balanced budget is to be reached by fiscal year 1984. Reductions in tax expenditures could also be used to fill this gap. Instead of simultaneous conversion of tax expenditure reductions into general tax cuts, the tax expenditure reductions could be used to finance the future-year tax cuts that have already been enacted.

Additionally, tax expenditure reductions could be used to fund still further reductions in general tax rates. The individual tax cuts enacted in 1981 actually do little more than hold the tax burden constant over the next few years, offsetting the tax increases that would otherwise have occurred because of inflation-induced increases in the individual income tax and scheduled increases in Social Security taxes.

It is, therefore, worth noting some of the considerations that arise in choosing between tax expenditures and general tax cuts.

In general terms, the choice is between relatively small per-taxpayer savings for large numbers of taxpayers and larger per-taxpayer savings for a more narrowly defined group of taxpayers. More specifically, however, the choice may turn on the possible effects of different alternatives on taxpayer behavior and on marginal tax rates.

Effects on Taxpayer Behavior

Because general across-the-board tax cuts usually involve small per-taxpayer savings, and, because the cuts do not specifically attempt to change taxpayer behavior, they normally do not alter taxpayer behavior in measurable ways. If the cuts include reductions in marginal tax rates, however, incentives to save, work, and invest may increase, leading to important changes in behavior. This is especially true for the highest marginal rates, such as the former top marginal rate of 70 percent on investment income, and the high rates that apply to low-income workers because of the phase-out of the earned income credit as income rises.[1]

Proponents of incentive-type tax expenditures usually argue that the targeted tax provisions that they propose will have greater effects on taxpayer behavior than broad across-the-board tax cuts. Those who advocate excluding a certain amount of interest income from tax, for example, suggest that this would do more to encourage increased saving than a cut in marginal tax rates with the same revenue loss. Opponents argue that most targeted savings incentives simply shift existing savings into the tax-favored forms without increasing overall net saving.

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1. The earned income credit is equal to 10 percent of the first $5,000 of income, but it gradually phases down as income exceeds $6,000, declining to zero for families with incomes over $10,000. Thus, for each $100 of extra income that a family earns above $6,000, the earned income credit declines by $12.50. This is equivalent to a marginal tax rate of 12.5 percent. When added to the marginal tax rates that result from the regular tax schedule, payroll taxes, and the phaseout of income-tested benefits from AFDC, food stamps, housing assistance, and the like, the cumulative marginal tax rates for such families can be well above 50 percent.

Generally, tax subsidies that favor a particular kind of economic activity will result in more resources being devoted to that activity, but this is usually a reallocation of existing resources rather than any overall increase. At least in the short run, targeted tax subsidies are likely to have about the same effect on overall economic activity as a general tax cut of the same size. Just as with a general tax cut, some taxpayers or sectors of the economy will be better off, but others will be worse off.

Some tax subsidies may serve to offset or compensate for other distortions in the economy, so that the reallocation of resources they represent may leave the economy better off in the long run. Accelerated depreciation and the investment tax credit, for example, may help to compensate for the overtaxation of corporate income that many economists believe results from the corporate income tax and the failure to adjust business depreciation allowances for inflation. Using one set of distortions to offset another, however, may require a greater understanding of how the economy works than now exists. Moreover, the kind of precise guiding of taxpayer behavior that, in theory, is necessary can be difficult to accomplish. It is hard to predict in advance how taxpayers will react to a specific provision, and to design and administer provisions that will assure those effects. Tax-exempt bond financing of industrial pollution control, for example, may well be encouraging "end of the pipe" control devices when more efficient control of pollution emissions could be achieved by basic changes in manufacturing processes or the treatment of raw materials. The residential energy conservation tax credit may simply have driven up the cost of home insulation and other energy-saving devices by the amount of the credit, while adding little to the incentive for energy conservation already provided by higher energy prices.

Whatever the merits of incentive-type tax subsidies, they represent an attempt by the federal government to induce taxpayers to do things they would not otherwise do in exchange for a tax saving. When compared to the alternative of a federal spending or regulatory program, this means of influencing behavior may appear less intrusive. But compared to a more general tax cut, it represents greater federal involvement in taxpayer decisions, and less reliance on market forces. With general tax cuts, taxpayers receive the tax savings automatically, and they can use them as they wish. With tax expenditures, the tax savings go only to those in specified circumstances, or who act in specified ways.

Marginal Tax Rates

Tax expenditures can be viewed as both a cause and an effect of high marginal tax rates. Because tax expenditures remove a large share of income from the tax base, tax rates must be higher on the income that is left to raise the same amount of revenue. And because marginal tax rates are so high, there is continual pressure for tax expenditures that can shield income from those high rates.

Effective marginal tax rates have increased substantially overall in recent years, even though there has been no legislated increase in tax rates. In 1969, fewer than 6 percent of all tax returns had income taxed at marginal rates of more than 30 percent. By 1979, more than 14 percent of returns had income taxed at rates above that level. The share of total personal income taxed at above 30 percent rose from less than 6 percent in 1969 to more than 8 percent in 1979.[2]

Most of this increase occurred because inflation and real growth in incomes pushed more and more income into the higher tax brackets. This "bracket creep" could have been offset by reductions in marginal tax rates, widening of rate brackets, or some combination, but it was not. Only one of the tax cuts in the 1970s involved any change in rates, and that one, in 1978, offset only one year's bracket creep. At the same time, an increasing share of personal income was being excluded from the tax base. The percentage of personal income excluded from adjusted gross income by law or regulation rose from 13.5 percent in 1969 to 18.6 percent in 1979. Income tax credits offset 1.5 percent of personal income in 1979, up from 0.5 percent in 1969.[3] Taxes were also reduced by increases in the personal exemption and the standard deduction, which are considered part of the normal tax structure rather than tax expenditures.

The emphasis in the 1970s on narrowing the tax base by increasing deductions, exclusions, exemptions, and credits rather than cutting tax rates reflected in part a desire to concentrate more of the tax savings on those with low and moderate incomes.

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2. Eugene Steuerle and Michael Hartzmark, "Individual Income Taxation 1947-79," OTA Paper 48 (April 1981), Office of Tax Analysis, Department of the Treasury, Table A-5, p. 36.

3. Ibid., Table 1, p. 8 and Table 2, p. 14.

Increases in personal exemptions and the standard deduction, for example, provide greater tax savings to lower-income taxpayers than do across-the-board rate cuts. Many tax expenditures, however, especially those that take the form of deductions or exclusions rather than credits, provide substantial tax savings to higher-income taxpayers. The expansion of tax expenditures during the 1970s thus extended significant tax relief to higher-income taxpayers as well, even though there were no reductions in rates until 1978.

It is clear that tax expenditures can serve to reduce the burden of high marginal tax rates on taxpayers. A number of tax expenditures are frequently combined into "tax shelters" for wealthy investors. The oil depletion allowance, the deduction for intangible oil and gas drilling expenses, accelerated depreciation allowances, the investment tax credit, and the lower rates on capital gains are examples. These tax shelters enable oil drillers, real estate developers, manufacturers, and others to obtain the investment funds they need by, in effect, selling the tax savings to high-bracket taxpayers.

While this serves to ease the burden of high marginal rates on many taxpayers, this method can create significant "transaction costs" and economic inefficiencies. Reducing marginal tax rates directly, as the Congress has now done, can eliminate some of these inefficiencies in the investment process, channeling more resources into productive investment. This is especially true with respect to the top 70 percent marginal rate on investment income, which has induced many investors to seek tax shelters.

There is thus a fairly direct trade-off between rate reductions and tax expenditures. The more rates are reduced, the less is the incentive to use tax expenditures to ease the burden of high rates. But the more tax expenditures erode the income tax base, the higher rates must be on the income that remains to be taxed.

TAX SUBSIDIES AND DIRECT EXPENDITURE SUBSIDIES

Tax subsidies can also serve as alternatives to spending or loan programs. Almost any feature that is included in a spending or loan program can be duplicated in a tax subsidy. Providing tax subsidies in the form of credits rather than deductions, and including the credit in taxable income, can assure that the value of the tax subsidy is the same as that of an equivalent direct grant. Making the credit refundable, as discussed below, can extend the subsidy to nontaxpayers, both individuals and businesses. Providing the subsidy in the form of a deferral of tax liability makes it the equivalent of a loan program. While no interest is normally charged on tax deferrals, it could be if the Congress wished. These are all questions of program design; the Congress can make tax subsidies look and work as much or as little like direct spending and loan programs as it chooses.

There are some practical differences between tax and direct expenditure subsidies, however, that may lead the Congress to choose one rather than the other. It can be difficult to extend tax subsidies to individuals and businesses that do not pay taxes; tax subsidies come under the jurisdiction of different committees than spending programs; they are subject to less precise control in the budget process; administrative control and review tends to be less detailed; and the beneficiaries of tax subsidies may prefer to receive subsidies in that form. Depending on the goals being sought, these can be viewed as either advantages or disadvantages.

Nontaxpayers

While it is possible to extend the benefits of tax subsidies to nontaxpayers, it can be cumbersome to do so. The most direct way is to provide the subsidy in the form of a refundable tax credit. This is a credit against taxes due that is paid directly in cash, or refunded, if the recipient does not owe enough taxes to use up the credit. The only refundable tax expenditure now in the law is the earned income credit paid to low-income workers with dependents, but it has frequently been suggested that the investment tax credit and other credits be made refundable as well.

Making tax credits refundable would be consistent with the underlying rationale for most such provisions, which is to provide a subsidy to the recipient. Since eligibility for nontax subsidies does not depend on whether or not the recipient has taxable income, subsidies provided through the tax code, proponents argue, should not be subject to this kind of limitation either. In addition, making tax credits refundable would eliminate the need for the current complex rules that specify the order in which credits must be taken, and provide for the carryback and carryforward of unused credits.

A number of objections have been raised to making credits refundable, including the extra cost, the administrative burden on the IRS, and the impropriety of "bailing out" money-losing businesses. But the underlying concern on the part of many tax policymakers appears to be that making more and more credits refundable could eventually result in a large share of federal spending programs being run through the tax system, diverting the Treasury and the IRS from their traditional revenue-raising tasks.

In the case of most businesses, refundable credits would present few administrative problems. The records needed are readily available, and the beneficiaries are easy to identify and keep track of.

Nontaxpaying individuals, especially those with low incomes, are more difficult to deal with through the tax system. People whose incomes are so low they do not have to pay taxes usually do not have to file tax returns, so the IRS may have no record of their existence. It is thus hard to inform them of their possible eligibility for a subsidy. Once they learn about the subsidy, they may have difficulty with the forms and paperwork necessary to establish their eligibility, and the IRS has relatively few resources to provide them with assistance. Many low-income nontaxpayers also have considerable fear and skepticism about dealing with the IRS, and may thus be reluctant to apply for an IRS-administered subsidy. It may also be a hardship for them to have to wait until tax returns can be filed to obtain the subsidy. While attempts have been made to have the earned income tax credit reflected currently in withholding, there have been administrative problems with this approach. In the case of subsidies for low-income individuals, therefore, it may be preferable to provide the subsidy in the form of a direct grant administered by an agency with more experience in dealing with low-income people.

There are also some less direct ways of extending the benefits of tax subsidies to those who have little or no taxable income. Tax credits and deductions can be carried back to offset tax liability from earlier years, or carried forward to offset possible future liability. The present value to the beneficiary of any tax saving is reduced, however, if it is not actually received until some year in the future.

Leasing arrangements are another possibility. A business with low tax liability can lease its equipment from a bank or other firm with enough tax liability to take advantage of the investment tax credit and other tax subsidies, and obtain at least part of the benefit of the subsidy in the form of reduced lease payments. The

Economic Recovery Tax Act of 1981 eased very significantly the tax rules that apply to leasing, clearing the way for a substantial expansion in this activity. Even with these more liberal rules, however, there can be transaction costs and economic inefficiencies associated with leasing that can make this a less than ideal solution.

Another way of circumventing the nonrefundability of present business tax credits is through acquisitions and mergers. Firms with large accumulations of unused tax credits are frequently attractive candidates for mergers with firms with large tax liabilities. How the benefits of the tax credits are then divided depends on the terms of the arrangement between the companies involved.

Committee Jurisdictions

Tax subsidies come under the jurisdiction of the House Committee on Ways and Means and the Senate Committee on Finance. The rules of both Houses permit legislation to be referred jointly to two or more committees, so that it is possible for other committees to consider tax subsidies as well. The Rules of the House of Representatives specifically provide for a degree of joint responsibility:

> Each standing committee of the House shall have the function of reviewing and studying on a continuing basis the impact or probable impact of tax policies affecting subjects within its jurisdiction . . . .[4]

But legislative jurisdiction lies with the tax-writing committees.

Proponents of a new program may prefer to cast it in the form of a tax subsidy in order to have it considered by the tax committees. This is especially likely if a proponent happens to be a member of one of those committees. More generally, however, the tax committees may simply be viewed as a more sympathetic forum, or the committees that would have jurisdiction over a direct spending subsidy may be hostile to the proposal or subject to budgetary constraints. Those proposing the subsidy may also not want to have

4. Rules of the House of Representatives, Rule X(2)(d).

it administered by the executive agency that would be in charge of the program if it took the form of a direct grant.

Specialization and Expertise. It is often argued that it is inappropriate to have housing, health, education, employment, energy, argiculture, and other subsidies legislated by the tax committees, since they lack expertise in those specialized subject areas. The Mortgage Subsidy Bond Tax Act of 1980, for example, which placed limits on the use of tax-exempt bonds to finance single-family housing, required the tax committees to deal with many issues that were more familiar to the committees with jurisdiction over housing. But the tax committees have substantial experience in dealing with a number of direct spending programs. They have jurisdiction over major health and welfare programs, unemployment compensation, and Social Security, and have dealt extensively in recent years with energy issues. To the extent that the tax committees lack experience or expertise in a specific area, it may be possible through the process of joint referral to have tax subsidy proposals reviewed by the committees that have this expertise.

Budgetary Control

Budget Act Requirements. The Budget Act requires that five-year projections of the estimated levels of tax expenditures by major budget functional category be included each year in the Budget Committee reports accompanying the First Concurrent Resolution on the Budget. In addition, committee reports on all bills providing for new or increased tax expenditures must include five-year estimates of the revenue loss from those provisions. Beyond that, however, there are no direct controls over tax expenditures in the budget process. The budget resolutions themselves do not set targets for tax expenditures by budget functional categories, as they do for direct spending programs. Nor are the tax committees allocated target ceilings for tax expenditures, as all committees are in the case of spending programs under their jurisdiction.

Revenue Floors. Nonetheless, the budget process does impose one very important constraint on tax expenditures. Once the overall revenue floor is established by the second concurrent resolution, any legislation with a revenue loss that would reduce total revenues below the floor is subject to a point of order. This of course applies to all revenue-reducing legislation, not just legislation that provides special-purpose tax subsidies in the form of tax expenditures. But the revenue floor sets up a "zero-sum game" in which all revenue-reducing bills must compete for the limited amount of tax reduction permitted by the budget resolution. If the budget resolution contemplates a tax cut of $20 billion, for example, the cut may take the form of a broad, across-the-board rate cut, a series of special-purpose tax subsidies, or some combination, but the total tax cut cannot exceed $20 billion. Elimination or reduction of existing tax expenditures would, of course, create room for additional general tax cuts. Across-the-board cuts that provide relatively modest tax relief to large numbers of taxpayers must therefore compete with tax subsidies that provide larger per-taxpayer savings to fewer taxpayers. While this kind of limit on the total amount of revenue-reducing legislation that the Congress may approve does not limit tax expenditures directly, it does create a situation in which they are likely to be subject to closer scrutiny.

The control over tax expenditures that results from the overall revenue floor is actually similar in many respects to the control over direct spending that is imposed by overall spending ceilings. While the second budget resolution does include limits on spending by major functional category, spending legislation is not subject to a point of order if it would breach those function-by-function ceilings. It is only the overall spending totals that are binding, just as it is only the overall revenue floor that limits tax expenditures or other tax cuts. The more detailed breakdown of spending categories may help to highlight potential breaches of the spending ceiling as bills move through the legislative process, but it is only the last spending bill that gets caught by the spending ceiling, just as it is only the last revenue-reducing bill that gets caught when the revenue floor is reached.

Reconciliation. Another budgetary control tool is the process called reconciliation, under which changes in spending and revenues can be ordered to reconcile current law spending and revenue levels with the overall totals agreed upon in the budget resolution. Reconciliation was first used in 1980 and resulted in fiscal year 1981 deficit reductions of approximately $8.2 billion, $4.6 billion from reduced outlays and $3.6 billion from additional revenues. Most of the additional fiscal year 1981 revenues came from a "cash management" speed-up of tax collections, but substantial future-year revenues were projected from the phase-out of tax-free mortgage subsidy bonds.

Reconciliation was greatly expanded in 1981. Fiscal year 1982 outlay reductions from reconciliation are estimated at $35 billion. Unlike 1980, however, reconciliation in 1981 did not include any revenue measures.

Nonetheless, as the 1980 experience demonstrates, reconciliation can be used to increase revenues as well as to reduce outlays. It cannot require changes in specific tax expenditures, however, just as it cannot require specific changes in spending programs. The decision on how to raise revenues is left to the tax committees. The revenue increases can come from across-the-board tax increases, increased user charges and excise taxes, reductions in tax expenditures, or other tightening and reform measures.

Visibility. It is often argued that tax subsidies have less visibility in the legislative and budget process than do direct spending programs, and that they are, therefore, subject to less regular and detailed scrutiny. This was certainly true in the past, but it has become somewhat less so in recent years. The tax expenditure budget, which lists all tax expenditures and the estimated revenue losses associated with them, is published each year along with the President's budget in January. It includes revenue loss estimates for the upcoming fiscal year and the two prior years. Two or three months later, five-year projections of estimated tax expenditure revenue losses are published by the Joint Committee on Taxation for the two Congressional tax-writing committees. These five-year projections of all tax expenditures are then included in the Budget Committee reports on the first concurrent resolution, and published separately by the CBO (see Appendix Table A-1).

Each bill increasing or reducing tax expenditures is accompanied by a report giving an estimate of the five-year loss or gain from the change, just as spending bills are accompanied by five-year cost estimates. Changes in tax expenditures have the same effect on the federal deficit as do any other tax or spending changes, and thus receive whatever attention and scrutiny that entails.

One problem with tax expenditures is that their cost in lost revenues can increase sharply and unexpectedly if economic or demographic conditions should change, since they are, in effect, "entitlement" programs that are automatically available to whoever meets the statutory eligibility requirements. Like Social Security, Medicare, and other entitlement spending programs, there is no overall limit on the costs of the program. While it is usually possible to make reasonably good estimates of future costs, there are cases in which higher costs can occur with little warning. The use of tax-exempt bonds to finance single-family housing grew rapidly in late 1978 and early 1979, for example, threatening multibillion dollar annual revenue losses until the Congress stepped in to impose limits.[5] Tax-exempt industrial revenue bonds have been used to a much greater extent than previously available data suggested, since most of the bonds are not reported beyond the state level, if at all.[6]

Like entitlement spending programs, therefore, the future costs of tax expenditures are not as visible and predictable as those of programs with statutory ceilings. The early signs of cost increases can be especially difficult to detect with tax expenditures, since total tax collections may fall below expectations for a whole host of reasons. It is usually not possible to tie a decline in revenues directly to increased use of a particular tax expenditure, whereas it becomes quickly apparent when spending for a particular entitlement spending program increases.

Periodic Review. Tax subsidies are not regularly reviewed in the way that spending programs subject to annual appropriations or periodic reauthorization are. Most spending programs are not subject to detailed full-scale review on a regular basis, however, while many tax subsidies receive review when major tax cut legislation is being considered or as a result of scheduled expiration dates.

With the growth in recent years in entitlement programs and programs with long-term contractual obligations, a steadily declining share of federal spending is subject to the annual appropriations process. In fiscal year 1982, only about 50 percent of federal spending will be subject to discretionary annual appropriations, compared to 56 percent ten years ago. Even those programs that are subject to annual appropriations may not receive detailed scrutiny every year, since the usual issue is whether a program should get a little bit more or a little bit less, not whether it

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5. Congressional Budget Office, Tax-Exempt Bonds for Single-Family Housing (April 1979).

6. Congressional Budget Office, Small Issue Industrial Revenue Bonds, (April 1981).

should exist at all. The same is true of spending programs that must be reauthorized every two or three years. Reauthorization requirements do not guarantee full-scale reexamination of programs and the need for them.

Five major tax cut bills were passed by the Congress in 1969, 1971, 1975, 1976, and 1978. Each provided the occasion for a review of existing tax subsidies, and four of them--the bills passed in 1969, 1975, 1976, and 1978--cut back or eliminated some significant tax subsidies. Each bill also created a number of new tax subsidies. Significantly, however, many of these new subsidies had scheduled expiration dates in order to give the Congress the opportunity to evaluate them after a few years of experience. Many also required that studies of the effectiveness of the new provisions be submitted to the Congress in advance of the expiration dates. Table 4 contains a listing of tax subsidies enacted since 1969 that included expiration dates and/or study requirements.

Setting an expiration date and requiring a study does not, of course, guarantee that the tax subsidy will be carefully reviewed before it is reauthorized, any more than similar requirements guarantee careful review of spending programs. But it does suggest that tax subsidies may become more like direct spending programs in the degree of periodic review that they receive.

Administration

Eligibility Rules. The ease of administration of any subsidy program depends mainly on the eligibility rules and how they are enforced. If eligibility depends on a few clear and simple rules, if the information needed to verify eligibility is readily available, and if no significant exercise of judgment is required to apply the rules, administration is relatively easy. But as the eligibility rules become more detailed and complicated, as the information needed to verify eligibility becomes harder to get, and as more individualized judgments become necessary, subsidies become more and more difficult to administer.

Administration of Tax Subsidies. Tax subsidies are not different from other subsidies in this respect. Tax subsidies do have some possible administrative advantages, however. First, a well-run bureaucracy to administer the subsidy already exists--the Internal Revenue Service. The IRS deals on an annual basis with nearly 100 million taxpayers. It has information on where they live, what their income is, how many dependents they have, whether

TABLE 4. NEW TAX EXPENDITURES WITH EXPIRATION DATES AND/OR STUDY REQUIREMENTS ENACTED BETWEEN 1969 AND 1981

New Tax Expenditure	Originally Scheduled Expiration Date and/or Study Requirement
Tax Reform Act of 1969	
5-year amortization of low-income rental housing rehabilitation expenses	December 31, 1974
5-year amortization of pollution control facilities	December 31, 1974
5-year amortization of railroad rolling stock	December 31, 1974
5-year amortization of coal mine safety equipment	December 31, 1974
Revenue Act of 1971	
5-year amortization of on-the-job training and child care facilities	December 31, 1976
Domestic International Sales Corporations (DISC)	Annual Treasury Department reports required on "operation and effect"of DISC system of taxation.
Tax Reduction Act of 1975	
Employee Stock Ownership Plan (ESOP) investment tax credit	December 31, 1976
New home purchase tax credit	December 31, 1976
Tax Reform Act of 1976	
Deduction for eliminating architectural and transportation barriers for the handicapped	December 31, 1979
Tax incentives for historic preservation	June 1981

(Continued)

TABLE 4. (Continued)

New Tax Expenditure	Originally Scheduled Expiration Date and/or Study Requirement
Tax Reform Act of 1976 (continued)	
Exclusion for group prepaid legal services	December 31, 1981; Treasury and Labor Department study required by December 31, 1980.
Possessions Corporation Tax Credit	Annual Treasury Department reports required on "operation and effect".
Tax Reduction and Simplification Act of 1977	
New jobs tax credit	December 31, 1978
Revenue Act of 1978	
Exclusion for employer educational assistance programs	December 31, 1983
Targeted jobs tax credit	December 31, 1981; Treasury and Labor Department report required by June 30, 1981.
Energy Tax Act of 1978	
Home insulation tax credit	December 31, 1985
Solar energy tax credit	December 31, 1985
Business alternative energy investment tax credits	December 31, 1982
Exclusion for employer-provided transportation	December 31, 1985
Investment credit for commuter vans	December 31, 1985

(Continued)

TABLE 4. (Continued)

New Tax Expenditure	Originally Scheduled Expiration Date and/or Study Requirement
Crude Oil Windfall Profit Tax Act of 1980	
Alternative fuel production credit	December 31, 2000
Alcohol fuel tax credit	December 31, 1992; annual Energy Department reports required through 1992
Credit for ocean thermal energy conversion equipment	December 31, 1985.
Credit for small-scale hydroelectric facilities	December 31, 1985
Credit for cogeneration equipment	December 31, 1982
Credit for intercity buses	December 31, 1985
Tax-exempt bonds for small-scale hydroelectric facilities	December 31, 1985
$200/400 interest and dividend exclusion	December 31, 1982
Economic Recovery Tax Act of 1981	
Charitable contribution deduction for nonitemizers	December 31, 1986
Tax credit for research and experimentation	December 31, 1985
Tax-exempt savings certificates	December 31, 1982
Tax-exempt bonds for purchase of mass transit equipment	December 31, 1984

SOURCES: Committee reports on each act.

they own a home or a business, and so forth. It has a way of spot-checking eligibility through its system of audits.

If eligibility for the subsidy is fairly broad and is based on information that already appears on tax returns, there can be advantages in providing it through the tax system. The extra personal exemption for the elderly, for example, is easy for the IRS to administer, since eligibility is open to all those over 65 who have enough income to owe some taxes. (If the subsidy was extended to those without tax liability, however, it would probably be easier to provide it through the Social Security system, since the IRS does not have records on most nontaxpayers over 65.)

To take another example, the tax credit for home insulation, however, presents significant administrative problems for the IRS. The eligibility rules are fairly complicated, since only certain kinds of energy conservation expenses are eligible, the home must be the taxpayer's principal residence, it must have been built before April 1977, and so on. The information needed to determine eligibility is not normally available on tax returns. The IRS has no easy way of checking on whether energy-saving items were actually installed, whether they were of the eligible type, whether they cost as much as the taxpayer claimed, and so forth. In theory some of this could be determined on audit, but only 2 percent of returns are audited, and even then auditors are unlikely to climb around in people's attics to see whether the eligible insulation actually has been installed.

Thus, if the Congress wants to keep fairly close check on eligibility for a subsidy program, providing the subsidy through the tax system may not be the best approach. This is especially true if eligibility rests on information not readily available to the IRS, or on judgments it is not skilled in making. Requiring subsidy recipients to submit detailed application forms in advance, with full review by multilayered bureaucracies, can be quite burdensome. But it is the price that must be paid if detailed checking on eligibility is considered necessary.

If, on the other hand, the Congress determined that the costs of eligibility checks of this kind were likely to be greater than any losses from payments to ineligible recipients, the tax system could have significant advantages as a subsidy distribution mechanism. Advance application is not necessary, and there are no time-consuming reviews before the subsidy is granted. The subsidy can simply be claimed on the tax return, and received either immediately in the form of a reduced tax bill, or shortly thereafter as a refund. If an audit subsequently determined that the subsidy was improperly claimed, it would have to be repaid with interest and perhaps a fine or penalty. Subsidy programs could be operated in this way outside of the tax system, of course, but the Congress has been reluctant to permit this degree of flexibility for programs other than tax subsidies.

Tax Complexity. While it may sometimes appear simpler to have the IRS administer a subsidy program--especially when there is so little checking on eligibility that the program is not really administered--there are costs in terms of increased complexity on tax instructions and tax forms. Even though only a very small percentage of taxpayers may take advantage of a particular subsidy, the instructions and forms used by all taxpayers must contain information on how to obtain the subsidy. Extra lines must be included on all returns and supplementary forms may be necessary. Table 5 lists some of the major tax expenditure subsidies and the percentage of taxpayers using each of them in calendar year 1978, the most recent year for which complete information is available. While each subsidy may look simple for the IRS to administer when considered alone, the multiplication of them can greatly complicate the task of the IRS and add to the compliance burdens of all taxpayers.

A further problem is that the 40 percent of taxpayers who use the short Form 1040A cannot take advantage of most tax expenditures, and the 70 percent who use the standard deduction cannot use tax expenditures that take the form of itemized deductions. Those who want to use tax expenditures must, therefore, use the long Form 1040 and its associated schedules and supplementary forms, thereby making the task of filing their tax returns much more complicated. As more taxpayers shift to these longer and more complex forms, the task of the IRS is also made much more difficult and time-consuming.

The extra burden imposed on the IRS by the expansion of tax subsidies puts more strains on already limited IRS resources. The percentage of returns that is audited has declined substantially in recent years, from 2.6 percent in 1976 to less than 2 percent in 1981. Audits themselves become more difficult and time-consuming as the complexity of returns increases. The slight likelihood that returns will be audited, combined with the possibility that IRS

TABLE 5. TAX RETURNS WITH SELECTED TAX EXPENDITURES, AS A PERCENTAGE OF TOTAL RETURNS FILED, CALENDAR YEAR 1978

Tax Expenditure	Percent of Total Returns With Expenditure
Charitable Contributions Deduction	26.67
State and Local Taxes Paid Deduction	28.54
Home Mortgage Interest Deduction	22.09
Medical and Dental Expense Deduction	19.91
Residential Energy Credit	6.51
Child Care Credit	3.82
Earned Income Credit[a]	4.40
Credit for the Elderly	0.77
Political Contributions Credit	3.97
Work Incentive (WIN) Credit	0.006
New Jobs Credit	0.84
Individual Retirement Account (IRA) Payment	2.65
Self-Employed Retirement (Keogh) Payment	0.70

SOURCE: Statistics of Income, 1978, Individual Income Tax Returns, Department of the Treasury, Internal Revenue Service (March 1981).

a. Includes refundable portion.

auditors may miss questionable items on complex returns, encourages many taxpayers to view the audit system as a lottery in which they can take chances with little risk. As this perception grows, the essentially voluntary income tax compliance system may start to break down. Signs of this can already be seen in reports of growing tax avoidance in the so-called "underground economy."

Not all of this increased complexity and extra IRS burden is caused by tax expenditures, of course. Furthermore, there are administrative costs associated with subsidy programs no matter which agency administers them. While the burden on the IRS is a substantial one, the costs of having a particular program administered by some other agency might be even greater.

Divergent Agency Goals. Another consideration in having the IRS administer a subsidy program is that the IRS is not likely to be as sympathetic to the goals of the program as an agency with jurisdiction over analagous direct spending programs might be. Those who work at the IRS consider their main job to be collecting taxes, as fairly and efficiently as they can. They do not view it as their responsibility to solve the nation's housing problems, provide jobs for the hard-core unemployed, preserve historic buildings, encourage the insulation of homes, or stimulate local economic development. Yet tax subsidies have these goals, and many more.

When the IRS is assigned the task of administering subsidy programs of this kind, its response usually is to treat the subsidy as if it were a normal tax provision rather than a subsidy program. The regulations governing eligibility tend to use rules and concepts familiar to tax administrators, whether or not they are appropriate for a subsidy program. Eligibility is restricted as narrowly as possible, consistent with the provisions of the statute, in order to limit opportunities for tax avoidance and to minimize the loss of revenue. Little attempt is made to publicize the availability of the subsidy or to promote its use.

The Congress sometimes seeks to circumvent these difficulties by requiring that administrative responsibility be shared with the agency that administers comparable spending programs. The Labor Department, for example, shares responsibility for administering the targeted jobs tax credit, while the Interior Department shares responsibility for the tax incentives for historic preservation. This may relieve the IRS of making determinations of eligibility in areas where it has little experience or expertise, but the IRS' limited sympathy with subsidy program goals is likely to remain, leading to interagency conflicts over eligibility rules and administrative procedures.

Beneficiary Perceptions and Preferences

The beneficiaries of a tax subsidy frequently prefer not to think of the tax savings they receive as a subsidy, or as something that is analogous to a federal grant or loan. They choose to view these tax benefits as normal features of the tax code, or as incentives for doing things society considers valuable.

The more tax subsidies are treated like spending programs for budgetary and administrative purposes, the harder it becomes to preserve the perception of tax subsidies that beneficiaries tend to prefer--that is, that they are not really receiving a subsidy. In most cases, the Congress may decide that it is not necessary to defer to this kind of fastidiousness--especially when it stands in the way of goals of budgetary visibility and control --but there may be occasions in which some acknowledgement of this concern is appropriate.

If there is likely to be substantial reluctance to use the subsidy, for example, there may be some justification for making it as easy and comfortable to use as possible. The targeted jobs tax credit is an illustration. It provides employers with a tax credit equal to a portion of the wages they pay to workers who fall into various categories of the hard-core unemployed. Many employers are very reluctant to hire such workers, even with the tax credit. Administrative difficulties and negative perceptions of the subsidy mechanism on the part of employers could increase this reluctance. Providing the subsidy through the tax code might lessen this possibility.

It is not always necessary, of course, to reconcile and standardize everyone's perception of what is going on. It may be possible to provide tax subsidies in ways that permit the beneficiaries to perceive them in the way they find congenial, while still providing the Congress with the information and incentives needed for budgetary review and control. Targeted jobs tax credits, for example, could continue to be provided through the tax code, but the budgetary cost could be charged to the Department of Labor and to the Congressional committees with jurisdiction over analogous spending programs. The Rashomon effect--differing perceptions of the same phenomenon by different people--has its uses in government as well as in literature and drama.

Predictability and Stability. Beneficiaries may also prefer receiving subsidies through the tax code because they may believe the amount of the subsidy and the manner in which it is provided will be less subject to change than would be the case with a spending program that is subject to annual appropriations and periodic reauthorizations. In general, it is true that tax subsidies are less subject to changes, cutbacks, and delays in funding than federal spending programs, although, as discussed earlier, this treatment of tax subsidies may be changing. Certainly those benefiting in recent years from various tax shelter and tax-exempt bond subsidies have not been immune from unpredictability, since both the Congress and the IRS have continually changed and tightened the rules that apply to these subsidies. Furthermore, the desire of beneficiaries for predictability and stability must always be traded off against the Congress' need to maintain control over the federal budget. Both are important goals, and they must be carefully balanced in evaluating any subsidy program.

CHAPTER IV. TAX EXPENDITURE CHANGES ENACTED IN CALENDAR YEARS 1980 AND 1981

Significant tax expenditure changes were enacted in both calendar years 1980 and 1981. The changes legislated in 1980 are reflected in the five-year projections of tax expenditures for fiscal years 1981-1986 in Appendix Table A-1, but those enacted in 1981 are not.

CALENDAR YEAR 1980 CHANGES

As shown in Table 6, the major 1980 changes were in the Crude Oil Windfall Profit Tax Act and the Omnibus Reconciliation Act. The Windfall Profit Tax Act included business energy investment tax credits, alternative fuel production credits, special provisions for alcohol fuels, tax-exempt industrial development bond financing for energy projects, and residential energy tax credits for homeowners and landlords. It also expanded the existing dividend exclusion to include certain kinds of interest, and doubled the limit on the amount that could be excluded to $200 ($400 for joint returns). Finally, the act repealed the "carryover basis" rule that would have required the heirs of inherited property to pay a capital gains tax on otherwise untaxed gains occurring before the inheritance.

The Omnibus Reconciliation Act substantially cut back the use of tax-exempt bonds to finance housing. The act bans further issues of mortgage subsidy bonds after 1983, resulting in a reduction in tax expenditures estimated at more than $10 billion in fiscal year 1985.

CALENDAR YEAR 1981 CHANGES

The only legislation affecting tax expenditures to date in 1981 is the Economic Recovery Tax Act of 1981. As shown in Table 7, the act makes extensive changes in tax expenditure legislation, including eight new tax expenditures, 21 provisions expanding existing tax expenditures, and two provisions reducing tax expenditures. In addition, since the revenue loss from tax expenditures

TABLE 6. REVENUE EFFECTS OF CHANGES IN TAX EXPENDITURES IN CALENDAR YEAR 1980 FOR FISCAL YEARS 1981-1985 (In millions of dollars)

Change	1981	1982	1983	1984	1985
The Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223)					
Business energy investment credits					
Solar and wind property, including solar process heat equipment, 15% energy credit	-15	-26	-67	-185	-377
Geothermal equipment, 15% energy credit	-2	-2	-3	-7	-9
Ocean thermal energy conversion equipment, 15% energy credit	a	a	a	-1	-2
Small-scale hydroelectric facilities, 11% energy credit	-11	-15	-19	-48	-109
Cogeneration equipment, 10% energy credit	-46	-64	-80	-74	-52
Petroleum coke and pitch, regular investment credit and accelerated depreciation	-31	-32	-36	-40	-44
Certain equipment for producing feed stocks	---	b	-7	-28	-29
Alumina electrolytic cells, 10% energy credit	-1	-1	-1	-1	-1
Coke ovens, 10% energy credit	-47	-51	-57	-53	-35
Biomass equipment, 10% energy credit	-2	-4	-10	-82	-246
Intercity buses, 10% energy credit	-5	-6	-6	-6	-7

(Continued)

TABLE 6. (Continued)

Change	1981	1982	1983	1984	1985
The Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223) (continued)					
Affirmative commitments, special transition rule	---	b	-202	-407	-288
Total energy investment credits	-160	-201	-488	-932	-1,199
Alternative fuel production credits					
Devonian shale gas, special rule	-18	-34	-25	---	---
Qualifying processed wood, phase-out suspension	-7	-18	-23	-15	-5
Steam from agricultural by-products, phase-out suspension	-1	-2	-2	-3	-3
Total, production credits	-26	-54	-50	-18	-8
Alcohol fuels provisions	-4	-4	-6	-8	-187
Industrial development bonds					
Solid waste disposal facilities	-1	-4	-5	-5	-5
Alchohol from solid waste facilities	---	a	a	a	-1
Small-scale hydro-electric facilities	a	a	-2	-3	-5
Additions to certain existing hydro-electric facilities	---	-1	-5	-7	-8

(Continued)

TABLE 6. (Continued)

Change	1981	1982	1983	1984	1985
Industrial development bonds (continued)					
State renewable resource programs	-1	-1	-3	-5	-7
Total bonds	-2	-6	-15	-20	-26
Residential energy tax credits					
Solar, wind, and geothermal credit, 40%	-42	-52	-67	-88	-128
Business energy tax credit to landlords, 15%	-2	-3	-7	-17	-20
Total residential tax credits	-44	-55	-74	-105	-148
Interest and dividend exclusion	-314	-2,278	-1,713	---	---
Repeal carryover basis	a	-36	-95	-163	-238
Miscellaneous Revenue Act of 1980 (P.L. 96-605)					
Amortization of business start-up costs	-22	-73	-121	-180	-254
Charitable deduction for certain contributions of real property for conservation purposes	-5	-5	-5	-5	-5
Investment tax credit for rehabilitated building leased to tax-exempt organizations or governments	-28	-32	-38	-44	-49

(Continued)

TABLE 6. (Continued)

Change	1981	1982	1983	1984	1985
Miscellaneous Revenue Act of 1980 (P.L. 96-605)(continued)					
Prevention of abuse of certain employee benefit requirements	+50	+75	+100	+100	+100
Retirement savings by tax credit employee stock ownership plan participants	-3	-3	-3	-3	-3
Cafeteria plans permitted to provide deferred compensation under rules applicable to cash or deferred profit-sharing and stock bonus plans	-3	-3	-3	-3	-3
Extension of time to amend government instruments of charitable split-interest trusts	-8	-8	---	---	---
Total miscellaneous	-19	-49	-70	-135	-214
Omnibus Reconciliation Act of 1980 (P.L. 96-449)					
Tax on gain on foreigners' real estate investments	+42	+92	+102	+111	+123
Mortgage Subsidy Bond Tax Act of 1980	+256	+1,305	+3,330	+6,320	+10,242
Total Omnibus Act	+298	+1,397	+3,432	+6,431	+10,365
Disclosure of Mailing Addresses (P.L. 96-603)					
Investment tax credit offset of alternative minimum tax	-99	-72	-57	-39	-22

(Continued)

TABLE 6. (Continued)

Change	1981	1982	1983	1984	1985
Net Operating Loss Deduction (P.L. 96-555)					
Tax treatment of employees of charities working abroad	-40	-18	-19	-21	-22
Miscellaneous Tax Revisions (P.L. 96-608)					
Special rule for certain distributions from money purchase pension plans	-3	-3	-3	-3	-3
Elimination of the Duty On Hardwood Veneers (P.L. 96-541)					
Extension of provisions relating to historic preservation	-2	-21	-66	-111	-131
60-month amortization for expenditures to rehabilitate low-income housing	---	-1	-8	-18	-26
Certain federal scholarship grants and National Research Service Awards	-4	-16	-22	-23	-24
Deductions for contributions for conservation purposes	-5	-5	-5	-5	-5
Total hardwood veneers	-11	-43	-101	-157	-186

(Continued)

TABLE 6. (Continued)

Change	1981	1982	1983	1984	1985
Recreational Boating Safety and Facilities Improvement Act of 1980 (P.L. 96-451)					
Investment credit and 7-year amortization for reforestation expenditures	-6	-5	-7	-8	-10

SOURCES: Committee Reports and Staff of the Joint Committee on Taxation.

NOTE: A plus sign (+) means a revenue gain and a reduction in tax expenditures; a minus (-) sign means a revenue loss and an increase in tax expenditures.

a. Less than $1 million.

b. Less than $5 million.

TABLE 7. REVENUE EFFECTS OF CHANGES IN TAX EXPENDITURES IN THE ECONOMIC RECOVERY TAX ACT OF 1981, FISCAL YEARS 1981-1986 (In millions of dollars)

Change	1981	1982	1983	1984	1985	1986
		New Tax Expenditures				
Deduction for Two-Earner Married Couples	---	-419	-4,418	-9,090	-10,973	-12,624
Credit for Increasing Research Activities	---	-448	-708	-858	-847	-485
Charitable Contributions of Scientific Property Used for Research	a	a	a	a	a	a
Motor Carrier Operating Rights	-21	-121	-71	-71	-54	-18
Exclusion of Interest On Certain Savings Certificates	---	-398	-1,791	-1,142	---	---
15% Net Interest Deduction	---	---	---	---	-1,124	-3,126
Reinvestment of Dividends in Public Utility Stock	---	-130	-365	-416	-449	-278
Deduction for Certain Adoption Expenses	---	-9	-9	-10	-11	-12
		Increases in Tax Expenditures				
Child and Dependent Care Credit	---	-19	-191	-237	-296	-356
Charitable Contributions Deduction for Non-Itemizers	---	-26	-189	-219	-681	-2,696
Rollover Period for Sale of Residence	b	c	c	c	c	c
Increased Exclusion on Sale of Residence	b	-18	-53	-63	-76	-91
Changes in Taxation of Foreign Earned Income	---	-299	-544	-563	-618	-696
Corporate Rate Reductions	---	-116	-365	-521	-565	-610
Credit for Rehabilitation Expenditures	-9	-129	-208	-239	-302	-409
Credit for Used Property	-24	-61	-74	-85	-137	-198
Charitable Contributions of Scientific Property Used for Research	a	a	a	a	a	a

(Continued)

TABLE 7. (Continued)

Change	1981	1982	1983	1984	1985	1986
Increases in Tax Expenditures (continued)						
Commercial Bank Bad Debt Deduction	---	-15	-15	---	---	---
Extension and Modification of Targeted Jobs Tax Credit	---	-63	-13	+57	+117	+161
Incentive Stock Options	a	a	a	a	+11	+21
Individual Retirement Savings	---	-229	-1,339	-1,849	-2,325	-2,582
Self-Employed Plans	---	-56	-157	-173	-183	-201
Employee Stock Ownership Plans	---	a	-61	-628	-1,659	-2,188
Group Legal Service Plans	---	-16	-24	-26	-8	---
Tax-exempt Bonds for Volunteer Fire Departments	---	d	d	d	d	d
Charitable Contributions by Corporations	---	-44	-93	-102	-112	-123
Amortization of Construction Period Interest and Taxes	---	-14	-33	-27	-23	-21
Amortization of Low-Income Housing Rehabilitation Expenditures	-1	-8	-16	-25	-35	-39
Industrial Development Bonds for Mass Transit	---	d	-7	-29	-54	-64
Reductions in Tax Expenditures						
Repeal of $200 Exclusion of Interest and Return to $100 Dividend Exclusion	---	+566	+1,916	---	---	---
Tax Straddles	+37	+623	+327	+273	+249	+229

SOURCE: Summary of H.R. 4242, the Economic Recovery Tax Act of 1981, prepared by the Staff of the Joint Committee on Taxation (August 5, 1981)

a. Less than $5 million.
b. Negligible
c. Less than $10 million.
d. Less than $1 million.

that take the form of exemptions, exclusions, and deductions is measured by multiplying the amount excluded by the appropriate marginal income tax rate, the reduction in individual income tax rates scheduled for 1981 to 1985 will reduce the revenue loss from those forms of tax expenditures. There is an offsetting effect for tax expenditures that take the form of itemized deductions, however. The zero bracket amount or standard deduction, which absorbs some of the revenue loss that would otherwise be assigned to itemized deductions, is not scheduled to be increased until indexing of the individual income tax starts in 1985. The erosion of the real value of the zero bracket amount by inflation between now and 1985 will add to the measured revenue loss from itemized deduction tax expenditures.

APPENDIXES

APPENDIX A

TABLE A-1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION, FISCAL YEARS 1981-1986 (In millions of dollars)[a]

	Corporations						Individuals					
Function and Subfunction	1981	1982	1983	1984	1985	1986	1981	1982	1983	1984	1985	1986
050 NATIONAL DEFENSE												
051 Department of Defense - Military												
Exclusion of benefits and allowances to Armed Forces personnel	---	---	---	---	---	---	1,585	1,715	1,850	2,000	2,160	2,335
Exclusion of military disability pensions	---	---	---	---	---	---	170	200	245	285	325	370
150 INTERNATIONAL AFFAIRS												
155 International Finance Programs												
Exclusion of income earned abroad by United States citizens	---	---	---	---	---	---	640	665	720	775	840	905
Deferral of income of domestic international sales corporations (DISC)	1,600	1,630	1,730	1,810	1,870	1,930	---	---	---	---	---	---
Deferral of income of controlled foreign corporations	480	520	560	605	650	705	---	---	---	---	---	---
250 GENERAL SCIENCE, SPACE, AND TECHNOLOGY												
251 General Science and Basic Research												
Expensing of research and development expenditures	1,990	2,235	2,500	2,790	3,110	3,455	40	45	50	55	60	70

(Continued)

TABLE A-1. (Continued)

	Corporations						Individuals					
Function and Subfunction	1981	1982	1983	1984	1985	1986	1981	1982	1983	1984	1985	1986
270 ENERGY												
271 Energy Supply												
Expensing of exploration and development costs												
Oil and gas	1,875	1,915	2,220	2,580	2,870	3,090	860	1,030	1,240	1,495	1,765	2,030
Other fuels	25	25	30	30	35	35	---	---	---	---	---	---
Excess of percentage over cost depletion												
Oil and gas	545	535	525	535	675	725	1,580	1,725	1,745	1,750	2,080	2,535
Other fuels	530	540	605	670	735	810	20	25	25	25	30	30
Capital gains treatment of royalties on coal	10	10	15	15	15	20	80	90	105	120	135	150
Alternative fuel production credit	25	55	50	20	10	---	---	---	---	---	---	---
Alcohol fuel credit	b	5	5	10	15	20	b	10	20	30	50	65
Exclusion of interest on state and local government industrial development bonds for energy production facilities	b	5	10	15	20	20	b	b	5	5	10	10
Residential energy credits												
Supply incentives	---	---	---	---	---	---	115	190	275	360	520	650
Alternative conservation and new technology credits												
Supply incentives	210	295	600	905	955	735	15	20	45	75	100	85
272 Energy Conservation												
Residential energy credits												
Conservation incentives	---	---	---	---	---	---	425	420	420	435	445	385
Alternative conservation and new technology credits												
Conservation incentives	295	375	320	175	80	25	---	---	---	---	---	---

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
272 Energy Conservation (continued)												
Energy credit for intercity buses	5	5	5	5	5	5	---	---	---	---	---	---
300 NATURAL RESOURCES AND ENVIRONMENT												
302 Conservation and Land Management												
Capital gains treatment of certain timber income	470	535	500	675	760	855	135	150	170	190	215	240
Investment credit and seven-year amortization for reforestation expenditures	b	b	b	b	b	b	5	5	5	10	10	10
303 Recreational Resources												
Tax incentives for preservation of historic structures	25	35	50	60	55	45	40	65	90	110	105	80
304 Pollution Control and Abatement												
Exclusion of interest on state and local government pollution control bonds	490	500	545	575	595	610	230	255	270	285	300	305
Five-year amortization on pollution control facilities	35	65	95	110	115	115	---	---	---	---	---	---
Exclusion of payments in aid of construction of water, sewage, gas and electric utilities	110	115	115	120	125	130	---	---	---	---	---	---

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
306 Other Natural Resources												
Expensing of exploration and development costs, nonfuel minerals	25	25	30	30	35	35	b	b	b	b	b	b
Excess of percentage over cost depletion, nonfuel materials	390	380	420	450	480	585	15	15	15	20	20	25
Capital gains treatment of iron ore	10	10	10	10	10	10	10	10	10	10	10	10
350 AGRICULTURE												
351 Farm Income Stabilization												
Expensing of certain capital outlays	75	80	85	90	95	100	455	485	505	520	540	555
Capital gains treatment of certain ordinary income	25	25	25	30	30	35	405	425	445	470	490	515
Deductibility of patronage dividends and certain other items of cooperatives	590	630	670	700	750	810	-190	-200	-210	-220	-230	-245
Exclusion of certain cost-sharing payments	---	---	---	---	---	---	75	80	80	75	80	80
370 COMMERCE AND HOUSING CREDIT												
371 Mortgage Credit and Thrift Insurance												
Excess bad debt reserves of financial institutions	340	470	525	620	750	895	---	---	---	---	---	---
Deductibility of mortgage interest on owner-occupied homes	---	---	---	---	---	---	19,805	25,295	31,115	37,960	46,310	56,500

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
371 Mortgage Credit and Thrift Insurance (continued)												
Deductibility of property tax on owner-occupied homes	---	---	---	---	---	---	8,915	10,705	12,740	15,160	18,040	21,465
Exclusion of interest on state and local housing bonds for owner-occupied housing	470	655	860	990	1,000	960	370	565	740	865	890	850
Deferral of capital gains on home sales	---	---	---	---	---	---	1,100	1,220	1,345	1,480	1,630	1,790
Exclusion of capital gains on home sales for persons age 55 and over	---	---	---	---	---	---	590	650	710	785	860	950
376 Other Advancement and Regulation of Commerce												
Dividend and interest exclusion	---	---	---	---	---	---	1,325	3,170	2,340	700	770	850
Exclusion of interest on state and local industrial development bonds	1,000	1,245	1,590	1,935	2,290	2,655	230	305	390	475	565	655
Exemption of credit union income	115	125	140	155	170	190	---	---	---	---	---	---
Exclusion of interest on life insurance savings	---	---	---	---	---	---	4,080	4,770	5,570	6,500	7,585	8,845
Deductibility of interest on consumer credit	---	---	---	---	---	---	5,260	6,040	7,050	7,965	9,005	10,175
Expensing of construction period interest and taxes	535	565	600	640	685	725	225	310	315	350	380	415
Excess first-year depreciation	50	55	55	60	65	65	145	150	160	170	180	185
Depreciation on rental housing in excess of straight line	75	80	85	95	100	110	325	345	370	400	435	470

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
376 <u>Other Advancement and Regulation of Commerce (continued)</u>												
Depreciation on buildings (other than rental housing) in excess of straight line	140	150	165	185	210	240	125	135	150	165	185	210
Asset depreciation range	3,585	3,895	4,330	4,285	3,990	3,835	180	215	225	225	210	200
Amortization of business start-up costs	b	10	10	20	25	30	20	65	105	160	230	285
Capital gains other than agriculture, timber, iron ore, and coal	940	1,020	1,150	1,295	1,455	1,640	16,230	18,990	21,070	23,360	25,905	28,710
Capital gains at death	---	---	---	---	---	---	5,085	5,440	5,820	6,225	6,660	7,130
Reduced rates on the first $100,000 of corporate income	7,395	7,590	8,495	9,485	10,520	11,650	---	---	---	---	---	---
Investment credit, other than for ESOP's, rehabilitation of structures, and energy	16,395	17,340	19,265	21,240	23,375	25,810	3,130	3,425	3,815	4,205	4,625	5,105
400 TRANSPORTATION												
401 <u>Ground Transportation</u>												
Five-year amortization on railroad rolling stock	-40	-40	-35	-20	---	---	---	---	---	---	---	---
403 <u>Water Transportation</u>												
Deferral of tax on shipping companies	75	75	80	90	95	105	---	---	---	---	---	---

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
450 COMMUNITY AND REGIONAL DEVELOPMENT												
451 Community Development												
Five-year amortization for housing rehabilitation	10	15	15	15	10	5	15	20	20	20	15	5
Investment credit for rehabilitation of of structures	150	175	205	225	245	265	145	160	180	200	215	230
500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES												
502 Higher Education												
Exclusion of scholarship and fellowship income	---	---	---	---	---	---	410	490	565	655	765	885
Employer educational assistance	---	---	---	---	---	---	35	40	45	25	---	---
Exclusion of interest on state and local student loan bonds	55	85	115	145	175	200	25	40	55	70	85	100
Parental personal exemption for students age 19 or over	---	---	---	---	---	---	1,045	1,055	1,065	1,075	1,085	1,095
Deductibility of charitable contributions (education)	310	310	340	375	420	465	950	1,150	1,400	1,685	2,040	2,465
504 Training and Employment Services												
Maximum tax on personal service income	---	---	---	---	---	---	1,655	2,105	2,640	3,270	4,085	5,110
Credit for child and dependent care expenses	---	---	---	---	---	---	1,025	1,175	1,350	1,555	1,785	2,055

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
504 Training and Employment Services (continued)												
Credit for employment of AFDC recipients and public assistance recipients under work incentive programs	50	50	55	60	60	65	10	10	10	10	10	10
General jobs credit	85	25	15	10	10	---	b	b	b	b	b	b
Targeted jobs credit	225	150	20	b	---	---	50	30	---	---	---	---
505 Other Labor Services												
Exclusion of employee meals and lodging (other than military)	---	---	---	---	---	---	380	410	445	485	525	570
Investment credit for ESOP's	770	820	895	580	195	115	---	---	---	---	---	---
506 Social Services												
Deductibility of charitable contributions, other than education and health	385	385	380	420	465	520	7,135	8,630	10,445	12,635	15,290	18,500
Exclusion of contributions to prepaid legal services plans	---	---	---	---	---	---	35	10	---	---	---	---
550 HEALTH												
551 Health Care Services												
Exclusion of employer contributions for medical insurance premiums and medical care[c]	---	---	---	---	---	---	14,165	16,610	19,485	22,855	26,810	31,445
Deductibility of medical expenses	---	---	---	---	---	---	3,580	4,080	4,650	5,305	6,045	6,610

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
551 Health Care Services (continued)												
Exclusion of interest on state and local hospital bonds	395	450	525	590	655	715	185	220	260	290	325	355
Deductibility of charitable contributions (health)	195	190	210	235	260	285	1,425	1,725	1,975	2,530	3,060	3,700
600 INCOME SECURITY												
601 General Retirement and Disability Insurance												
Exclusion of Social Security benefits												
Disability insurance benefits	---	---	---	---	---	---	815	955	1,055	1,185	1,350	1,575
OASI benefits for retired workers	---	---	---	---	---	---	9,020	11,265	13,260	15,605	18,320	21,435
Benefits for dependents and survivors	---	---	---	---	---	---	1,250	1,480	1,695	1,945	2,225	2,535
Exclusion of railroad retirement system benefits	---	---	---	---	---	---	380	435	500	570	655	750
Exclusion of workmen's compensation benefits	---	---	---	---	---	---	2,675	3,260	3,965	4,825	5,870	7,145
Exclusion of special benefits for disabled coal miners	---	---	---	---	---	---	100	105	110	120	130	140
Exclusion of disability pay	---	---	---	---	---	---	170	170	170	170	170	170
Net exclusion of pension contributions and earnings												
Employer plans	---	---	---	---	---	---	23,605	27,905	32,930	38,855	45,850	54,100
Plans for self-employed and others	---	---	---	---	---	---	2,105	2,305	2,525	2,770	3,040	3,345

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
601 General Retirement and Disability Insurance (continued)												
Exclusion of other employee benefits												
Premiums on group term life insurance	---	---	---	---	---	---	1,855	2,055	2,275	2,520	2,790	3,090
Premiums on accident and disability insurance	---	---	---	---	---	---	100	105	110	120	130	140
Additional exemption for the blind	---	---	---	---	---	---	30	30	30	30	30	30
Additional exemption for the elderly	---	---	---	---	---	--	2,260	2,505	2,800	3,015	3,485	3,885
Tax credit for the elderly	---	---	---	---	---	---	125	120	115	110	105	100
603 Unemployment Compensation												
Exclusion of other employee benefits												
Income of trusts to finance supplementary unemployment benefits	---	---	---	---	---	---	20	20	25	30	30	35
Exclusion of untaxed unemployment insurance benefits	---	---	---	---	---	---	5,275	4,530	4,440	4,335	4,460	4,610
604 Housing Assistance												
Exclusion of interest on state and local housing bonds for rental housing	195	240	295	350	410	475	235	315	385	450	530	620
609 Other Income Security												
Exclusion of public assistance benefits	---	---	---	---	---	---	465	510	580	665	755	860

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
609 Other Income Security (continued)												
Deductibility of casualty and theft losses	---	---	---	---	---	---	715	895	1,015	1,195	1,410	1,665
Earned income credit[d]	---	---	---	---	---	---	635	575	525	475	460	425
700 VETERANS' BENEFITS AND SERVICES												
701 Income Security for Veterans												
Exclusion of veterans' disability compensation	---	---	---	---	---	---	1,300	1,575	1,860	2,135	2,460	2,825
Exclusion of veterans' pensions	---	---	---	---	---	---	85	95	105	120	130	145
702 Veterans' Education, Training and Rehabilitation												
Exclusion of GI bill benefits	---	---	---	---	---	---	180	160	130	110	90	75
800 GENERAL GOVERNMENT												
806 Other General Government												
Credits for political contributions	---	---	---	---	---	---	100	80	80	80	100	80
850 GENERAL PURPOSE FISCAL ASSISTANCE												
851 General Revenue Sharing												
Exclusion of interest on general purpose state and local debt	4,035	4,315	4,885	5,335	5,720	6,040	1,895	2,165	2,420	2,645	2,840	3,005

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1981	1982	1983	1984	1985	1986	Individuals 1981	1982	1983	1984	1985	1986
851 General Revenue Sharing (continued)												
Deductibility of non-business state and local taxes (other than on owner-occupied homes)	---	---	---	---	---	---	18,405	23,060	28,060	33,670	40,405	48,485
852 Other General Purpose Fiscal Assistance												
Tax credit for corporations receiving income from doing business in United States possessions	1,005	1,095	1,200	1,320	1,455	1,600	---	---	---	---	---	---
900 INTEREST												
901 Interest on the Public Debt												
Deferral of interest on savings bonds	---	---	---	---	---	---	-75	335	335	335	335	335
TOTAL	48,775	52,090	58,190	63,750	68,905	74,565	179,845	214,190	248,245	286,780	334,820	390,725

SOURCES: Staffs of the Treasury Department and the Congressional Joint Committee on Taxation.

a. All estimates are based on the tax law enacted as of December 31, 1980.
b. Less than $2.5 million.
c. CBO estimates that this tax expenditure will result in a significantly higher revenue loss than the JCT-Treasury estimate shown above. CBO estimates a loss of $17.4 billion in 1981, $20.5 billion in 1982, $24.1 billion in 1983, $28.4 billion in 1984, $33.5 billion in 1985, and $39.5 billion in 1986.
d. The figures in the table indicate the effect of the earned income credit on receipts. The effect on outlays is: $1,205 million in 1981, $1,115 million in 1982, $1,030 million in 1983, $955 million in 1984, $885 million in 1985, and $815 million in 1986.

APPENDIX B

APPENDIX B. TAX EXPENDITURES BY CONGRESSIONAL COMMITTEE WITH AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS

Committee	Tax Expenditure
	House of Representatives
Agriculture	Capital gains treatment of certain ordinary income Expensing of certain capital outlays Deductibility of noncash patronage dividends and certain other items of cooperatives Capital gains treatment of certain timber income Exclusion of certain cost-sharing payments
Armed Services	Exclusion of benefits and allowances to Armed Forces personnel Exclusion of miliary disability pensions
Banking, Finance, and Urban Affairs	Exclusion of interest on state and local pollution control bonds Exemption of credit union income Excess bad debt reserves of financial institutions Deductibility of mortgage interest on owner-occupied homes Deductibility of property tax on owner-occupied homes Exclusion of interest on state and local industrial development bonds Exclusion of interest on state and local housing bonds Deductibility of interest on consumer credit Deferral of capital gains on home sales

(Continued)

Committee	Tax Expenditure
Banking, Finance, and and Urban Affairs (continued)	Capital gains (other than farming, timber, iron ore, and coal) Depreciation of rental housing in excess of straight-line Depreciation of buildings (other than rental housing) in excess of straight-line) Investment credit for certain rehabilitated structures 5-year amortization for housing rehabilitation Exclusion of capital gains on home sales for persons age 55 and over Expensing of construction period interest and taxes Exclusion of income earned abroad by U.S. citizens Deferral of income of Dometic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Dividend and interest exclusion Corporate surtax exemption Reduced rates on first $100,000 of corporate income Excess first-year depreciation Asset Depreciation Range Capital gains at death Tax incentives for the preservation of historic structures Investment tax credit Deferral of capital gains on homes sales Deferral of interest on savings bonds
Education and Labor	Exclusion of scholarship and fellowship income

(Continued)

Committee	Tax Expenditure
Education and Labor (continued)	Parental personal exemption for children age 19 and over
	Deductibility for charitable contributions (education)
	Credit for child and dependent care expenses
	Employer educational assistance
	Expensing of removal of architectural and transportation barriers to the handicapped
	Credit for the employment of AFDC and public assistance recipients under work incentive programs
	Additional exemption for the elderly
	Additional exemption for the blind
	Exclusion for workmen's compensation benefits
	Exclusion of special benefits for disabled coal miners
	Net exclusion of pension contributions and earnings
	Employer plans
	Plans for self-employed and others
	Exclusion of other employee benefits
	Premiums on group term life inurance
	Premiums on accident and disability insurance
	Tax credit for the elderly
	Earned income credit
	Deductibility of casualty losses
	Exclusion of employee meals and lodging (other than military)
	Maximum tax on personal service income
	Exclusion for contributions to prepaid legal service plans
	Investment credit for ESOP's

(Continued)

Committee	Tax Expenditure
Education and Labor (continued)	Deductibility of charitable contributions for other than education and health
	Exclusion of employer contributions for medical insurance premiums and medical care
	General jobs credit
	Targeted jobs credit
Government Operations	Tax credit for corporations doing business in U.S. possessions
	Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes)
	Exclusion of interest payments on state and local industrial development bonds
	Exclusion of interest on state and local pollution control bonds
	Exclusion of interest on general purpose state and local debt
House Administration	Credits for political contributions
Interior and Insular Affairs	Tax incentives for preservation of historic structures
	Capital gains treatment of royalties on coal
	Capital gains treatment of royalties on iron ore
	Expensing of exploration and development costs
	Excess of percentage over cost depletion
	Alternative fuel production credit
	Alcohol fuel credit
	Residential energy credits
	Alternative, conservation and new technology credits

(Continued)

Committee	Tax Expenditure
Foreign Affairs	Exclusion of income earned abroad Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations

Interstate and Foreign Commerce	Deferral of income of Domestic International Sales Corporations (DISC)
	Deferral of income of controlled foreign corporations
	Dividend and interest exclusion
	Exclusion of interest payments on state and local industrial development bonds (other than for education and health)
	5-year amortization for railroad rolling stock
	Exclusion of sick pay
	Expensing of removal of architectural and transportation barriers to the handicapped
	Deductibility of medical expenses
	Exclusion of employee contributions for medical insurance premiums and medical care
	Deferral of tax on shipping companies
	Deferral of interest on savings bonds
	Exclusion of other employee benefits
	  Premiums on group term life insurance
	  Premiums on accident and disability insurance
	Tax credit for corporations doing business in U.S. possessions
	Exclusion of railroad retirement system benefits

(Continued)

Committee	Tax Expenditure
Interstate and Foreign Commerce (continued)	Exclusion of payments in aid of construction in water and sewage utilities Exclusion of interest on state and local pollution control bonds 5-year amortization of pollution control facilities
Judiciary	Group legal services exclusion
Merchant Marine and Fisheries	Deferral of tax on shipping companies
Public Works and Transportation	Deductibility of state gasoline taxes Exclusion of payments in aid of construction of water and sewage utilities Exclusion of interest on state and local industrial development bonds
Science and Technology	Expensing of research and development expenditures
Veterans' Affairs	Exclusion of veterans' disability compensation Exclusion of veterans' pensions Exclusion of GI Bill benefits
Ways and Means	Exclusion of unemployment insurance benefits Exclusion of income of trusts to finance supplementary unemployment benefits Exclusion of public assistance benefits Earned income credit

(continued)

Committee	Tax Expenditure
Ways and Means (continued)	Exclusion of Social Security benefits Disability insurance benefits OASI benefits for retired workers Benefits for dependents and survivors
	Senate
Agriculture, Nutrition, and Forestry	Capital gains treatment of certain timber income Capital gains treatment of certain ordinary income Expensing of certain capital outlays Deductibility of noncash patronage dividends and certain other items of cooperatives Exclusion of certain cost-sharing payments
Armed Services	Exclusion of benefits and allowances to Armed Forces personnel Exclusion of military disability pensions
Banking, Housing, and Urban Affairs	Exclusion of income earned abroad by U.S. citizens Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Exemption of credit union income Excess bad debt reserves of financial institutions Deductibility of mortgage interest on owner-occupied homes

(Continued)

Committee	Tax Expenditure
Banking, Housing, and Urban Affairs (continued)	Deductibility of property tax on owner-occupied homes
	Deductibility of interest on consumer credit
	Deferral of capital gains on home sales
	Dividend and interest exclusion
	Reduced rates on first $100,000 of corporate income
	Investment tax credit for certain rehabilitated structures
	Capital gains (other than farming, timber, iron ore, and coal)
	Capital gains at death
	Depreciation on rental housing in excess of straight-line
	Depreciation on buildings (other than rental housing) in excess of straight-line
	Expensing of construction period interest and taxes
	Excess first-year depreciation
	Asset Depreciation Range
	5-year amortization for housing rehabilitation
	Tax incentives for preservation of historic structures
	Deferral of interest on savings bonds
	Exclusion of interest on general purpose state and local debt
	Exclusion of capital gains on home sales for persons 55 or older
	Exclusion of interest on state and local pollution control bonds
	Exclusion of interest on state and local industrial development bonds

(Continued)

Committee	Tax Expenditure
Commerce, Science, and Transportation	Expensing of research and development expenditures
	5-year amortization on railroad rolling stock
	Deductibility of nonbusiness state gasoline taxes
	Deferral of tax on shipping companies
	Tax credit for corporations doing business in U.S. possessions
Energy and Natural Resources	Expensing of exploration and development costs
	Excess of percentage over cost depletion
	Capital gains treatment of royalties on iron ore
	Investment credit for certain rehabilitated structures
	Tax incentives for preservation of historic structures
	Alternative fuel production credit
	Alcohol fuel credit
	Residential energy credits
	Alternative, conservation and new technology credits
Environment and Public Works	Exclusion of interest on state and local government pollution control bonds
	5-year amortization of pollution control facilities
	Exclusion of payments in aid of construction of water and sewage facilities
	Exclusion of interest on state and local industrial development bonds

(Continued)

Committee	Tax Expenditure

Finance	Exclusion of Social Security benefits
	  Disability insurance benefits
	  OASI benefits for retired workers
	  Benefits for dependents and survivors
	Exclusion of unemployment insurance benefits
	Exclusion of public assistance benefits
	Exclusion of interest on general purpose state and local debt
	Exclusion of interest on state and local pollution control bonds
	Exclusion of interest on state and local housing bonds

Foreign Relations	Exclusion of income earned abroad by U.S. citizens Deferral of income of Domestic International Sales Corporations (DISC)
Governmental Affairs	Exclusion of interest on general purpose state and local debt Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes) Tax credit for corporations doing business in U.S. possessions
Labor and Human Resources	Exclusion of scholarship and fellowship income Parental personal exemption for students aged 19 and over Deductibility of charitable contributions (education) Credit for child and dependent care expenses

(Continued)

Committee	Tax Expenditure
Labor and Human Resources (continued)	Expensing of removal of architectural and transportation barriers for the handicapped
	Credit for employment of AFDC and public assistance recipients under work incentive programs
	Maximum tax on personal service income
	Exclusion of employee meals and lodging (other than military)
	Exclusion of contributions to prepaid legal service plans
	Investment credit for Employee Stock Ownership Plans (ESOPs)
	Deductibility of charitable contributions to other than education and health
	Exclusion of employer contributions for medical insurance premiums and medical care
	Deductibility of medical expenses
	Deductibility of charitable contributions (health)
	Exclusion of railroad retirement system benefits
	Exclusion of workmen's compensation benefits
	Exclusion of special benefits for disabled coal miners
	Net exclusion of pension contributions and earnings
	Employer plans
	Plans for self-employed and others
	Exclusion of other employee benefits
	Premiums on group term life insurance
	Premiums on accident and disability insurance

(Continued)

Committee	Tax Expenditure
Labor and Human Resources (continued)	Exclusion of capital gains on home sales for persons age 55 and over
	Additional exemption for the elderly
	Tax credit for the elderly
	Exclusion of interest on life insurance saving
	Exclusion of sick pay
	Exclusion of income of trusts to finance supplementary unemployment benefits
	Additional exemption for the blind
	Deductibility of casualty losses
	General jobs credit
	Targeted jobs credit
	Employer educational assistance
Judiciary	Exclusion of contributions to prepaid legal services plans
Rules and Administration	Credits for political contributions
Veterans' Affairs	Exclusion of veterans' disability compsation
	Exclusion of veterans' pensions
	Exclusion of GI bill benefits

NOTE: Some tax expenditures are listed under more than one category because of overlapping committee jurisdictions.