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Tax Expenditures: Budget Control Options and Five-Year Budget Projections For Fiscal Years 1983–1987

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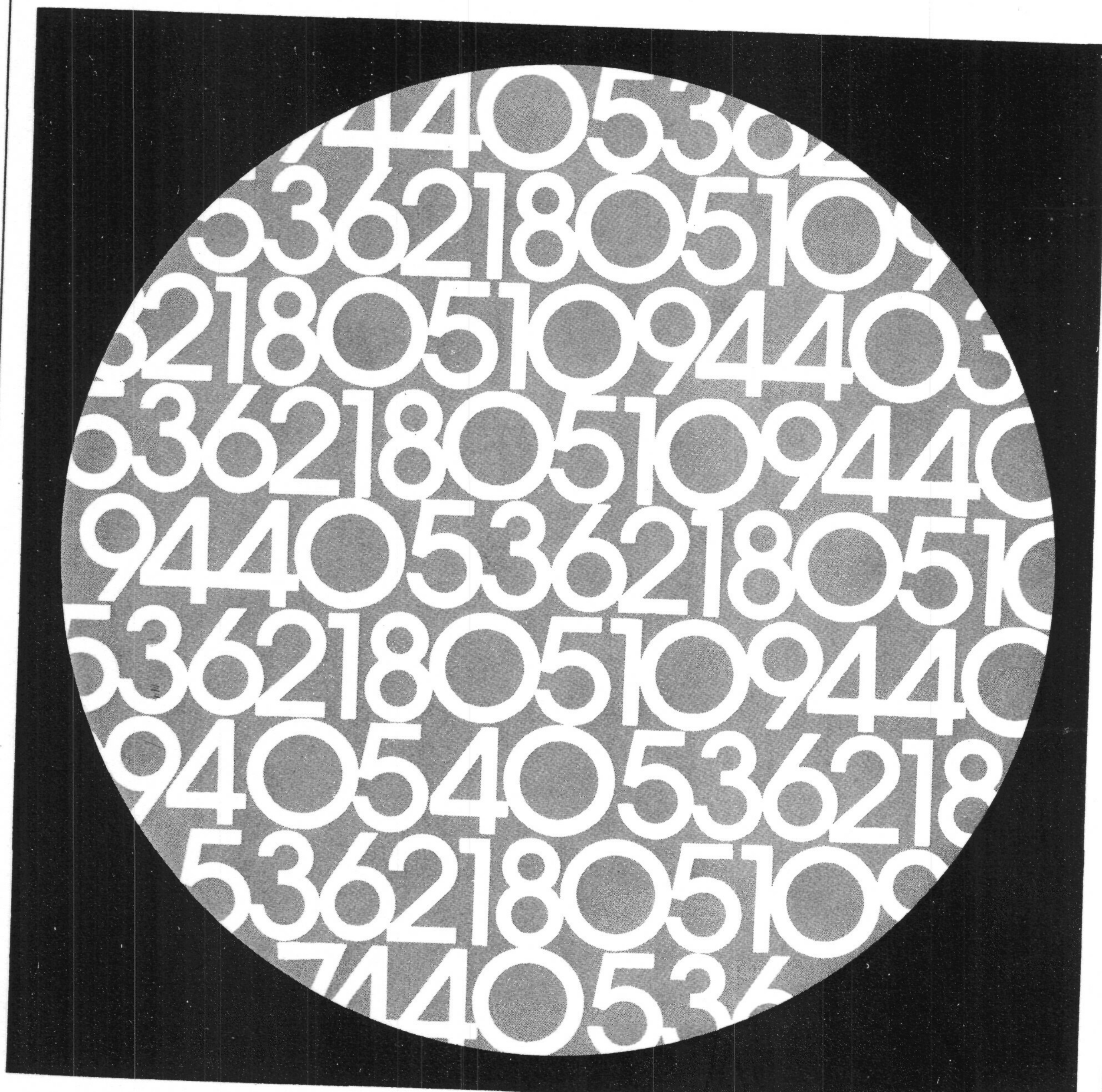

CONGRESS OF THE UNITED STATES

CONGRESSIONAL BUDGET OFFICE

TAX EXPENDITURES: BUDGET CONTROL OPTIONS AND FIVE-YEAR BUDGET PROJECTIONS FOR FISCAL YEARS 1983-1987

Congress of the United States
Congressional Budget Office

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 fills that statutory requirement for fiscal years 1983 to 1987.

This report also discusses a variety of options for controlling tax expenditures through the budget process, an issue that has been the subject of hearings and study in both the House and Senate during the past year. The report also details the changes in tax expenditures made during calendar year 1982, including those in the Tax Equity and Fiscal Responsibility Act of 1982, and discusses the implications of that experience for future control of tax expenditures through the budget process. Finally, the report describes the Canadian "envelope" system of budget making, which requires direct comparisons and trade-offs among tax expenditures and related direct spending programs, and discusses some of the implications of this Canadian system for control over tax expenditures through the U.S. Congressional budget process.

The report was prepared by James M. Verdier and Martha J. Smith of the Tax Analysis Division, with assistance from Robert Lucke. All members of the Tax Analysis Division provided valuable comments and suggestions, as did a number of others both inside and outside of the CBO, including James L. Blum, Albert Buckberg, Bruce Davie, Richard Emery, Alfred B. Fitt, Robert W. Hartman, Robert Keith, Susan Kramer, Jerome Kurtz, Paul R. McDaniel, Mitchell Mutnick, Joseph A. Pechman, Shirley Ruhe, Allen Schick, Emil M. Sunley, Stanley S. Surrey, Paul Van de Water, and James W. Wetzler. In addition, valuable assistance on the chapter on the Canadian envelope system was provided by Richard M. Bird, Sandford F. Borins, Neil Brooks, Don Drummond, David A. Good, Richard LaLiberte, Nicholas LePan, John H. Sargent, and Philip M. Smith. Patricia H. Johnston edited the manuscript, and Linda Brockman typed it.

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SUMMARY

Tax expenditures are provisions of the federal tax code that give special incentives for particular kinds of activities or that give selective tax relief to certain groups of taxpayers. Examples are the investment tax credit for investment in business machinery and equipment and the extra $1,000 personal exemption for persons age 65 and over.

Tax expenditures are similar in important ways to direct spending programs. They add to the federal deficit in the same way that direct spending programs do, and they allocate resources and provide incentives and benefits in the same way that spending programs do.

The growth in tax expenditures in recent years and the need to make substantial reductions in future federal deficits have combined to stimulate Congressional interest in finding better ways to control tax expenditures. The budget process as it currently operates imposes fewer controls on tax expenditures than it does on direct spending programs. Tax expenditures are controlled only indirectly, through the floor that budget resolutions set on total revenues. Spending programs, by contrast, are controlled not only by a ceiling on outlays, but also by a process that establishes targets for various categories of outlays, and divides those targets among the committees that have jurisdiction over spending programs. The Congress as a whole is thus able to indicate systematically its broad priorities for spending programs in a way that it cannot for tax expenditures.

Tax expenditures can be controlled by seeking to limit the total level of tax expenditures, the purposes for which tax expenditures are used, or both. Emphasizing control over the aggregate level of tax expenditures reflects an assumption that the major problem is excessive use of the tax code to achieve special, nonrevenue purposes. Reducing total tax expenditures is mainly a tax policy goal, prompted by the complexities, perceived inequities, and economic distortions that can result when the tax system is pushed beyond its basic function of raising revenues. Control over the aggregate level of tax expenditures is generally not necessary to achieve overall fiscal policy or revenue goals; the total revenue floor in the budget resolution is usually sufficient for those purposes.

Emphasizing control over the purposes for which tax expenditures are used, on the other hand, reflects mainly a concern over budget priorities and the proper allocation of scarce budget resources to particular groups or

activities. The desirability of either of these approaches, therefore, depends on the weight that is attached to these different goals and the likely effectiveness of each approach in achieving them.

LESSONS FROM RECENT EXPERIENCE

Tax expenditures have grown sharply in recent years. In 1967, the first year for which a tax expenditure budget was compiled, there were 50 items with a total revenue loss of $36.6 billion--4.4 percent of gross national product (GNP). By fiscal year 1982, tax expenditures had grown to a total of $253.5 billion--8.3 percent of GNP. The most recent list of tax expenditures, included in Appendix A of this report, shows 104 items totaling an estimated $273.1 billion for fiscal year 1983.

The Economic Recovery Tax Act of 1981 added 11 new tax expenditures, expanded 21 existing ones, and reduced only two. The 1981 act directly increased tax expenditures by $25.4 billion in fiscal year 1983 and $57.3 billion in fiscal year 1985, although this was offset to some extent by reductions in tax expenditures resulting from the multiyear reduction in individual income tax rates in the act.

In 1982, by contrast, the Congress made major reductions in tax expenditures. The first concurrent resolution on the budget for fiscal year 1983 required revenue increases totaling nearly $98.3 billion for fiscal years 1983 to 1985. The Tax Equity and Fiscal Responsibility Act of 1982 met that requirement by raising an estimated $100 billion over the 1983-1985 period, $31 billion of it from reduction or elimination of tax expenditures. The act contained 13 provisions that reduced tax expenditures and only two that increased them.

The budget resolution for fiscal year 1983 did not specify to the tax committees how the required tax increases were to be achieved. Nonetheless, many of the tax expenditure modifications made by the tax committees were of a type frequently advocated by those who support strengthening the budget process' control over tax expenditures. Some tax expenditures were targeted more narrowly on individuals with the greatest need, business tax incentives that many argued were so large that they could distort investment decisions were scaled back, and some older provisions that were being used in ways the Congress did not originally anticipate were reined in. Furthermore, these tax expenditure reductions were used to avoid the need to cut back scheduled future rate reductions, thereby following the combined base-broadening and rate-reduction approach favored by many who seek to use the budget process to achieve tax policy goals.

A continuation of this new pattern could reduce the case for expanding existing controls over tax expenditures. Experience over longer periods suggests, however, that extrapolations based on one-year trends in tax policy may not be wholly reliable.

CONTROLLING AGGREGATE TAX EXPENDITURES

The budget process can be used to require, for example, that total revenues be raised by $10 billion, but under current procedures it cannot be used to require a $10 billion reduction in tax expenditures. As a result, the tax-writing committees are free to reach budgetary revenue-raising targets by any combination they choose of increases in individual or corporate income taxes, reductions in tax expenditures, or increases in other taxes. In terms of overall fiscal policy, it may make relatively little difference how it is done, since there are few systematic differences between the macroeconomic effects of changes in tax expenditures and other kinds of tax changes. In terms of tax policy, however, and the use of the tax system to achieve nontax purposes, it can make a big difference. Reducing some of the special exclusions, deductions, and exemptions in the tax code by reducing tax expenditures can help to achieve tax policy goals of simplicity, equity, and neutrality. In general, tax expenditures make the tax code more complicated by adding extraneous provisions to which both taxpayers and the IRS must devote additional time, they make it less equitable by treating differently taxpayers who are otherwise alike, and they make it less neutral by favoring some types of economic activity over others.

To the extent that tax policy goals are furthered by limiting or cutting back tax expenditures, the present system of placing a floor on total revenues can have a significant effect by itself, without the additional step of putting a ceiling on total tax expenditures. With a revenue floor, increases in tax expenditures crowd out opportunities for rate reductions or other forms of general across-the-board tax reductions, while reductions in tax expenditures make revenues available for these more general kinds of tax cuts. The explicit competition between these two different approaches that is forced by a floor on revenues puts an extra burden of proof on tax expenditures.

While there are definitional and measurement problems with the arithmetic total of tax expenditures that have led many to argue that it should not be used for budget control purposes, most of these problems can be avoided if controls are focused on incremental changes to the total rather than on the total itself. Instead of saying, for example, that tax expenditures shall not exceed some total dollar amount in a particular year, or some percentage of total GNP or revenues, the budget resolution could specify that existing tax expenditures must be reduced by $10 billion, or that no more than $10 billion in new tax expenditures may be enacted. With this approach, the fact that there may be controversy over whether some items in the current tax expenditure list are properly classified is irrelevant; the only question is the more manageable one of whether the law changes currently under consideration represent changes in tax expenditures. Similarly, the question of whether it is proper to add up all the items on the current tax expenditure list without taking into account possible interactions among them and other parts of the tax system is also irrelevant; only the revenue effects of bills currently being considered are important, and any relevant interactions among them and the rest of the tax system can be calculated fairly easily.

CONTROLLING THE PURPOSES FOR WHICH TAX EXPENDITURES ARE USED

Budget resolutions do not require changes in specific spending programs or specific taxes. The authorization and appropriation committees that have jurisdiction over spending programs have considerable discretion in deciding what program changes to make to meet outlay ceilings in budget resolutions, and the tax committees currently have complete discretion to decide what kind of tax changes to make to meet budget resolution revenue floors.

In the case of spending programs, however, committee discretion is constrained by a procedure that breaks down the overall outlay ceiling into 19 separate budget functional categories, such as national defense, energy, agriculture, commerce and housing credit, income security, and so forth. The programs within these categories are then further broken down and allocated to the authorization and appropriation committees that have jurisdiction over them. Neither the budget functional categories nor the committee allocations are binding; they serve only as targets. But they enable the Congress as whole to indicate what its broad priorities are with respect to the overall allocation of federal spending.

Tax expenditures are also broken down into separate budget functional categories according to their various purposes, but this is done solely for informational purposes. The breakdown is included in the budget committees' reports on the budget resolution, but it is not included in the resolution itself and so is not voted on by the full Congress.

Argument For Controlling Tax Expenditures by Purpose

The argument for taking steps to control the purposes for which tax expenditures are used is that they are so close to spending programs in their effects on resource allocation that they ought to be subject to the same priority-setting process that is used for spending programs. Under current procedures, if the Congress as a whole has some preference as to how tax subsidies for various purposes should be allocated, there is no way of reflecting that preference, other than through ad hoc decisions on tax bills as they happen to come up for a vote.

The current process also provides no systematic way of avoiding duplication and overlap among spending programs and tax expenditures that serve similar purposes, or of forcing trade-offs among tax expenditures and spending programs to determine which is the most effective or least costly for a given purpose. Some other kinds of trade-offs are possible under current procedures, however; reductions in tax expenditures can be used to lower deficits and increase opportunities for rate reductions and other more general tax cuts. Trade-offs of this kind can be achieved without involving any committees other than those with jurisdiction over taxes.

To go beyond this, however--to set up direct trade-offs among tax expenditures and related spending or loan programs--other committees with jurisidction over those programs must be involved. In such an expanded system, reductions in tax expenditures could permit increases in related spending programs, and increases in tax expenditures could require reductions in related spending programs.

Involvement of Spending Committees

A full-scale system of this kind could present some problems. First, not all tax expenditures fit neatly within the jurisdiction of a particular spending committee, so it may not always be clear which spending programs, if any, should suffer or benefit when particular tax expenditures are changed. Second, the Congress may prefer that the revenue from any reduction in tax expenditures be used to reduce the deficit or fund a more general tax cut, rather than to fund additional spending.

This suggests that any system for involving spending committees in the consideration of tax expenditures should be an ad hoc one, at least at the outset. Case-by-case decisions would have to be made, perhaps initially by the Budget Committees, on which tax expenditures were appropriate for consideration by the spending committees, and on how the proceeds of any changes in tax expenditures should be allocated. There are

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a number of procedures that the Congress could use to initiate this kind of joint consideration of tax expenditures and spending programs.

Reconciliation. A reconciliation instruction like those now used to reinforce the deficit reduction decisions made in budget resolutions could go jointly to the tax committees and the committees with jurisdiction over spending programs in areas where cutbacks are sought. The committees involved could be given a target for total reduction in the deficit, with the distribution of that amount among reductions in direct spending and tax expenditures left to those committees.

This could begin with tax expenditures that are very closely related to specific spending programs, such as the exclusion from tax of Social Security benefits, workmen's compensation, veterans' disability compensation, and part of unemployment insurance benefits. Instead of directly reducing the benefits in these programs, the benefits could be made subject to tax. In some cases, such as Social Security, the spending program is under the jurisdiction of the tax committees, so joint action with other committees would not be required.

Referral of New or Increased Tax Expenditures. All legislation providing for new or increased tax expenditures approved by the tax committees could be referred to the committee or committees with jurisdiction over analogous spending programs. The spending committees could then recommend approval, approval with modifications, or disapproval. This could be merely an advisory procedure, or the spending committees could be allowed to amend the tax expenditures referred to them in ways that would limit the revenue loss, much as the appropriations committees may now limit authorizations for new entitlement programs referred to them under Section 401 of the Budget Act. The Congress might want to go even further and provide that approval of a new or increased tax expenditure by a spending committee to which it was referred would entail a corresponding reduction in that committee's spending allocation if the tax expenditure increase was ultimately approved by the full Congress.

Recommendations by Spending Committees. The spending committees could also be allowed to recommend to the tax committees that certain tax expenditures be increased or reduced. A spending committee might recommend an increase in tax expenditures for a particular purpose if that committee had decided to reduce a related spending program within its jurisdiction. Alternatively, spending committees faced with the need to reduce spending on programs within their jurisdiction might recommend that tax expenditures allocated to them be reduced instead. The banking committees might recommend, for example, that the new tax provisions allowing more rapid depreciation for commercial and residential real estate be scaled back in order to provide more funding for low- and moderate-income rental housing.

Arguments For and Against Involving Spending Committees. The main argument for involving spending committees in the consideration of tax expenditures is that their greater expertise in the related program areas enables them to evaluate tax expenditures more critically and to identify opportunities for trade-offs and reductions in duplication. The argument on the other side is that the spending committees have long-standing relationships with the beneficiaries and administrators of spending programs that may lead them to act as advocates for the allocation of more resources to these areas, rather than as skeptical critics.

Lessons From Credit Budgeting

The technical, jurisdictional, and other questions that may arise in any attempt to expand the controls of the budget process over tax expenditures suggest that any new procedures be used in a limited and experimental way for a period of time before being fully implemented. This is the path the Congress has followed in establishing a credit budget. The credit budget began in the first budget resolution for fiscal year 1981 with just nonbinding aggregate totals for direct loans and primary and secondary loan guarantees. The next year's resolution broke the targets down by budget functions, and the resolution for fiscal year 1983 included an allocation of the functional targets to committees. In addition, the credit limits for new loans and guarantees were made binding for the first time.

As in the case of the credit budget, new procedures for tax expenditures would not necessarily require amending the Budget Act, since Section 301 of the act allows budget resolutions to contain "such other matters relating to the budget as may be appropriate to carry out the purposes of this Act."

TAX EXPENDITURES AND THE BUDGET PROCESS IN CANADA

Canada has integrated the consideration of tax expenditures into its formal budget process more thoroughly than has the United States. In 1979, Canada instituted a new Policy and Expenditure Management System, usually called the "envelope system," under which all of the government's direct spending programs are assigned to one of ten policy areas or "envelopes." In addition to direct spending, these envelopes also include tax expenditures enacted or proposed after 1979. The combined direct spending programs and new tax expenditures in each envelope are required to stay within a spending limit set for each fiscal year. The budget-making system thus facilitates direct comparisions and trade-offs among tax expenditures and related direct spending programs.

The new Canadian system has only been in place for a relatively short period of time, so it is still a little early to judge its impact. Nonetheless, it appears to have significantly reduced the rate of increase in estimated tax expenditures (not all tax expenditures are estimated). From an annual rate of increase of about 20 percent from 1976 through 1978, the rate dropped to about 7 percent in 1979, and rose to about 11 percent in 1980. In addition, there have been a number of cases where tax expenditures have been reduced with corresponding increases in spending programs, and vice versa.

A number of features of the Canadian system for control of tax expenditures may have implications for the United States, including the Canadian decision to focus only on new tax expenditures. This decision recognizes the fact that changes in existing tax expenditures tend to be harder to make, since people have come to depend on them and strong constituencies have often developed to defend them. But it may also lead policymakers to neglect some opportunities for repeal or modification of older tax expenditures that changing circumstances have left ripe for reexamination.

CHAPTER I. INTRODUCTION

Tax expenditures are revenue losses from provisions of the tax code that provide incentives for particular kinds of activities or that give special or selective tax relief to certain groups of taxpayers. The investment tax credit, for example, provides an incentive for investment in business machinery and equipment, while the extra $1,000 personal exemption for those age 65 or over gives tax relief to that group of taxpayers. The most recent compilation of tax expenditure estimates, which is presented in Appendix A, lists 104 such provisions with an estimated total revenue loss in fiscal year 1983 of over $273 billion. This list was compiled before enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), and thus does not include its effects. As discussed in more detail in Chapter II, that act contained 13 provisions that reduced tax expenditures and two that increased them. Next year's tax expenditure estimates will incorporate the effects of these changes.

The prospect of large and continuing federal budget deficits and the perceived necessity of cutting direct expenditures have prompted growing interest in improving Congressional control over tax expenditures. Bills have been introduced in both the House and Senate to subject tax expenditures to more detailed control through the budget process. Hearings on these bills were held before the Senate Committee on the Budget and the House Committee on Rules in late 1981. The June 1982 Conference Report on the First Concurrent Resolution on the Budget for Fiscal Year 1983 reflected the same concern:

> The managers of the Conference urge the budget committees and the other appropriate committees of Congress to study ways in which tax expenditures and off-budget spending can be addressed more fully in budget resolutions and incorporated into the procedures of the Congressional budget process. (p. 34)

The first resolution required revenue increases totaling nearly $98.3 billion from fiscal years 1983 to 1985. The Tax Equity and Fiscal Responsibility Act of 1982 met that requirement by raising an estimated $100 billion over the 1983-1985 period, $31 billion of it from reduction or elimination of tax expenditures.

The present budget process controls tax expenditures only indirectly, mainly through the floor imposed on total revenues in budget resolutions. Once the revenue floor is reached, any bill or amendment that would reduce revenues further is subject to a point of order. The same rule applies to outlays; any bill or amendment that would increase outlays once the budget resolution ceiling is reached is subject to a point of order. Before these limits are reached, however, there is more opportunity for the Congress as a whole to indicate its spending priorities than its priorities for tax expenditures.

Outlays are broken down in the budget resolution into budget functions (national defense, commerce and housing credit, health, income security, and so forth) in order to enable the Congress to establish broad priorities for spending programs. These function-by-function spending targets are then broken down further through a procedure that allocates the targets to the Congressional committees that have jurisdiction over specific spending programs. (This process is called "crosswalking.")

No comparable procedure is specified for tax expenditures. They are lumped together with aggregate revenues and assigned solely to the tax-writing committees. The Congress as a whole is thus unable to indicate which categories of tax expenditures it would like to see increased or reduced, as it can for broad categories of outlays. Budget resolutions can be used to put pressure on the tax committees to limit or reduce tax expenditures in general by increasing the revenue floor in the resolution, perhaps accompanied by a directive to raise revenues using reconciliation procedures. But there is no way currently for the entire Congress to indicate which categories of tax expenditures should be reduced or increased.

Control over aggregate revenues and outlays is generally sufficient to meet the fiscal policy goals of the budget process, since the macroeconomic effects of different individual spending or tax changes of the same size are often quite similar, and in any event are difficult to predict with confidence. The large econometric models that must be used to estimate such effects normally do not include enough detail to measure the effects of individual program changes and often produce conflicting estimates of the effects of even major fiscal policy changes.[1] But if the budget process

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1. For a discussion of the macroeconomic effects of four major types of fiscal policy changes (reductions in individual and corporate income taxes and reductions in federal purchases and transfer payments to individuals), see Congressional Budget Office, How Changes in Fiscal Policy Affect the Budget: The Feedback Issue (June 1982).

is also to serve as a means of setting priorities for resource allocation within an overall fiscal policy framework, then some breakdown of the aggregates is necessary. This priority-setting mechanism is used now for spending programs, and it is being developed for loan programs, but it has not been applied to tax expenditures.

Chapter II describes some of the major changes made in tax expenditures this year as a result of the first budget resolution for fiscal year 1983 and the actions taken by the tax committees to implement it, and discusses some of the implications of this experience for the control of tax expenditures. Chapter III examines some options for controlling tax expenditures through the budget process, and discusses the pros and cons of extending the scope of the budget process in this way. Chapter IV describes the new Canadian system for controlling both tax expenditures and direct outlays by establishing budgetary "envelopes" that include all spending and tax expenditure programs in related areas, and by requiring direct trade-offs among both types of programs. Appendix A shows tax expenditure estimates for fiscal years 1982 to 1987, covering tax expenditures under the law in effect on December 31, 1981. Appendix B groups tax expenditures under the Congressional committees with authorizing jurisdiction over related direct spending programs. Appendix C gives the initial authorization date for all current tax expenditures, and Appendix D gives the expiration dates for all tax expenditures that have them. Appendix E provides estimates of certain tax expenditures by adjusted gross income class.

CHAPTER II. TAX EXPENDITURE CHANGES IN CALENDAR YEAR 1982

THE BUDGET RESOLUTION AND THE 1982 TAX ACT

The Congress enacted major changes in tax expenditures in 1982. In contrast to recent years, tax expenditures, on balance, were reduced rather than increased. In large measure this was an outcome of the severe budget pressures faced by the Congress. As noted in Chapter I, these pressures led to a budget resolution and a tax act that will increase revenues by an estimated $100 billion over fiscal years 1983-1985. As shown in Table 1, existing tax expenditures were reduced by 13 provisions of the Tax Equity and Fiscal Responsibility Act (TEFRA). Two of the provisions--the alternative minimum tax for individuals and the reduction in business preference items--apply to a wide variety of tax expenditures. Two provisions of the 1982 act increase tax expenditures, with the major increase coming from an expansion and extension of the targeted jobs tax credit. Altogether, these tax expenditure changes will result in an estimated net increase in revenues of $31 billion over the 1983-1985 period, nearly a third of the total revenue increases in the act.

By contrast, the Economic Recovery Tax Act of 1981 (ERTA) added 11 new tax expenditures, expanded 21 existing ones, and reduced only two (see Table 2). The 1981 act directly increased tax expenditures by $25.4 billion in fiscal year 1983 and $57.3 billion in fiscal year 1985, but this was offset to some extent by reductions in tax expenditures resulting from the multiyear reduction in individual income tax rates in the act. As discussed in the next chapter, reductions in tax rates reduce the revenue loss from all existing tax expenditures that take the form of deductions, exemptions, or exclusions from income. Because of complex interactions, the total effect of rate reductions on existing tax expenditures is normally not separately calculated, but it is reflected in the tax expenditure budgets that are prepared after rate cuts are enacted. The full effects of the Economic Recovery Tax Act of 1981 are included in the tax expenditure estimates in Appendix A.

IMPLICATIONS FOR THE FUTURE

The 1982 experience has shown that substantial reductions in tax expenditures can be achieved through the budget process as it is now applied. The budget resolution for fiscal year 1983 established an overall

TABLE 1. ESTIMATED REVENUE EFFECTS OF CHANGES IN TAX EXPENDITURES IN THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982, FISCAL YEARS 1983-1987 (In millions of dollars)

Change	1983	1984	1985	1986	1987
Reductions in Tax Expenditures					
Alternative minimum tax	a	+659	+701	+741	+729
Medical deduction	+272	+1,788	+1,671	+1,795	+1,947
Ten percent casualty deduction floor	---	+666	+734	+800	+880
Reduction in corporate preference items	+515	+936	+948	+918	+995
Investment tax credit basis adjustment	+362	+1,374	+2,658	+4,109	+5,579
Limit ITC to 85 percent of tax liability	+152	+259	+213	+178	+164
Accelerated depreciation--1985 and 1986	---	---	+1,541	+9,907	+18,442
Construction period interest and taxes	+555	+1,179	+1,206	+1,084	+819
Modifications to pre-ERTA and safe-harbor leasing rules[b]	+1,036	+2,649	+4,252	+5,496	+7,000
Limit on U.S. possessions credit	+201	+428	+473	+516	+559
Private purpose tax-exempt bonds	+63	+261	+539	+748	+1,076
Pension provisions	+194	+780	+870	+970	+1,058
Reduction to $18,000/12,000 of income threshhold for tax on unemployment compensation benefits	+763	+734	+611	+618	+650
Subtotal	+4,113	+11,713	+16,417	+27,880	+39,898
Increases in Tax Expenditures					
Targeted jobs credit	-182	-551	-591	-271	-54
National Research Service Awards	-8	-7	-4	-2	a
Subtotal	-190	-558	-595	-273	-54
Total	+3,923	+11,155	+15,822	+27,607	+39,844

SOURCE: Summary of the Revenue Provisions of H.R. 4961 (The Tax Equity and Fiscal Responsibility Act of 1982), prepared by the Joint Committee on Taxation, August 24, 1982.

a. Negligible.
b. ERTA = Economic Recovery Tax Act of 1981.

target for revenue increases, without specifying to the tax committees how those increases were to be achieved. While the budget resolution also did not specify exactly how its required reductions in spending were to be achieved, the process by which spending targets were allocated to various committees left them with less discretion than the tax committees had over revenues.

Nonetheless, many of the modifications in tax expenditures made by the tax committees were of a type frequently advocated by those who support strengthening budget process controls over tax expenditures. The limits on medical and casualty deductions, the increased taxation of unemployment compensation benefits, and the reduced ceilings on company-based pension plan benefits all served to target tax expenditures more narrowly on individuals with the greatest need. The cutbacks in the investment tax credit and accelerated depreciation served to reduce investment incentives that many economists argued were too large and were thus distorting investment decisions and reducing overall economic efficiency. The limits on private purpose tax-exempt bonds and the tax credit for corporations in U.S. possessions scaled back provisions that were being used in ways the Congress did not originally anticipate.

Furthermore, these tax expenditure reductions were linked with reductions in marginal tax rates, since they enabled the Congress to meet its revenue-raising goals without disturbing the multiyear income tax rate cuts and the 1985 tax rate indexing enacted in the Economic Recovery Tax Act of 1981. The tax committees thus followed the base-broadening, rate-reduction approach frequently advocated by those who seek to use budget process controls over tax expenditures to achieve tax policy goals. The major difference was that the rate reductions were enacted first, with the base broadening coming later, rather than all being done at once.

As indicated, this year's experience represented a departure from the pattern of previous years. A continuation of this new pattern could reduce the case for expanding existing controls over tax expenditures. Experience over longer periods suggests, however, that extrapolations based on one-year trends in tax policy may not be wholly reliable. The arguments for and against imposing additional controls on tax expenditures are discussed in more detail in the next chapter.

OTHER MISCELLANEOUS TAX EXPENDITURE CHANGES

In addition to the major changes in tax expenditures that were made in the Tax Equity and Fiscal Responsibility Act, two smaller changes were made in other legislation. The Miscellaneous Revenue Act of 1982 (P.L.

TABLE 2. ESTIMATED 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						
Safe-harbor leasing	-439	-2,649	-3,614	-5,065	-6,732	-8,512
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
Amortization of motor-carrier operating rights	-21	-121	-71	-71	-54	-18
Exclusion of interest on certain savings certificates	---	-398	-1,791	-1,142	---	---
Net interest deduction	---	---	---	---	-1,124	-3,126
Reinvestment of dividends in stock of public utilities	---	-130	-365	-416	-449	-278
Deduction for certain adoption expenses	---	-9	-9	-10	-11	-12
Suspension of regulations relating to allocation under Section 861 of research and experimental expenditures	---	-57	-120	-62	a	---
Exclusion for employer-provided child care	b	b	b	b	b	b
Industrial development bonds (IDBs) for mass transit	---	c	-7	-29	-54	-64
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	d	e	e	e	e	e
Increased exclusion on sale of residence	d	-18	-53	-63	-76	-91
Changes in taxation of foreign earned income	---	-299	-544	-563	-618	-696
Accelerated cost recovery system	-1,064	-6,920	-13,182	-21,185	-30,553	-44,285
Corporate rate reductions	---	-116	-365	-521	-565	-610

(Continued)

a. Less than $5 million.
b. Included in child and dependent care credit.

TABLE 2. (Continued)

Change	1981	1982	1983	1984	1985	1986
Credit for rehabilitation expenditures	-9	-129	-208	-240	-302	-414
Credit for used property	-24	-61	-74	-85	-137	-198
Charitable contributions of scientific property used for research	a	a	a	a	a	a
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	-627	-1,548	-2,298
Group legal service plans	---	-16	-24	-26	-8	---
Tax-exempt bonds for volunteer fire departments	---	c	c	c	c	c
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
	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
Total	-1,521	-11,075	-25,417	-42,355	-57,331	-79,318

SOURCE: General Explanation of the Economic Recovery Tax Act of 1981, prepared by the Joint Committee on Taxation, December 31, 1981.

c. Less than $1 million.
d. Negligible
e. Less than $10 million.

97-362) contained a provision expanding the definition of shale oil equipment for purposes of the energy investment tax credit which was estimated to result in an increase in the energy credit tax expenditure of less than $5 million in fiscal year 1983 and nothing in later years. In another bill, now Public Law 97-328, the Congress amended the District of Columbia Self-Government and Governmental Reorganization Act to allow the issuance of tax-exempt revenue bonds to finance college student loan programs. This provision is estimated to increase tax expenditures by less than $5 million a year.

No other changes in tax expenditures were finally enacted prior to the Congress' recess on October 2. All changes in tax expenditures enacted during calendar year 1982 will be reflected in the tax expenditure estimates for fiscal years 1983-1988, which will be prepared early next year.

CHAPTER III. CONTROLLING TAX EXPENDITURES THROUGH THE BUDGET PROCESS

The growth in tax expenditures in recent years and the need to make substantial reductions in future federal deficits have combined to stimulate Congressional interest in finding better ways to control tax expenditures. Two general and not mutually exclusive approaches have been suggested. One concentrates on limiting the overall level of tax expenditures, while the other focuses more on the purposes for which tax expenditures are used. Both approaches and their implications are dealt with in this chapter. The chapter also includes a brief review of the progress that has been made in the use of the budget process to control credit programs, and the lessons that can be learned from that experience in evaluating proposals to control tax expenditures.

No attempt is made to distinguish specifically between the kinds of changes in the budget process that can be made under existing authority and those that would require an amendment to the Budget Act. Section 301 of the Budget Act provides that concurrent resolutions on the budget may include "such other matters relating to the budget as may be appropriate to carry out the purposes of this Act." As the budget process has evolved, this authority has been used to experiment with changes such as the expanded use of reconciliation and development of a credit budget. As experience has developed with these new procedures, the Congress has become better able to decide which of them has worked well enough to merit actual embodiment in the Budget Act, and which require further development and modification. This same process of experiment and evolution would presumably be followed in any effort to impose further controls on tax expenditures.

THE IMPORTANCE OF CONTROLLING TAX EXPENDITURES

Tax expenditures have become one of the major ways in which the federal government allocates resources and affects private sector decisions. In 1967, the first year for which a tax expenditure budget was compiled, there were 50 items with a total revenue loss of $36.6 billion--4.4 percent of the gross national product (GNP). By fiscal year 1982, tax expenditures had grown to a total of $253.5 billion--8.4 percent of GNP (see Table 3). The most recent tax expenditure budget, included in Appendix A, shows 104 items totaling $273.1 billion for fiscal year 1983.

TABLE 3. TAX EXPENDITURE GROWTH, SELECTED CALENDAR YEARS 1967-1973 AND FISCAL YEARS 1975-1982[a]

	1967	1969	1971	1973	1975
Tax Expenditures					
Totals (in billions of dollars)	36.6	46.6	51.7	65.4	92.9
Percent of federal outlays	20.5	23.7	22.3	24.3	28.5
Percent of federal revenues	23.8	24.1	24.8	24.7	33.1
Percent of total federal "spending" (outlays plus tax expenditures)	18.8	20.3	19.7	21.0	22.3
Percent of GNP	4.4	4.8	4.6	4.7	6.3
Federal Outlays as a Percent of GNP	21.4	20.3	20.6	19.5	22.0
GNP (in billions of dollars)	777.3	910.6	1,031.5	1,252.0	1,479.9

(Continued)

a. Tax expenditures estimates were prepared only on a calendar year basis for the years 1967 to 1973. The estimates for calendar years 1967 to 1973 correspond roughly to fiscal years 1968 to 1974, and are thus compared to the GNP, outlay, and revenue figures for those fiscal years.

TABLE 3. (Continued)

	1977	1979	1981	1982
Tax Expenditures				
Totals (in billions of dollars)	113.5	149.8	228.6	253.5
Percent of federal outlays	28.2	30.3	34.6	34.6
Percent of federal revenues	31.7	32.3	37.9	40.8
Percent of total federal "spending" (outlays plus tax expenditures)	22.1	23.4	25.7	25.7
Percent of GNP	6.1	6.4	8.0	8.4
Federal Outlays as a Percent of GNP	21.6	20.9	23.1	24.2
GNP (in billions of dollars)	1,864.1	2,417.8	2,937.7	3,033.8

In many areas, the federal government exerts more influence through tax expenditures than it does through direct spending. The tax expenditures for general purpose fiscal assistance (mainly tax-exempt bonds and deductions for state and local taxes) are greater than direct federal outlays (mainly general revenue sharing), and tax expenditures for housing exceed outlays by more than four to one. Table 4 shows total tax expenditures and outlays by budget function for selected years between 1967 and 1987 and compares their growth. The tax expenditures for natural resources and environment, for example, grew by more than 800 percent between 1974 and 1981, while outlays for that purpose grew by just over 140 percent.

Tax expenditures add to the federal deficit in the same way that direct spending programs do. They also allocate resources and provide

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TABLE 4. CHANGE IN TAX EXPENDITURES AND OUTLAYS BY BUDGET FUNCTION, 1967-1987[a]

Budget Function	Amount (In billions of dollars) 1967	1974	1981	1987[b]	Percent Increase/Decrease 1967-1974	1974-1981	1981-1987	1967-1987
National Defense								
Tax expenditures	0.5	0.7	1.8	2.7	43	145	53	436
Outlays	78.8	77.8	159.7	303.5	-1	105	90	285
International Affairs								
Tax expenditures	0.3	1.7	2.7	4.5	481	61	66	1,453
Outlays	5.3	5.7	11.1	14.3	8	95	29	172
General Science, Space and Technology								
Tax expenditures	0.5	0.6	2.0	2.7	21	236	33	438
Outlays	5.5	4.0	6.4	8.1	-28	61	26	47
Energy								
Tax expenditures	1.6	3.0	6.6	10.7	84	124	63	570
Outlays	1.0	0.8	10.6	6.3	-17	1,171	-41	528
Natural Resources and Environment								
Tax expenditures	0.1	0.2	2.0	3.4	69	805	69	2,488
Outlays	3.0	5.7	13.8	11.6	89	143	-16	288
Agriculture								
Tax expenditures	0.8	1.3	1.4	1.9	63	10	32	137
Outlays	4.5	2.2	5.6	8.2	-51	151	46	80
Commerce and Housing Credit								
Tax expenditures	12.1	36.5	98.2	212.6	201	169	116	1,654
Outlays	4.3	3.9	4.0	5.7	-9	2	42	31
Transportation								
Tax expenditures	c	1.0	c	0.2	9,600	-96	386	1,600
Outlays	6.3	9.2	23.3	25.1	46	154	8	298
Community and Regional Development								
Tax expenditures	0.0	0.1	0.3	1.1	NA	276	250	NA
Outlays	1.4	4.1	9.3	9.1	199	124	-2	560
Education, Training, Employment and Social Services								
Tax expenditures	3.1	6.2	14.6	31.3	101	135	114	910
Outlays	7.6	12.3	30.6	30.9	62	148	8	331
Health								
Tax expenditures	2.6	5.1	19.9	35.3	95	294	77	1,257
Outlays	9.7	22.1	69.3	145.0	127	214	109	1,393

(Continued)

TABLE 4. (Continued)

Budget Function	Amount (In billions of dollars) 1967	1974	1981	1987[b]	Percent Increase/Decrease 1967-1974	1974-1981	1981-1987	1967-1987
Income Security								
Tax expenditures	9.7	13.8	52.0	89.2	42	278	71	822
Outlays	33.7	84.4	225.6	361.5	151	167	60	973
Veterans' Benefits and Services								
Tax expenditures	0.5	0.8	1.6	1.5	45	96	-3	177
Outlays	6.9	13.4	22.9	29.0	95	71	26	322
Administration of Justice								
Tax expenditures	0.0	0.0	0.0	0.0	NA	NA	NA	NA
Outlays	0.6	2.5	4.7	5.2	279	92	11	703
General Government								
Tax expenditures	0.0	c	0.1	0.1	NA	900	-20	NA
Outlays	1.6	3.2	4.7	5.2	109	46	11	237
General Purpose Fiscal Assistance								
Tax expenditures	4.7	11.2	25.3	42.0	139	127	66	797
Outlays	0.3	6.9	6.6	8.7	1,926	-4	31	2,451
Interest								
Tax expenditures	0.0	0.0	-0.1	0.4	NA	NA	-573	NA
Outlays	13.8	28.0	82.6	205.3	104	195	149	1,393
Allowances								
Tax expenditures	0.0	0.0	0.0	0.0	NA	NA	NA	NA
Outlays	0.0	0.0	0.0	11.6	NA	NA	NA	NA
Undistributed Offsetting Receipts								
Tax expenditures	0.0	0.0	0.0	0.0	NA	NA	NA	NA
Outlays	-5.5	-16.7	-30.3	-65.8	-205	-82	-117	-1,106
Total								
Tax expenditures	36.5	82.0	228.6	439.4	124	179	92	1,102
Outlays	178.8	269.6	660.5	1,130.5	51	145	71	532

NOTES: NA = not applicable.
Details may not add to totals because of rounding.

a. Tax expenditure estimates were prepared only on a calendar year basis for the years 1967 to 1973. The estimate for calendar year 1967 corresponds roughly to fiscal year 1968, and is therefore compared to the outlays for that year. These estimates reflect legislative and definitional changes in tax expenditures as well as inflation and economic growth.

b. The 1987 outlay estimates are from Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987 (February 1982).

c. Less than $50 million.

incentives and benefits in the same way. They are one of the ways by which the federal government plays a role in the economy and involves itself in the lives of its citizens.

Unlike direct spending programs, however, tax expenditures have low visibility in the budget process and are controlled in only a limited and indirect way. The Budget Act requires that a tax expenditure budget be compiled each year, but it is presented only for informational purposes. No direct budgetary decisions are based on it, and accordingly it receives relatively little attention. One consequence of this low visibility is that activities that may not have sufficient support to obtain federal funding through direct outlays may be funded through the back door by tax expenditures.

Tax expenditures show up as revenue losses, and thus have an important effect on the revenue totals that are included in Congressional budget resolutions. But they are treated for this purpose as simply another form of tax cut; they are not treated as alternatives to spending programs. There is an important distinction between general tax cuts that reduce taxes broadly across the board and tax expenditures that provide a tax cut only to those in certain specified circumstances or who act in certain specified ways. General tax cuts return resources to taxpayers to use in whatever way they see fit; tax expenditures return resources to taxpayers only if they do what the government would like them to do, or if they are thought deserving of special help. The present treatment of tax expenditures in the budget process blurs the distinction between these two ways of reducing taxes.

APPROACHES TO CONTROLLING TAX EXPENDITURES

Tax expenditures can be controlled by seeking to limit the total level of tax expenditures, the purposes for which tax expenditures are used, or both. Emphasizing control over the aggregate level of tax expenditures reflects an assumption that the major problem is excessive use of the tax code to achieve special, nonrevenue purposes. Reducing total tax expenditures is mainly a tax policy goal, prompted by the complexities, perceived inequities, and economic distortions that can result when the tax system is pushed beyond its basic function of raising revenues. Control over the aggregate level of tax expenditures is generally not necessary to achieve overall fiscal policy or revenue goals; the total revenue floor in the budget resolutions is usually sufficient for these purposes.

Emphasizing control over the purposes for which tax expenditures are used, on the other hand, reflects mainly a concern over budget priorities and the proper allocation of scarce budget resources to particular groups or activities. The desirability of either of these approaches, therefore, depends on the weight that is attached to these different goals and the likely effectiveness of each approach in achieving them.

Controlling Aggregate Tax Expenditures

The arithmetic total of all tax expenditures in fiscal year 1983 is estimated to be $273 billion, compared to CBO's most recent estimate of $633 billion for total revenues. The budget process can currently be used to require that total revenues be raised by, say, $10 billion, but under current procedures it cannot be used to require a $10 billion reduction in tax expenditures. As a result, the tax-writing committees are free to reach budgetary revenue-raising targets by any combination they choose of general increases in individual or corporate income taxes, reductions in tax expenditures, or increases in other taxes.[1] In terms of overall fiscal policy, it may make relatively little difference how it is done, since there are few systematic differences between the macroeconomic effects of changes in tax expenditures and other kinds of tax changes. In terms of tax policy, however--and the use of the tax system to achieve nontax purposes--it can make a big difference. Reducing some of the special exclusions, deductions, and exemptions in the tax code by reducing tax expenditures can help achieve tax policy goals of simplicity, equity, and neutrality. In general, tax expenditures make the tax code more complicated by adding provisions to which both taxpayers and the IRS must devote additional time. They make the code less equitable by treating differently taxpayers who are otherwise alike, and they make it less neutral by favoring some types of economic activity over others.

There is no guarantee that a limit on the aggregate total of tax expenditures would always serve these tax policy goals, since tax expenditures could be reduced in ways that make the tax system less simple, equitable, or neutral. Minimum tax plans, for example, tend to make the

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1. Section 301(d)(4) of the Budget Act requires that the Budget Committee reports on the first budget resolution contain "an allocation of the level of Federal revenues recommended in the concurrent resolution among the major sources of such revenues." The major sources include individual and corporate income taxes, social insurance taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. Since this allocation does not appear in the budget resolution and is not voted on by the full Congress, it has no formal effect on tax committee decisions.

system more complicated, even though they reduce the revenue loss from tax expenditures. Tightening the eligibility rules for various tax expenditures can reduce the revenue loss, but usually at the cost of greater complexity and sometimes at the cost of some perceived unfairness, especially if people have made important decisions on the basis of the old rules. Cutbacks in tax expenditures benefiting one industry could make the tax system less neutral overall if similar tax expenditures in related industries were preserved.

To the extent that tax policy goals are furthered by limiting or reducing tax expenditures, the present system of placing a floor on total revenues can have a significant effect by itself, without the additional step of putting a ceiling on total tax expenditures. This is especially true if the goal of reducing tax rates, or avoiding rate increases, continues to have a high priority. Given a revenue floor, increases in tax expenditures crowd out opportunities for rate reductions or other forms of general across-the-board tax reductions, while reductions in tax expenditures make revenues available for more general kinds of tax cuts. The explicit competition between these two different approaches to tax reduction that is forced by a floor on revenues puts an extra burden of proof on the use of tax expenditures.

It is true, of course, that the burden of proof would be even greater with a ceiling that focused precisely on the aggregate total of tax expenditures. There are, however, definitional and measurement problems with this total that have led many to argue that it should not be used for budget control purposes. These problems can be largely avoided, however, if the controls are focused primarily on incremental changes to the tax expenditure total rather than on the total itself. Instead of saying, for example, that tax expenditures shall not exceed some total dollar amount in a particular year, or some percentage of GNP or total revenues, the budget resolution could specify that existing tax expenditures must be reduced by $10 billion, or that no more than $10 billion in new tax expenditures may be enacted. To see why this would minimize definitional and measurement issues, some discussion of these issues may be helpful.

Definitional Issues. Tax expenditures are defined in the Budget Act as the revenue losses attributable to provisions of the tax law that 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."[2] In general, tax expenditures are provisions that have some special purpose beyond simply collecting revenue in accordance with the

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

standard tax policy goals of simplicity, equity, and neutrality. Provisions that are part of the normal structure of the tax code--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--are not classified as tax expenditures.

Inevitably there are a few ambiguous cases. The deduction for two-earner married couples, for example, is treated as a tax expenditure.[3] But if the Congress had adopted a broader approach and allowed married couples to be taxed separately at the lower rates applicable to single persons, the change would probably have been regarded as a modification of the basic tax structure rather than as a tax expenditure. Despite such uncertainties at the borderline, there has been general agreement between the Congress and the Administration in the past on which provisions of the tax code are "special" enough to be termed tax expenditures. In the first three years after the Budget Act required the Administration to submit a formal tax expenditure budget (1975 to 1977), there were only three to four differences between the Congressional and Administration lists each year, while the lists were identical between 1978 and 1981.[4]

In February 1982, however, the tax expenditure budget submitted by the Reagan Administration omitted thirteen items that appear in the tax expenditure budget prepared for the Congress by the Joint Committee on Taxation, which is included as Appendix A of this report. Table 5 shows the items omitted from the Administration budget, and their estimated revenue effects for fiscal years 1982-1987. The Administration argued that the items omitted were not properly classified as tax expenditures.[5] This argument was countered in a later analysis by Professors Paul R. McDaniel and Stanley S. Surrey that relied on the legislative history of the

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3. This provision, enacted in 1981 to ease the so-called "marriage penalty," allows a deduction, when fully phased in in 1983, of 10 percent of the lower-earning spouse's wage and salary income up to $30,000 (maximum deduction of $3,000).

4. In 1975, the Congressional list contained four items not on the Administration's: deferral of income of controlled foreign corporations, Asset Depreciation Range (ADR), capital gains at death, and maximum tax on earned income. The maximum tax was added to the Administration's list in 1976, but the other three were still not included. Those three were omitted again in 1977.

5. The Budget of the United States Government, Fiscal Year 1983, Special Analysis G, "Tax Expenditures," pp. 5-8, 37 (February 1982).

TABLE 5. PROVISIONS INCLUDED IN THE CONGRESSIONAL TAX EXPENDITURE BUDGET BUT NOT IN THE ADMINISTRATION BUDGET (By fiscal year, in millions of dollars)

Tax Expenditure	1982	1983	1984	1985	1986	1987
Deferral of income of controlled foreign corporations[a]	520	560	605	655	705	760
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	55	120	60	b	b	b
Exclusion of payments in aid of construction of water, sewage, gas, and electric utilities[a]	30	45	70	75	80	75
Deductibility of patronage dividends and certain other items of cooperatives[a]	545	560	580	600	615	640
Exclusion of certain agricultural cost-sharing payments[a]	60	50	45	40	30	25
Depreciation on rental housing in excess of straight-line	565	705	820	885	940	990
Depreciation on buildings other than rental housing in excess of straight-line	330	400	465	525	590	660
Accelerated depreciation on equipment other than leased property	7,300	12,400	18,620	26,550	38,280	45,530
Reduced rates on the first $100,000 of corporate income[a]	6,605	7,125	8,065	8,740	8,660	8,630
Exclusion of scholarship and fellowship income[a]	465	415	375	395	410	435
Exclusion of employer-provided child care	b	10	25	55	85	120
Deduction for two-earner married couples	705	3,980	7,030	7,980	8,945	10,070
Exclusion of public assistance benefits[a]	445	430	430	440	455	470

SOURCES: For the Administration budget, The Budget of the United States Government for Fiscal Year 1983, Special Analysis G, "Tax Expenditures," Table G-2 (February 1982); for the Congressional budget, Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 1982-1987 (March 8, 1982).

NOTE: The Administration includes the expiring general jobs credit in its budget while the Congressional budget omits it. The Administration estimates that the credit will increase tax expenditures by $65 million in 1982 and $5 million in 1983. Also, the Administration includes "Income of trusts to finance supplemental unemployment benefits," under the heading of "Exclusion of other employee benefits," which is estimated to increase tax expenditures by $20 million in fiscal years 1982 and 1983. The Congressional budget also omits this.

a. Listed in Table G-3, Special Analysis G, "Revenue Loss Estimates of Provisions Previously Designated 'Tax Expenditures'."

b. Less than $2.5 million.

Budget Act to argue that the Administration had departed from congressionally established guidelines in omitting such items from the list.[6]

As long as the tax expenditure budget is simply an informational document, as it is now, there is usually little objection to including items about which there is some uncertainty. If actual legislative decisions are to turn on whether an item is included or not, however, more strains may be placed on the classification process. If a budget resolution ceiling were to be placed on total tax expenditures, for example, questions could conceivably be raised about whether each item in the present tax expenditure budget is properly classified. Most of these issues could be bypassed, however, if the limits were focused just on incremental changes to the total. The only question then would be whether a bill or amendment currently under consideration added a new tax expenditure or increased or reduced an existing one.

Measurement Issues. Since tax expenditures are revenues the government does not collect, they can not be directly observed. Instead, they must be estimated, using a set of assumptions and estimating conventions. The revenue loss from each individual 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. This is a good approximation of the revenue cost of each individual tax expenditure, and is consistent with the way costs are estimated for individual direct spending programs. The arithmetic total of all these individual tax expenditure estimates, however, is a less meaningful number than the total of outlays for all spending programs.

The major difficulties arise because of interactions with the standard deduction (zero bracket amount) and the progressive income tax rate structure. If several tax expenditures that take the form of personal deductions did not exist, revenue would be higher by less than the sum of the tax expenditures, since more people would take the standard deduction. If several tax expenditures that take the form of exclusions from income did not exist, more income would be taxed at higher marginal tax rates, so revenue would be higher by more than the sum of the tax expenditures.

6. Paul R. McDaniel and Stanley S. Surrey, "Tax Expenditures: How To Identify Them; How To Control Them," Tax Notes (May 24, 1982), pp. 595-597.

This is spelled out in more detail in Chapter II of CBO's September 1981 report on tax expenditures.[7]

These interactions can be taken into account if a limited number of tax expenditures is being considered, but the calculation becomes increasingly more complicated as more items are included. Including all tax expenditures and taking into account all of the interactions would require constructing a wholly new tax system without tax expenditures. The higher revenues that such a system would produce, assuming no other changes in the tax system and no effects on the economy from the tax increases, could be characterized as the total revenue loss from tax expenditures. Because these are not realistic assumptions, however, the resulting number would be an artificial one. Furthermore, it would no longer be a useful estimate of the revenue loss from each individual tax expenditure, since there would be no way to assign the difference between the total and the sum of the parts to any one of the parts.

These problems with the aggregate number essentially fall away if the focus is shifted from controlling the total of tax expenditures to controlling incremental changes to that total. If a budget resolution specified that tax expenditures were to be increased or decreased by $5 billion, the only question would be whether the provisions reported out by the tax-writing committees had that effect. This is the kind of estimate on which the Congress relies all the time in considering tax legislation. It presents few unique measurement problems.

One related accounting problem would remain, however: the question of how to treat changes in overall tax rates or the standard deduction (zero bracket amount). A reduction in income tax rates would reduce the revenue loss from all tax expenditures that take the form of deductions, exemptions, or exclusions from income, since the revenue loss is measured by multiplying the amount excluded by the relevant marginal tax rate. Similarly, increases in the standard deduction would reduce the revenue loss from all tax expenditures that take the form of itemized deductions. Both of these changes tend to serve tax policy goals of improving simplicity, equity, and neutrality. This suggests that such changes should be scored as reductions in tax expenditures for budget purposes.[8]

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7. Congressional Budget Office, Tax Expenditures: Current Issues and Five-Year Budget Projections for Fiscal Years 1982-1986 (September 1981), pp. 7-8.

8. Adopting such an accounting rule would, however, raise the question of whether all the exclusions, exemptions, and deductions in the tax

Such a rule might allow the Congress to increase specific tax expenditures after a rate cut or standard deduction increase had left room by reducing tax expenditures across the board. This would be unlikely, however, since the Congress would continue to be governed by an overall revenue floor. Rate cuts or standard deduction increases would reduce revenues toward that floor, and would normally leave little room for the additional revenue reductions that would result from increases in specific tax expenditures.

Conclusion. In short, controls on tax expenditures in the aggregate are quite feasible if they are focused on incremental changes to the totals. Such controls can help to achieve tax policy goals, but they are generally not needed to achieve fiscal policy goals.

Controlling the Purposes for Which Tax Expenditures Are Used

Under current procedures, control over specific tax expenditures is exclusively in the hands of the tax-writing committees. By establishing an overall revenue floor, the Budget Committees can exert some pressure on the tax-writing committees to reduce tax expenditures. As discussed in Chapter II, this procedure resulted in substantial cutbacks in tax expenditures this year in the Tax Equity and Fiscal Responsibility Act of 1982. But the decision about how to raise the required amount of revenue is left solely to the tax-writing committees. It need not be done by reducing tax expenditures.

Similarly, the authorization and appropriation committees have considerable discretion in deciding what program changes are needed to meet the outlay ceiling in budget resolutions. In the case of spending programs, however, that discretion is constrained by the procedure that breaks down the overall outlay ceiling into 19 separate budget functional categories, such as national defense, energy, agriculture, commerce and housing credit, income security, and so forth. The programs within these categories are then further broken down and allocated to the authorization and appropriation committees that have jurisdiction over them. Neither the budget functional categories nor the committee allocations are binding; they serve only as targets. But they enable the Congress as a whole to indicate what its broad priorities are with respect to the overall allocation of federal spending.

(Footnote 8. Continued)
expenditure budget meet the definition of a tax expenditure, a problem that is avoided if only the revenue effect of changes in specific tax expenditures is at issue.

Furthermore, while these targets are not binding, they are generally adhered to fairly closely. The current major exception is the appropriations committees, which have frequently departed from the budget functional targets, while still staying within their overall committee allocations. In addition, the process of reconciliation puts more teeth in committee allocations. Reconciliation bolsters the outlay ceiling in the budget resolution by requiring committees to cut spending by specific amounts by making changes in programs within their jurisdiction. Changes in specific programs are not required by reconciliation directives, but the options for program cuts actually available to the committees are usually so limited that their discretion is significantly constrained.

Tax expenditures can be broken down into separate budget functional categories according to their various purposes, just as is done for spending programs. Indeed, tax expenditure budgets have always been presented in this way, with refinements in recent years to make them correspond as closely as possible to the budget functional categories on the spending side. The most recent tax expenditure budget, included in Appendix A, takes the additional step of assigning each tax expenditure to a separate budget subfunction (energy supply and energy conservation within the energy function, for example), something that the CBO first did last year. Each CBO tax expenditures report since 1978 has also included an illustrative allocation of tax expenditures to committees with jurisdiction over analogous spending programs, a feature that is included in Appendix B of this report.

All this has been done solely for informational purposes, however; no actual legislative decisions are made on the basis of these breakdowns and allocations. If the Congress wanted to exercise control over tax expenditures that is analogous to the control that is exercised over spending programs, this information could be a starting point.

Argument for Controlling Tax Expenditures by Purpose. The argument for taking such a step is that tax expenditures are so close to spending programs in their effects on resource allocation that they ought to be subject to the same priority-setting process that is used for spending programs. Under current procedures, if the Congress as a whole has some preference as to how tax subsidies for various purposes should be allocated, there is no way of reflecting that preference, other than through ad hoc decisions on tax bills as they happen to come up for a vote. Less than 1 percent of total outlays is devoted to commerce and housing credit, for example, while that budget function includes more than 40 percent of total tax expenditures. This may represent the allocation that the Congress prefers, but the process as it now operates provides no way to decide that systematically.

The current process also provides no systematic way of avoiding duplication and overlap among spending programs and tax expenditures that serve similar purposes, or of forcing trade-offs among tax and spending programs to determine which is the most effective or least costly. For spending programs alone, the present system of grouping spending programs into budget functions facilitates these comparisons and trade-offs, even though the budget functions serve only as nonbinding targets. Duplication and overlap become more apparent when programs must be considered together, and increases in programs within a function tend to come at the expense of other programs within the same function. The exclusion of tax expenditures from these budget functional controls makes it more difficult to identify and pursue opportunities for efficiencies and cost savings.

If both spending programs and tax expenditures were considered together, the Congress could better determine whether there is avoidable overlap and duplication when, for example:

- Residential energy conservation is subsidized by tax credits from one agency and grants and loans from another;

- Construction of low- and moderate-income rental housing is subsidized by rent and interest subsidies from the Department of Housing and Urban Development and by tax subsidies in the form of accelerated depreciation, immediate write-off of construction period interest and taxes, tax-exempt bonds, and special treatment of capital gains;

- The Interior Department provides direct grants for historic preservation and helps to administer separate tax incentives for the same purpose;

- Both the targeted jobs tax credit and the Job Corps seek to provide jobs for hard-core unemployed youth; and,

- Both the Export-Import Bank and the Domestic International Sales Corporation (DISC) tax provisions subsidize U.S. exports.

If the goal is to control the use of tax expenditures to allocate resources, some system that requires them to be considered in conjunction with related direct expenditure and loan programs is necessary. And for the system to be meaningful, there must also be incentives to make trade-offs. Reductions in tax expenditures must be directly translatable into something that those involved in the process find desirable, and increases in tax expenditures must involve some costs.

Under current procedures, reductions in tax expenditures can provide benefits in the form of lower deficits and increased opportunities for rate reductions or other more general tax cuts. Increases in tax expenditures have corresponding costs, adding to the deficit and reducing opportunities for general tax cuts. Trade-offs of this kind can be achieved without involving any committees other than those with jurisdiction over taxes.

To go beyond this, however--to set up direct trade-offs between tax expenditures and related spending or loan programs--other committees with jurisdiction over those programs must be involved. In such an expanded system, reductions in tax expenditures could permit increases in related spending programs, and increases in tax expenditures could require reductions in related spending programs. The following sections describe some of the ways in which such a system might work, and analyze the arguments for and against such an extension of the budget process. The approach that is outlined is conceptually similar to the Canadian "envelope" system for controlling tax expenditures, which is described in more detail in the next chapter.

Involvement of Spending Committees. The obvious starting point for any system involving the spending committees in the consideration of tax expenditures would be to include a breakdown of tax expenditures by budget function in the budget resolution, and then allocate the tax expenditures in each function to the committees with jurisdiction over analogous spending programs.

A full-scale system might then require spending programs within the jurisdiction of the spending committees to be reduced whenever the tax committees approved a new or increased tax expenditure in the same category. Correspondingly, a spending committee could recommend to the tax committee that tax expenditures assigned to the spending committee be reduced and, if the tax committee agreed, spending programs within the spending committee's jurisdiction could be increased by the same amount.

There are two conceptual problems with such a system, however. First, not all tax expenditures fit neatly within the jurisdiction of a particular spending committee. The tax expenditures for accelerated depreciation, the investment tax credit, and capital gains, for example, provide incentives for a wide range of different types of investments. There are no truly comparable spending programs, so it is far from clear which spending committees, if any, should bear the costs of increases in such tax expenditures or benefit from their reduction.

Second, the Congress might prefer that the revenue from any reduction in tax expenditures be used to reduce the deficit or fund a more general tax cut rather than to increase spending. Similarly, the Congress might prefer that increases in tax expenditures be used to provide increased total resources for a particular purpose, to be financed through a higher deficit or increased taxes elsewhere.

These considerations suggest that any system for involving spending committees in the consideration of tax expenditures should be a fairly ad hoc one, at least at the outset. Decisions would have to be made on a case-by-case basis about whether, for example, a particular tax expenditure was analogous enough to existing or proposed spending programs to require a direct trade-off, and whether a reduction in a particular tax expenditure should be used to finance an increase in related spending programs, a general tax cut, or a reduction in the budget deficit.

The initial decisions on these issues could be made by the Budget Committees, subject to approval by the full House and Senate.[9] There are a variety of ways in which the Budget Committees could seek to involve the spending committees in selected decisions on tax expenditures, including the use of reconciliation, referral of new or increased tax expenditures to the spending committees, and recommendations from the spending committees for changes in existing tax expenditures. Experimentation with different procedures would be consistent with the Budget Committees' responsibility, as set out in the Budget Act, "to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays." (Sections 101 and 102) Some of the possibilities are described below.

Reconciliation. One mechanism for forcing such trade-offs could be the reconciliation process that the Congress now uses to reinforce budget resolutions by requiring committees to reduce outlays or increase revenues by specific amounts by changing programs and laws within their jurisdiction. A reconciliation directive could go jointly to the tax committees and the committees with jurisdiction over the spending programs in which cutbacks are sought. The committees involved could be given a target for total reduction in the deficit, with the distribution of that amount between

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9. Other possible initial decisionmakers include the House Committee on Rules or the House and Senate Parliamentarians. The kinds of decisions involved, however, would require judgments about issues of fiscal policy and resource allocation rather than the application of formal rules to particular circumstances. They are thus more like other decisions that the Budget Committees must make than they are like Rules Committee or Parliamentarian decisions.

reductions in direct spending and tax expenditures left to the committees involved.

This could begin with tax expenditures that are very closely related to spending programs. The exclusion from tax of Social Security benefits, railroad retirement benefits, workmen's compensation, veterans' disability compensation, and part of unemployment insurance benefits are tax expenditures that the Congress probably took into account to varying degrees in setting existing benefit levels. These tax expenditures could well be considered in conjunction with proposals to cut back spending on those programs. Instead of applying some form of across-the-board cutback or income test to Social Security or workmen's compensation benefits, for example, those benefits could be made subject to tax.

Given the inevitable difficulties in coordinating the activities of two different committees, such a procedure might begin with spending programs that are already within the jurisdiction of the tax committees. There were some precedents this year for trade-offs of this kind. The Tax Equity and Fiscal Responsibility Act of 1982 contained a provision authorizing payment of additional weeks of unemployment compensation benefits, to be financed by reducing the income levels below which unemployment compensation benefits are tax-free from $25,000 for joint returns and $20,000 for single returns to $18,000 and $12,000, respectively. Since the unemployment compensation program is under the jurisdiction of the tax committees, the offset could be handled with no jurisdictional problems. The Senate Budget Committee also considered this year a proposal that would have required the tax committees to achieve $40 billion in Social Security savings over the fiscal year 1983-1985 period either by increasing taxes or reducing benefits. Again, both the spending program and the taxes were within the jurisdiction of the tax committees.

Referral of New or Increased Tax Expenditures. Another way to involve the spending committees in the consideration of tax expenditures would be to require that all legislation providing for new or increased tax expenditures approved by the tax committees be referred to the committee or committees with jurisdiction over analogous spending programs.[10] Again, since some tax expenditures, like accelerated depreciation, are not

10. The Rules of the House of Representatives already provide authority for the nontax committees to review tax issues on a less formal basis: "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 . . . ." (Rule X 2.(d))

closely related to any particular spending programs, this referral process would probably have to be done on a selective basis, with the initiative perhaps coming from the Budget Committees.

For any new or increased tax expenditures referred to them, the spending committees could recommend approval, approval with modifications, or disapproval. Its recommendation would then accompany the bill to the floor. This could be merely an advisory procedure, or it could go further, following the pattern of Section 401 of the Budget Act, which requires review by the appropriations committees of bills providing new spending authority for entitlement programs. Section 401 allows the appropriations committees to amend bills referred to them under this procedure, but only amendments limiting new spending authority are permitted, since the purpose of the section is to limit open-ended spending commitments. For the same reason, appropriations committee review of reductions in existing spending authority is not required. If the Congress wanted to use spending committee review of tax expenditures solely as a device to limit tax expenditures, this same pattern could be followed; the spending committees could be allowed to amend tax expenditure provisions referred to them, but only in ways that would limit the revenue loss, and reductions in existing tax expenditures would not have to be referred to the spending committees. If the Congress wanted to give this tax expenditure review even more bite, it could provide that spending committee approval of a new or increased tax expenditure would entail a corresponding reduction in that committee's spending allocation if the tax expenditure increase was ultimately adopted by the full Congress.

If, on the other hand, the Congress wanted to allow spending committees to recommend increases in tax expenditures, or to use the revenues raised by reductions in tax expenditures to fund spending programs within their jurisdiction, a procedure like that described below could be followed.

<u>Recommendations by Spending Committees</u>. The spending committees could be allowed to recommend to the tax committees that a tax expenditure included in the spending committee's allocation be reduced or eliminated, and if the tax committee agreed, the spending committee's spending allocation could be increased. Spending committees faced with the need to reduce spending on programs within their jurisdiction might recommend that tax expenditures allocated to them be reduced instead. The energy committee, for example, might recommend that the home insulation tax credit be reduced in order to provide additional funding for grant and loan programs for home insulation. The public works committee might recommend that tax-exempt industrial revenue bonds be limited in order to provide more funding for Economic Development Administration

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programs. The banking committee might recommend that the new tax provisions allowing more rapid depreciation for commercial and residential real property be scaled back in order to provide more funding for low- and moderate-income rental housing.

If, however, the Congress's main concern was to reduce the deficit or to free more resources for taxpayers' own use, it might prefer that any amount saved by reducing tax expenditures be used to cut the deficit or to fund general tax cuts instead of being used by the spending committees to fund alternative spending programs. The Budget Committees could perhaps act as the initial arbiters on this issue, with the final decision made by the full House and Senate.

Arguments For and Against Involving Spending Committees. The arguments for more direct involvement of the committees with jurisdiction over analogous spending and loan programs in the control of tax expenditures rely mainly on those committees' greater expertise in the related program areas. This expertise might enable them to give tax expenditure proposals a more critical evaluation. They could determine more readily whether a tax expenditure would duplicate or overlap with similar spending programs, and might be able to suggest ways of coordinating the administration of tax expenditures with that of similar spending programs. They might also help to prevent those who are unable to obtain federal assistance through grant or loan programs from making end runs around the budget process and obtaining it through tax expenditures.

The argument on the other side is that the spending committees have long-standing relationships with the beneficiaries of many of these programs and with the agencies that administer them. These relationships might lead the spending committees to act as advocates for the allocation of more resources to these areas, rather than as skeptical critics. They might welcome the opportunity afforded by tax expenditures to provide assistance to groups or causes they favor in a way that is less visible and less subject to budget controls. If a system for involving spending committees in the review of tax expenditures is to serve the goal of budgetary restraint, therefore, the expansion of tax expenditures must not be costless for them. The procedures outlined above would generally limit opportunities for cost-free increases in tax expenditures. Reconciliation has been used almost exclusively to cut rather than increase spending and tax expenditures. Approval by the spending committees of any new or increased tax expenditures referred to them could entail some costs if related spending programs in their jurisdiction were threatened with cutbacks if approval was granted. Recommendations by the spending committees for increases in tax expenditures could undermine the rationale for related spending programs within their jurisdiction by raising the question of why the spending committees think those programs are less effective than tax expenditures.

Lessons From Credit Budgeting

The technical, jurisdictional, and other questions that might arise in any attempt to expand the controls of the budget process over tax expenditures suggest that any new procedures be tried in a limited and experimental way for a period of time before being fully implemented. This is especially important at a time like the present, when the Congress is already struggling with two major extensions of the budget process--reconciliation and credit budgeting. Adding a full set of controls over tax expenditures right away could overload the system.

The experience over the last few years with a credit budget may be a useful guide to gradual implementation. The budget resolution for fiscal year 1981 included only aggregate nonbinding totals for direct loans and primary and secondary loan guarantees. The resolution for fiscal year 1982 went a little further, breaking down the targets by budget function, but there was no allocation of credit limits to committees with jurisdiction over loan programs. In addition, the Congress enacted some limitations on new loans and loan guarantees through the appropriations process for fiscal years 1981 and 1982.

In the budget resolution for fiscal year 1983, the Congress for the first time provided for binding limits on new direct loan obligations and new primary and secondary loan guarantee commitments for fiscal year 1983. Also for the first time, these limits on new credit were allocated to the Senate and House committees with jurisdiction over new credit authority. The resolution also provided that, with a few exceptions, all legislation providing authority for new direct loan obligations or loan guarantee commitments must specify that the credit is available only to the extent that it is provided for in separate appropriations bills, thereby eliminating new open-ended credit authority for most programs.

A similar procedure could be followed with tax expenditures. The Congress could start with an annual limit on total increases in tax expenditures from new legislation. This could be supplemented with function-by-function breakdowns for informational purposes, and non-binding allocations to the spending committees. The Congress might then experiment with the referral of new or increased tax expenditures to spending committees that have very closely analogous spending programs within their jurisdiction. Approval might or might not entail reduction in the committees' spending allocations.

The Congress could also experiment with ways of reducing existing tax expenditures, either at the same time as controls on new and increased tax expenditures were tested, or after experience was gained with these more limited controls. The credit budget system has concentrated first on limiting new loans and guarantees, and the Canadian envelope system described in the next chapter has been applied to all direct outlays but only to new tax expenditures. The major reason for limiting any new control system to new or increased tax expenditures is that people have not yet come to depend on such provisions or made important decisions on the expectation that they would continue. Thus it would be less disruptive and controversial to cut them back or eliminate them.

Two of the procedures outined earlier--reconciliation and spending committee recommendations for changes in tax expenditures--are aimed primarily at making changes in existing tax expenditures. They also lend themselves to a selective approach, however, so that it might be possible through these procedures to deal with a few existing tax expenditures whose reduction or elimination might be less burdensome or contentious.

CHAPTER IV. TAX EXPENDITURES AND THE BUDGET PROCESS IN CANADA

In the late 1970s, worsening economic conditions in Canada, as in the United States and Europe, called for a more disciplined approach to government spending in order to cope with larger deficits, persistent inflation, and rising unemployment.[1] In 1979, using institutional reform to help allocate its limited resources more carefully, the Canadian government unveiled the Policy and Expenditure Management System. Deflating the ballooning cost of tax expenditures and increasing ministerial accountability

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1. During the late 1970s, Canada faced growing deficits. While expenditures averaged around 20 percent of GNP from 1974 to 1980, revenues declined from about 19 percent to about 16 percent of GNP, mostly the result of indexing the income tax for inflation. The deficit grew from $1.7 billion (1.2 percent of GNP) in fiscal year 1974-1975 to $12.2 billion (5.3 percent of GNP) in 1978-1979, then declined slightly to $11.5 billion (4.4 percent of GNP) in 1979-1980 and grew again in 1980-1981 to $12.7 billion (4.3 percent of GNP). The Canadian Department of Finance, The Budget in More Detail (November 12, 1981), Tables 1.2, 1.3, and 9.2, and Budget Papers (June 28, 1982), Table 2.1. (Dollars referred to in this chapter are Canadian dollars.)

   At the same time, Canadian inflation averaged about 9 percent a year from 1973 to 1980 (CPI percentage change) and the unemployment rate averaged about 7 percent for the same years. (The Canadian Department of Finance, Budget Papers (June 28, 1982), Table 1.1.) The recent worldwide recession has left the Canadian economy severely strained. The year-over-year increase in the CPI for August 1982 was 10.6 percent and the unemployment rate, seasonally adjusted, was 12.2 percent. The Canadian Department of Finance.

   Note: The exchange rate for the Canadian dollar in terms of the U.S. dollar varied over the period. It was 1.00 in 1973 (annual average) and hovered around that point until it started to decline in 1977 (annual average, 0.94). It was 0.85 (annual average) in 1979, 0.84 (period end value) in 1981, and 0.78 (period end value) as of June 1982. Statistics Canada, Canada Year Book 1980-1981, Table 23.39, p. 879 and Canadian Department of Finance, Budget Papers (June 28, 1982), Table 1.2.

for direct spending and tax expenditure decisions were two parts of the goal of improving the expenditure process. Policymakers did not attempt to reduce tax expenditures below their 1979 level, but rather to curtail or at least discourage further discretionary increases in tax expenditures. The motivation for the integration of tax expenditures into the spending review process was to give cabinet ministers a better perspective on the policy trade-offs between direct spending and tax expenditure approaches to particular issues. For example, some tax expenditures may efficiently pursue policy goals such as economic stabilization, but others may not be the best policy tools available.

The Policy and Expenditure Management System, usually called the "envelope system," reorganized the budget decisionmaking process by assigning all of the government's direct spending and new tax expenditure programs to ten policy areas, or "envelopes." The combined direct spending and tax expenditures in each envelope are required to stay within a spending limit set for each fiscal year. Loan guarantees and the use of regulatory and legislative devices such as user fees are also included in the envelopes. Tax expenditures in place before the reform are not assigned to envelopes; only newly created ones are subject to the fiscal discipline imposed by the trade-off of options within each envelope. As a result, the bulk of the revenue loss from all of Canada's tax expenditure provisions is not touched by the new system. Of course, certain spending programs may also remain safe from cuts despite their annual review by envelope committees. The efficiency of most tax expenditures as policy tools is still not monitored as closely as the performance of direct spending programs, however, and the revenue cost of tax expenditures is less often subject to debate.

The envelope system has, nonetheless, proved to be an effective deterrent to additional tax expenditures. Canadian policymakers recognized the political cost of removing tax subsidies once they were in place, and they wanted to reduce the temptation to create new ones. The system was structured so that new tax expenditures, like increases in direct spending, would reduce the funds available for allocation to each department or agency as well as the government as a whole. In other words, the new system effectively eliminates the possibility for a department to propose a program for its constituency that would be paid for through the "back door"--that is, the tax system--leaving the department's direct spending budget untouched.

CANADA'S BUDGET PROCESS: HOW THE ENVELOPE SYSTEM WORKS

As in the United States, both the Canadian executive and the legislative branches of government play a role in the budget process, but in

Canada the Cabinet and the central agencies make all the detailed decisions. Parliament can only accept or reject the final product, knowing that a no vote must bring down the government. Once there is a vote of confidence for a proposed budget (and Parliament thus accepts the budget in principle), however, Parliament often suggests minor modifications as it reviews the specific budget measures requiring changes in the law. Good examples are the modifications made to the November 1981 budget during the spring of 1982.[2]

Also, the division between the executive and the legislative branches of government is not as sharp in Canada as in the United States; all the cabinet ministers, including the Prime Minister, are elected members of Parliament, appointed to the various ministries after each election when a new government is formed. Instead of the checks and balances provided by a separately elected executive, there is a political imperative to maintain solidarity within the ruling party in Parliament if that party's policies are to appear viable and popular at the time of the next general election.

History

The Policy and Expenditure Management System was the product of years of struggle with an inadequate and outdated budget process. In the 1960s, the government recognized the need for increased coordination between spending decisions and declared national priorities. Previously, cabinet committees had only been formed on an ad hoc basis to review specific problems, but in the late sixties the Cabinet Committee on Priorities and Planning began setting annual expenditure and revenue levels

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2. After the November 12, 1981 budget was announced, the Minister of Finance, Allan J. MacEachen, agreed to some minor changes after he received representations from interested government officials, lobbyists, and academics. Transitions to the new measures were made easier and restrictions on retirement plans, small business bonds, and the deductibility of interest expense were slightly modified. In addition, the minister listed several matters to be dealt with in parliamentary committees including rules relating to corporate reorganizations, the taxation of whole life insurance, charitable foundations, retirement allowances, and work in progress. He made it clear, however, that he was not altering the fundamental principles underlying his budget, "not today nor at any time during the consideration of the necessary legislation." Press Release from the Office of Honorable Allan J. MacEachen, Minister of Finance (December 18, 1981) (No. 81-127).

to guide decisionmaking. In the mid-1970s, the government proclaimed its general intention to keep the rate of growth of government spending below the rate of growth of the whole economy. Towards this end, the government began to work within the bounds of informal spending ceilings set by the Committee on Priorities and Planning. Government spending decisions were gradually becoming more integrated with the central policy planning process.

In the late 1970s, the financial requirements for statutory payments to the provinces (medical and hospital services and education) and to individuals (family allowances and old age security), combined with continued indexing of the personal income tax, placed ever growing demands on constrained government spending. This pressure to spend more during a time of fiscal restraint found an escape hatch: tax expenditures. From 1976 to 1979, the rate of growth of tax expenditures was about 50 percent higher than the rate of growth of direct spending.[3] It soon became clear, however, that the tax system could not be used continually to deliver programs that were really replacements for direct spending programs. In addition, multi-year planning was needed so that the cuts and reallocations forced by tight expenditure ceilings could be made with a better understanding of policy priorities. The envelope system was devised to deal with these problems. Policymakers felt that the new system would help to promote more realistic policy objectives and more efficient resource allocations, thereby increasing public support for the government's policy aims and choices.

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3. Allan J. MacEachen, former Minister of Finance, "Integration of Tax Expenditures into the Government Fiscal Management System," Bulletin for Fiscal Documentation, International Bureau of Fiscal Documentation, vol. 36(8-9), (August-September 1982), p. 348. Also reprinted in the Congressional Record (September 27, 1982), p. S12318. In its 1980 Tax Expenditure Account, the Department of Finance provided estimates for about half of the listed personal and corporate income tax expenditures. Those estimated grew about 65 percent between 1976 and 1980, from about $19 billion to about $30 billion. About two-thirds of that increase took place between 1976 and 1978, with the rate of increase slowing during 1979 and 1980 as the envelope system was phased in. In real terms, tax expenditures increased on average about 4 percent a year over the five-year period, but almost all of this increase took place before 1979. While these totals leave out many important unestimated tax expenditures, they do give at least some rough indication of the rate of growth of tax expenditures in Canada. The Canadian Department of Finance, Tax Expenditure Account (December 1980), Table 1.

The Envelope System

Under the new system, each department or spending program is assigned to one of ten envelopes so that expenditures for related purposes may be compared and traded off when limited resources force reductions. Four policy-area cabinet committees oversee eight of the envelopes (acting like Congressional authorization and appropriation committees) and one coordinating committee (Priorities and Planning) directly oversees the other two (see Table 6). The Committee on Priorities and Planning (the inner circle of the Cabinet, chaired by the Prime Minister) works with the Department of Finance (analogous to the U.S. Treasury), the Treasury Board (the cabinet committee in charge of administration of the executive branch), and the cabinet committees responsible for the envelopes to determine both individual envelope and total spending ceilings over the coming five-year period.[4] The Treasury Board is supported by a staff called the Treasury Board Secretariat, somewhat analogous to the Office of Management and Budget. The out-year targets are reviewed each year when the fiscal plan is re-set, and it is recognized that adjustments may be necessary in light of a changed economic climate. The two levels of cabinet committees, one coordinating and one subject-oriented, are linked because the chairmen of each of the policy area committees are also members of the Committee on Priorities and Planning.

A central reserve has also been established to cover cost overruns of the large statutory programs (similar to the "entitlement" programs in the United States) that result from fluctuating economic conditions or erroneous estimates. Like entitlement programs, these programs are required to provide services to all those who meet the statutory eligibility requirements. Many of them are also indexed for inflation, or provide increased benefits when the unemployment rate reaches a certain level. They are thus highly vulnerable to cost overruns when increases in inflation or

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4. Tax expenditures are considered when the envelope amounts are determined as well as in later policy choices. "These decisions would take into account, in a broad way, the amounts of tax expenditures in various policy areas. There would not, however, be explicit totals or targets set for tax expenditures by Priorities and Planning. The purpose of taking account in this fashion is to avoid setting priorities by looking at only one side of the government's fiscal operations." The Prime Minister's letter to Ministers, July 3, 1980, "Procedures for the Integration of Tax Expenditures into the Policy and Expenditure Management System," included as Appendix B in Government of Canada, Privy Council Office, "Policy and Expenditure Management System: Envelope Procedures and Rules" (July 1981).

TABLE 6. THE CABINET COMMITTEES AND THE TEN ENVELOPES OF CANADA'S POLICY AND EXPENDITURE MANAGEMENT SYSTEM

Cabinet Committee on Priorities and Planning

1. Fiscal Arrangements
2. Public Debt

Cabinet Committee on Social Development

3. Justice and Legal Affairs--consists of those government programs aimed at maintaining and enhancing justice and protection of the individual. Ninety percent of the expenditures are allocated to the two major programs, Royal Canadian Mounted Police and Correctional Services.

4. Social Affairs--consists of all social programs including major statutory programs that involve direct payments to individuals from the federal government (income maintenance), or payments to support essential social services through arrangements with the provinces (Established Programs Financing), as well as cultural programs.

Cabinet Committee on Economic Development

5. Economic Development--consists of those government programs that are directly related to the key economic sectors, including resources, manufacturing, and tourism, as well as horizontal policy activities such as import-export policy, regional development, and transportation.

6. Energy--includes energy and energy-related programs, including the government's planned new initiatives.

Cabinet Committee on Government Operations

7. Services to Government--includes those programs and activities of government whose primary purpose is to provide support and services to program departments or which are primarily service-oriented (for example, Post Office). It also includes Executive Functions (mainly central agencies) and agencies that report to Parliament but for which the government retains a financial and management responsibility.

8. Parliament--a separate envelope has been defined for the Senate, the House of Commons, and the Library of Parliament.

Cabinet Committee on Foreign and Defense Policy

9. External Affairs and Aid--includes external affairs and assistance to developing countries.

10. Defense--both capital and operating expenses for the Department of National Defense.

SOURCE: Government of Canada, the Privy Council Office, The Policy and Expenditure Management System (March 1981), pp. 10-11.

unemployment lead to increases in spending. A total of 26 government programs included under 16 budget functions have access to the central reserve. In the November 1981 fiscal plan, the central reserve was set at about 1.0 percent of total government outlays, or $500 million, and scheduled to grow as government outlays grow over the next five years. The figure was readjusted to $800 million as the deepening recession forced outlay estimates upward. (Dollars referred to in this chapter are Canadian dollars.)

In addition, any program may be eligible for additional funds from the "operational reserves" allocated to each envelope. A program may draw from the operational reserve of its envelope when the program's cost overrun is the result of factors other than direct statutory requirements. For example, if demographic changes, economic growth, or other external factors influencing the demand for government services increase the administrative or other costs of running a program, these additional costs may be funded out of an operational reserve. Increased costs resulting from changes in policy, however, may not be funded out of these reserves. The Treasury Board reviews each application on a case-by-case basis to judge whether a given cost overrun resulted from policy decisions or external circumstances. Typically, these operational reserves equal roughly 1 to 2 percent of an envelope's total allotment for a given year.[5]

Proposed new programs, whether direct spending or tax expenditures, must compete for funding when each committee portions out its "policy reserve"; policy reserves hold the funds that are not committed to existing programs and are available for new or expanded programs. Not all envelopes are granted such an extra reserve, however. The government may decide that a given budget area should be cut back, or at least not increased. A committee may also create policy reserve funds by reducing or eliminating existing programs. In 1980, the Economic Development envelope was deemed an important priority, and it received new policy reserves of $250 million per year for the next three years, while the Social Affairs envelope (the other major spending area) was granted no additional policy reserve at all.[6]

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5. Government of Canada, Privy Council Office, "Policy and Expenditure Management System: Envelope Procedures and Rules" (July 1981), pp. 6-7 and Appendix A.

6. Sandford F. Borins, "Ottawa's Expenditure Envelopes: Workable Rationality at Last?" G. Bruce Doern, ed., How Ottawa Spends Your Tax Dollars, 1982, (Toronto: James Lorimer & Co., 1982), p. 67.

Existing programs are also subject to scrutiny each year, although this is mainly to assess the influence of changed economic conditions upon them. Aside from reassessing the impact of a changed economy, a committee may also want to reassess existing programs in light of changed priorities. It may be that a reduction is desired to create policy reserves for a new program.

The projected rate of growth of ongoing programs largely determines the projected growth of each envelope. It is not just a mechanical process, however; there is some room for internal negotiation. The Social Affairs envelope again received no additional policy reserve in 1981, but during the year the Social Development Committee ministers argued effectively for their cause, emphasizing that Social Affairs is an especially inflation-prone envelope. The ministers presented a clear outline of the envelope's need for increased funding if only to maintain previous levels of service. Because they displayed a willingness to choose among options when pressed by difficult economic conditions and because the statutory requirements of many programs left little room to maneuver, the Committee on Priorities and Planning allocated more funds to the envelope. The five-year real growth estimate for the Social Affairs envelope was raised from 30 percent, where it had been set in 1980, to 40 percent in 1981.[7]

Roles of Various Agencies

The staff support for the envelope committees is structured to provide detailed information from the departments, a general strategy for each policy sector, and an overview of national priorities. As an automatic member of the appropriate envelope committee, each department's minister voices his programs' requirements and reports on their performance with the help of his department staff. The two ministries of state--one for economic and regional development (MSERD) and the other for social development (MSSD)--provide additional staff support as does the Privy Council Office (PCO). (The Privy Council Office is one of two staffs responsible to the Prime Minister. The Prime Minister's Office concentrates mainly on political and party issues--insofar as they can be separated--and the PCO oversees the rest of government policy.) On the most general level, the Cabinet Committee on Priorities and Planning charts the direction of government policy, which is why it is also responsible for setting the amounts for each envelope.

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7. Borins, ibid., pp. 67-68.

The policy committees in charge of each envelope manage the allocation of policy reserves and decide on proposals to change the existing base of current programs. As the government's administrator, however, the Treasury Board must evaluate any proposals that involve cost adjustments to current programs. The line dividing policy changes and cost adjustments can be blurred, and in the case of uncertainty, the Minister of Finance and the President of the Treasury Board together determine which agency should handle a given proposal. Disputes could occur because the policy committes may be tempted to label as a cost adjustment what is really a future expansion of an ongoing program. This would allow the committee to increase its program base for coming years without having its policy reserve reduced to account for the cost of the increase.

Once the policy committees have made all their decisions, the machine has been set in motion. The next step is to keep track of all spending and of the envelope totals over the course of the fiscal year. Envelope accounting is not a simple task. The Treasury Board is the master scorekeeper; it keeps track of all the committees' cutting and spending decisions, checks that all budgetary predictions are arrived at consistently, and decides how to treat proposals for spending that do not fit neatly into the system (usually after conferring with the Department of Finance). Ambiguous items such as nongovernment borrowing by publicly owned corporations and the remission of tariffs on imports in certain cases are examples of possible avenues that may take spending outside of the envelope system completely. Since the envelope system is still evolving, however, future proposals of these kinds may be treated by the envelope policy committees in a manner similar to the present approach for tax expenditures. Other alternate routes are the special allocations for major projects received directly from the Committee on Priorities and Planning. These detours are not mere technicalities when considered all together. If the volume of exceptions were to grow large enough, ministers would have little incentive to continue making the hard choices needed to promote fiscal discipline through the envelope system.[8]

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8. Borins notes that special allocations could pose a serious threat to the success of the envelope system and he lists two recent allocations as examples of a trend: C$350 million to promote industrial restructuring and manpower training and C$2 billion for the Western Development Fund. But his argument rests more on politics than on precedent: "The question of special allocations also has strong political overtones. Allan MacEachen, the Minister of Finance, whose departmental role would lead to resisting such allocations, is also one of the main contenders to replace Prime Minister Trudeau. Therefore,

Tax Expenditures and the Envelope System

In Canada, not much attention was focused on the tax expenditure concept until the mid-seventies. While the United States has published an annual tax expenditure list since 1967, Canada's first tax expenditure account came out in 1979. The 1980 account gave historical data back through 1976. About 75 percent of the revenue loss from tax expenditures that have been estimated (estimates are provided for only about half of the tax expenditures listed) is under two budget functions--economic development and support and health and welfare. The concentration of direct spending is also very high in these two areas, a reflection of the government's policy priorities for economic and social development. About 80 percent of the quantifiable increase in revenue loss from tax expenditures between 1976 and 1980 resulted from increases under these two budget functions. The annual rate of increase for all estimated tax expenditures dropped dramatically in 1979 compared to 1978, from about 20 percent to about 7 percent, and rose to about 11 percent in 1980. The switch to the envelope system helped policymakers to slow the rising cost of both individual and corporate tax expenditures at a time when they felt fiscal restraint was vital.

Tax expenditure programs are usually less visible to the public; a department's minister reaps more political benefits from a direct spending program because he is more closely identified with it. Then why the significant increase in tax expenditures during the 1970s? The answer is that, before the envelope system was instituted in 1979, the creation of a tax expenditure represented no immediate budgetary cost to the ministers representing departments or agencies whose constituencies received the benefits. Once direct spending or tax expenditure programs cost the same amount to the Cabinet policy committees, ministers were more likely to favor the type of spending that had higher political benefits.

The Department of Finance plays a crucial role in the choice between direct and tax spending, so the ministers representing other departments and agencies must take into account the likely position of the Minister of Finance when they propose changes in tax expenditures. The Department of Finance has jurisdiction over the entire tax system and its use. It may introduce a tax expenditure measure out of a concern for general economic stabilization or for other considerations such as a department's request for a special provision. No matter where the proposal originated, the Depart-

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(Footnote 8. Continued)
MacEachen might be willing to make some special allocations if he can claim credit for them, or if they can be used to win a minister's support in the leadership race." Borins, ibid., p. 83.

ment of Finance must approve the measure. The envelope system changes the manner in which departments lobby for tax expenditures, but it does not take away the Minister of Finance's power to create or revoke any tax expenditure unilaterally. It is assumed, however, that the Minister of Finance must win the agreement of the appropriate department's minister before he cuts a tax expenditure closely identified with a department.

The decrease in revenue loss from such a cut may or may not be credited to the department's envelope to be disbursed in another manner. Whether tax expenditure reductions are credited to policy reserves depends upon how much the repealed tax expenditure was targeted toward policy goals beyond those of a particular department or agency. Tax subsidies that were directed towards a very limited policy goal and that could have been just as easily structured as departmental direct spending programs are more likely to be considered policy tools of a particular department or policy committee. A repeal of this kind of tax expenditure is more likely to be credited to an envelope instead of the general fund. Negotiation between the program departments and the Department of Finance thus remains an integral part of the decisionmaking process for spending.

TWO RECENT BUDGETS AND CHANGES IN TAX EXPENDITURES

The last two budgets proposed by Allan J. MacEachen, then Minister of Finance, provide evidence of Canada's recent effort to control tax expenditures. In the November 12, 1981 budget, tax-base broadening and a general tax cut were announced. With the restriction or repeal of several tax expenditures, the government hoped to increase the fairness of the tax system, to reduce the economic distortions which are unavoidably the product of tax expenditures, to increase the effectiveness of the tax expenditures still in place (because a smaller body of tax expenditures automatically implies that the remaining tax preferences are more special, that they are targeted more precisely, and that they are less likely to create unwanted interrelated effects which may be economically distortive); and last, but not least, to help reduce the government deficit. At the same time, tax rates were reduced, although the standard credit was also reduced for some taxpayers.

The base-broadening measures more than paid for the tax cut, according to projections. Revenues from the total tax package were projected to increase by $1.4 billion in fiscal year 1982-1983 and by $5.8 billion in fiscal years 1982-1983 through 1985-1986. (The Canadian fiscal year runs from April 1 to March 31.) For individuals, one tax expenditure was repealed, ten others were restricted or reduced, and three were expanded. For corporations, one tax expenditure was repealed, five were restricted or reduced, two were expanded, and one was added. These last three measures were aimed at helping small businesses.[9]

Most measures took effect as soon as they were announced on "budget night," although Parliamentary approval had not yet been given. To change or reverse an announced budget significantly would require a no confidence vote from Parliament, an extreme and unlikely response. Parliament may help iron out details of announced measures, however, and this in fact took place between November and June.

The June 1982 Budget

Given the economic hardships of a worldwide recession, the government's November revenue predictions proved to be quite optimistic. Facing a spiralling deficit, the June 28, 1982 budget most importantly announced caps on indexing the personal income tax and social security payments. There were few new tax measures that affected tax expenditures. Small businesses and homeowners received some benefit from two new tax expenditure provisions and the child tax credit was increased to offset a reduction in the family allowance program.[10] Generally, however, the government's effort in November to control tax expenditures stood firm.[11]

It is interesting to note that the tax expenditure changes announced in both the 1981 and 1982 budgets avoided the envelope system almost completely. Because the tax expenditure changes were considered to be aimed at bolstering the entire economy and reforming the tax system, envelopes were not credited either for reduced or increased revenue losses.

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9. The Canadian Department of Finance, Budget in More Detail (November 12, 1981), pp. 29-31.

10. The child tax credit provides a flat dollar amount per child (C$343 in 1982). It is refundable, so that families whose income tax is less than the amount of the credit still benefit in full, and it phases out at higher income levels. It was instituted in 1978 in conjunction with a reduction in direct spending under the family allowance program. The June 1982 budget act thus continues the pattern of using cutbacks in family allowances and increases in the child tax credit to target benefits more on lower-income families.

11. The Canadian Department of Finance, Budget Papers (June 28, 1982), p. 13.

The Minister of Finance has the power to guide macroeconomic policy without going through the envelope committee decisionmaking process, provided that his policy strategy has been approved by the Cabinet Committee on Priorities and Planning. Negotiation among the most powerful ministers--those who head the central agencies--occurs constantly, inside and outside the envelope committee meetings.

Since 1979, fiscal policy concerns and the increased visibility of tax expenditures have reinforced the discipline that the envelope system imposes on the creation of large tax expenditures. Growing deficits have made government leaders more critical of all types of government spending. Although most tax expenditures are still not touched by the budget process because they were in place before 1979, their impact on the government's financial position does not go unobserved. For a new tax expenditure to be approved, it must fit very well into the government's proclaimed list of national priorities which now stress economic growth and stabilization.[12] Of course, there is also a political risk if the public were to perceive any abuse of spending power. A tax expenditure that proves excessive or hard to defend could be turned back on the ruling party and used as a weapon by the opposition party in Parliament, and might ultimately cause problems in future elections.[13]

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12. Borins points out how government priorities may be subject to change as the next election draws near and the government in power is almost done with its mandate: "To some extent, the envelope system was introduced to promote awareness of future choices and to provide a constraint on the long-run growth of the federal budget. We can expect any government to succumb to temptations of changing its plans in order to bribe voters with their own money. Clearly that temptation would become even stronger in a minority government. In short, politics is politics, and the envelope system probably will not provide the discipline to 'rise above politics,' even if there is a general consensus against a rapid increase in spending." Borins, "Ottawa's Expenditure Envelopes," pp. 83-84.

13. For more on how the Canadian budget process generally works, both politically and structurally, see Douglas G. Hartle, The Revenue Budget Process of the Government of Canada: Description, Appraisal, and Proposals, Canadian Tax Foundation, Canadian Tax Paper No. 67, 1982; David A. Good, The Politics of Anticipation, School of Public Administration, Carleton University, 1980; and R. Van Loon, "Stop the Music: The Current Policy and Expenditure Management System in Ottawa," Canadian Public Administration (Summer 1981), Volume 24, Number 2, pp. 175-199.

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IMPLICATIONS FOR CONTROL OF TAX EXPENDITURES IN THE UNITED STATES

The Canadian parliamentary system of government is obviously much different from the United States system, and this leads to important differences in budget making. In Canada, the budget is prepared by the Prime Minister and the members of his cabinet, who are all members of the Parliament. The rest of the Parliament plays only a limited independent role, however. In the United States, by contrast, both the executive and the legislative branches play strong and independent roles in making up the budget. Some aspects of the Canadian system may be more directly applicable to executive than to Congressional budget making, but there are nonetheless several features of the Canadian budget process and its envelope system that are worth noting when considering possible changes in the way tax expenditures are controlled through the Congressional budget process.[14]

First, only tax expenditures created since 1979 are normally subject to the envelope system in Canada. Tax expenditures in existence before then are generally left undisturbed. As discussed in Chapter III, changes in existing tax expenditures tend to be harder to make, since people have come to depend on them and strong constituencies have often developed to defend them. The Canadian envelope system does contemplate review of existing tax expenditures put in place since 1979, however. Those in place before 1979 are reviewed only on an ad hoc basis, as they were before the

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14. The U.S. executive branch has already taken some steps toward considering tax expenditures and related direct spending programs together. The budget estimate guidance the Office of Management and Budget provides to executive agencies states that:

> Agencies will assure that their requests for budgetary resources reflect full and explicit consideration of the resources being made available by the Federal Government through tax expenditures. Before submitting proposals to OMB for new or modified taxes or tax expenditures, agencies must consult with the Office of Tax Analysis, Department of the Treasury. . . . In addition, agencies may be required to justify the continuation or reenactment of existing taxes and tax expenditures in the program areas for which they have primary responsibility. OMB Director David A. Stockman, Circular A-11, Section 13.2(j) (July 8, 1982), pp. 10-11.

envelope system was established. When the Minister of Finance exercises his prerogative to reduce a tax expenditure unilaterally, it is assumed that he will seek the consent of the minister heading the department that handles closely related spending programs. In some cases, the revenue raised from the cutback or elimination of such a tax expenditure might be used to fund additional spending programs or tax expenditures in the same envelope, in which case the envelope system would come into play. During a trial period, the Congress might wish to consider only new tax expenditures with spending programs as a way to phase in slowly a modification of the Congressional treatment of tax expenditures in the budget process.

Second, the Canadian procedure provides for review of reductions in tax expenditures by ministers of departments with closely related spending programs. A similar procedure might be appropriate for the U.S. Congressional budget process. It was suggested in the last chapter that if the Congress' principal goal is to limit tax expenditures, then only new or increased tax expenditures should be referred to the spending committees with jurisdiction over related spending programs, with approval by the spending committees perhaps entailing a reduction in related spending programs. If, however, the Congress also wanted to permit the spending committees to protest reductions in tax expenditures, or to request increases in related spending programs if tax expenditures were reduced, this Canadian procedure could be followed. There has not yet been enough experience with this feature of the envelope system to determine whether it might place unwanted roadblocks in the way of overall budget discipline.

Third, the Canadian experience indicates that a central arbiter is needed to decide crucial questions such as whether tax expenditure changes are designed to serve primarily macroeconomic and tax policy goals, and thus need not be handled through the envelope system, or whether they are so closely related to the goals of a particular spending department that consideration in the envelope system is required. In Canada, decisions of this kind are made jointly by the Minister of Finance and the President of the Treasury Board. A similar question that might arise in the United States is whether the amount raised from reducing an existing tax expenditure should be assigned to a spending committee to fund a program within its jurisdiction, to the tax committee to fund a more general tax reduction, or be used instead to reduce the deficit. In the Congressional budget process, this central arbiter's role could be performed by the Budget Committees, subject to review by the full House and Senate.

Fourth, the fact that the Canadians have prepared revenue loss estimates for only about half of the identified tax expenditures could limit the long-term effectiveness of their tax expenditure control system. Tax expenditures have less visibility and are less likely to be subject to effective control if actual estimates are not provided. Out of sight, out of mind. All the unestimated Canadian tax expenditures are in the pre-1979 category, which is generally not subject to the envelope system, so the absence of estimates does not impair the current operation of the system. Future expansion of the system to cover pre-1979 tax expenditures is inhibited, however. The United States, despite the difficulties of definition and measurement discussed in the last chapter, has a much more comprehensive and reliable information base for tax expenditure control than does Canada.

Finally, beyond the question of tax expenditure control, the central reserve and the operational reserves that Canada has established in its envelope system to cover cost overruns that result from fluctuating economic conditions or erroneous budget estimates suggest one way to deal with the rapidly changing economic and budget estimates that have made budget control so difficult in this country. Given the fact that economic forecasts and budget estimates can never be completely accurate, this kind of reserve for contingencies might be a useful way to avoid the disappointed expectations that occur when budget plans are made on the basis of assumptions that turn out to be wrong. While the Canadian central and operational reserves represent only about two percent of total outlays, and are thus not large enough to cover major economic fluctuations, they can help to facilitate more orderly budgeting and program operations.

APPENDIXES

APPENDIX A. TAX EXPENDITURE ESTIMATES FOR FISCAL YEARS 1982-1987

This appendix gives tax expenditure estimates by budget function and subfunction for fiscal years 1982-1987 (see Table A-1). These tax expenditure estimates are identical to those prepared by the Joint Committee on Taxation (JCT) and published in March of this year. As shown in Table 5 in Chapter III, there are substantial differences between these estimates and those prepared by the Administration as part of its budget submission for fiscal year 1983.[1] The Administration in its budget submissions also calculated the "outlay equivalents" of all tax expenditures, that is, the amount of budget outlays that would be necessary to provide an equivalent amount of subsidy to tax expenditure recipients. The outlay equivalents are generally higher than tax expenditures, since recipients normally must pay tax on outlay subsidies but not on tax subsidies. The concept of outlay equivalents is discussed in more detail in Special Analysis G of the Administration's budget, and on pp. 38-40 of CBO's September 1981 report on tax expenditures.[2]

The estimates in this appendix are standard revenue loss estimates. They are for the law in effect on December 31, 1981. No changes in the law enacted subsequently are reflected in these estimates, although Chapter II summarizes the changes in tax expenditures enacted thus far in calendar year 1982.

Table A-2 summarizes changes in the tax expenditure budget between fiscal years 1981 and 1982, as published by the JCT staff and the CBO. Fourteen new items were added to the 1982 tax expenditure budget--11 because of legislative action and three because of definitional changes--and nine items were dropped--three because of legislative action and six because of definitional changes.

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1. The Budget of the United States Government, Fiscal Year 1983, Special Analysis G, "Tax Expenditures" (February 1982).

2. CBO, Tax Expenditures: Current Issues and Five-Year Budget Projections For Fiscal Years 1982-1986 (September 1981).

TABLE A-1. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION, FISCAL YEARS 1982-1987 (In millions of dollars)[a]

Function and Subfunction	Corporations						Individuals					
	1982	1983	1984	1985	1986	1987	1982	1983	1984	1985	1986	1987
050 NATIONAL DEFENSE												
051 Department of Defense - Military												
Exclusion of benefits and allowances to Armed Forces personnel	---	---	---	---	---	---	1,885	1,940	2,025	2,160	2,310	2,465
Exclusion of military disability pensions	---	---	---	---	---	---	165	170	175	190	200	215
150 INTERNATIONAL AFFAIRS												
155 International Finance Programs												
Exclusion of income earned abroad by United States citizens	---	---	---	---	---	---	985	1,285	1,340	1,460	1,600	1,795
Deferral of income of Domestic International Sales Corporations (DISCs)	1,560	1,665	1,750	1,820	1,885	1,950	---	---	---	---	---	---
Deferral of income of controlled foreign corporations	520	560	605	655	705	760	---	---	---	---	---	---
250 GENERAL SCIENCE, SPACE, AND TECHNOLOGY												
251 General Science and Basic Research												
Expensing of research and development expenditures	1,900	2,055	2,245	2,350	2,415	2,475	100	105	120	125	125	130
Credit for increasing research activities	375	545	665	665	390	80	15	30	35	40	30	5
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	55	120	60	b	---	---	b	b	b	---	---	---

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
270 ENERGY												
271 Energy Supply												
Expensing of exploration and development costs												
Oil and gas	2,720	3,060	3,500	3,875	4,205	4,635	1,350	1,470	1,620	1,850	2,125	2,385
Other fuels	25	30	30	35	35	40	---	---	---	---	---	---
Excess of percentage over cost depletion												
Oil and gas	415	390	380	470	530	550	1,555	1,305	1,125	1,255	1,490	1,540
Other fuels	365	410	450	495	550	615	15	15	20	20	20	25
Capital gains treatment of royalties from coal	10	15	15	15	20	20	95	80	90	105	115	130
Alternative fuel production credit	95	70	70	95	140	175	---	---	---	---	---	---
Alcohol fuel credit[c]	15	30	30	30	30	30	5	5	5	5	5	5
Exclusion of interest on state and local government industrial development bonds for energy production facilities	5	10	15	20	30	35	b	5	5	10	15	15
Residential energy credits												
Supply incentives	---	---	---	---	---	---	205	260	345	500	595	35
Alternative conservation and new technology credits												
Supply incentives	180	295	460	610	510	475	20	25	30	30	30	20
272 Energy Conservation												
Residential energy credits												
Conservation incentives	---	---	---	---	---	---	415	410	400	400	340	10
Alternative conservation and new technology credits												
Conservation incentives	315	280	180	55	25	10	---	---	---	---	---	---
Energy credit for intercity buses	5	5	5	5	b	b	---	---	---	---	---	---

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
300 NATURAL RESOURCES AND ENVIRONMENT												
302 Conservation and Land Management												
Capital gains treatment of certain timber income	460	500	535	585	635	680	140	115	110	125	135	145
Investment credit and seven-year amortization for reforestation expenditures	b	b	b	b	b	b	5	5	10	10	10	10
303 Recreational Resources												
Tax incentives for preservation of historic structures	55	70	85	95	110	130	80	100	125	145	165	190
304 Pollution Control and Abatement												
Exclusion of interest on state and local government pollution control bonds	565	655	740	820	900	975	275	320	365	405	445	485
Exclusion of payments in aid of construction of water, sewage, gas and electric utilities	30	45	70	75	80	75	---	---	---	---	---	---
306 Other Natural Resources												
Expensing of exploration and development costs, nonfuel minerals	50	55	60	65	75	80	b	b	b	b	b	b
Excess of percentage over cost depletion, nonfuel minerals	390	425	450	480	515	550	15	15	20	20	25	25
Capital gains treatment of iron ore	10	10	10	10	10	10	10	10	10	10	10	10

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
350 AGRICULTURE												
351 Farm Income Stabilization												
Expensing of certain capital outlays	85	85	90	95	100	100	460	475	495	510	530	545
Capital gains treatment of certain income	25	25	30	30	35	35	430	455	475	500	525	550
Deductibility of patronage dividends and certain other items of cooperatives	920	950	980	1,010	1,040	1,075	-375	-390	-400	-410	-425	-435
Exclusion of certain cost-sharing payments	---	---	---	---	---	---	60	50	45	40	30	25
370 COMMERCE AND HOUSING CREDIT												
371 Mortgage Credit and Thrift Insurance												
Excess bad debt reserves of financial institutions	250	515	765	905	1,005	1,085	---	---	---	---	---	---
Deductibility of mortgage interest on owner-occupied homes	---	---	---	---	---	---	23,030	25,490	28,465	32,770	37,830	44,360
Deductibility of property tax on owner-occupied homes	---	---	---	---	---	---	10,065	10,635	11,055	12,105	13,280	14,805
Exclusion of interest on state and local housing bonds for owner-occupied housing	650	835	980	1,005	980	960	420	535	645	670	655	640
Exclusion of interest on state and local housing bonds for rental housing	310	345	415	525	655	780	155	170	200	255	320	380
Deferral of capital gains on home sales	---	---	---	---	---	---	1,525	1,655	2,020	2,485	3,010	3,530
Exclusion of capital gains on home sale for persons age 55 and over	---	---	---	---	---	---	510	550	675	830	1,005	1,175

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
376 Other Advancement and Regulation of Commerce												
Exclusion of interest on state and local industrial development bonds	1,295	1,690	2,160	2,670	3,235	3,875	315	410	525	650	790	945
Exemption of credit union income	110	115	120	125	135	140	---	---	---	---	---	---
Exclusion of interest on life insurance savings	---	---	---	---	---	---	4,535	4,805	5,165	5,790	6,615	7,245
Deductibility of nonmortgage interest in excess of investment income	---	---	---	---	---	---	7,585	7,690	8,085	8,625	9,220	10,010
Expensing of construction period interest and taxes	505	610	735	855	975	1,110	275	320	390	455	515	590
Depreciation on rental housing in excess of straight-line	105	130	155	165	180	195	460	575	665	720	760	795
Depreciation on buildings (other than rental housing) in excess of straight-line	175	210	245	280	315	350	155	190	220	245	275	310
Reinvestment of dividends in stock of public utilities	---	---	---	---	---	---	130	365	415	450	280	---
Net interest exclusion	---	---	---	---	---	---	---	---	---	1,115	3,090	3,425
Exclusion of interest on certain savings certificates	---	---	---	---	---	---	400	1,790	1,140	---	---	---
Accelerated depreciation on equipment other than leased property	6,455	10,705	16,080	23,020	33,140	39,075	845	1,695	2,540	3,530	5,140	6,455
Safe-harbor leasing:												
Accelerated depreciation and deferral	1,285	2,180	3,285	4,530	5,785	6,860	---	---	---	---	---	---
Investment credit	1,365	1,435	1,780	2,200	2,730	3,380	---	---	---	---	---	---
Amortization of business start-up costs	5	10	15	20	25	30	65	95	130	175	230	255
Capital gains other than agriculture, timber, iron ore, and coal	1,495	1,710	1,900	2,100	2,300	2,500	18,315	14,390	13,385	14,225	14,505	14,685
Capital gains at death	---	---	---	---	---	---	5,245	3,975	3,565	3,665	3,920	4,195

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
376 Other Advancement and Regulation of Commerce (continued)												
Dividend and interest exclusion[d]	---	---	---	---	---	---	2,185	550	555	580	605	635
Reduced rates on the first $100,000 of corporate income	6,605	7,125	8,065	8,740	8,660	8,630	---	---	---	---	---	---
Investment credit, other than for ESOPs, rehabilitation of structures, reforestation and leasing	14,970	14,825	19,775	22,825	22,550	23,555	3,475	3,825	4,205	4,625	5,090	5,595
400 TRANSPORTATION												
401 Ground Transportation												
Amortization of motor-carrier operating rights	120	70	70	55	20	b	b	b	b	b	b	b
Exclusion of interest on state and local government IDBs for mass transit	10	35	65	85	90	90	5	15	30	40	45	45
403 Water Transportation												
Deferral of tax on shipping companies	65	85	80	50	40	35	---	---	---	---	---	---
450 COMMUNITY AND REGIONAL DEVELOPMENT												
451 Community Development												
Five-year amortization for housing rehabilitation	35	40	45	50	60	65	55	60	70	75	80	85
Investment credit for rehabilitation of structures other than historic structures	455	505	570	640	725	825	80	90	100	115	130	145

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
500 EDUCATION, TRAINING, EMPLOYMENT AND SOCIAL SERVICES												
502 Higher Education												
Exclusion of scholarship and fellowship income	---	---	---	---	---	---	465	415	375	395	410	435
Employer educational assistance	---	---	---	---	---	---	40	40	20	---	---	---
Exclusion of interest on state and local student loan bonds	60	95	135	175	220	260	30	45	65	85	105	125
Parental personal exemption for students age 19 or over	---	---	---	---	---	---	995	900	845	835	845	855
Deductibility of charitable contributions (education)	315	365	445	515	550	575	580	560	570	660	830	860
504 Training and Employment Services												
Credit for child and dependent care expenses	---	---	---	---	---	---	1,350	1,465	1,515	1,660	1,820	2,030
Targeted jobs credit	235	75	60	35	10	5	b	b	b	b	b	b
505 Other Labor Services												
Exclusion of employee meals and lodging (other than military)	---	---	---	---	---	---	655	680	725	795	870	945
Investment credit for ESOPs	1,005	1,095	1,245	1,830	2,320	2,460	---	---	---	---	---	---
Exclusion for employer-provided child care	---	---	---	---	---	---	b	10	25	55	85	120
506 Social Services												
Deductibility of charitable contributions, other than education and health	385	450	555	635	680	710	7,960	7,635	7,840	9,045	11,335	11,790
Exclusion of contributions to prepaid legal services plans	---	---	---	---	---	---	20	25	25	10	---	---
Deduction for two-earner married couples	---	---	---	---	---	---	705	3,980	7,030	7,980	8,945	10,070
Deduction for adoption expenses	---	---	---	---	---	---	10	10	10	10	10	15

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
550 HEALTH												
551 Health Care Services												
Exclusion of employer contributions for medical insurance premiums and medical care[e]	---	---	---	---	---	---	15,330	16,380	17,895	20,300	23,285	26,705
Deductibility of medical expenses	---	---	---	---	---	---	3,925	4,175	4,190	4,495	4,840	5,305
Exclusion of interest on state and local hospital bonds	430	505	590	665	735	805	210	250	290	330	365	395
Deductibility of charitable contributions (health)	195	225	275	320	340	355	1,165	1,120	1,150	1,325	1,660	1,725
600 INCOME SECURITY												
601 General Retirement and Disability Insurance												
Exclusion of Social Security benefits												
Disability insurance benefits	---	---	---	---	---	---	915	910	910	950	1,000	1,060
OASI benefits for retired survivors	---	---	---	---	---	---	9,980	10,525	10,955	11,825	12,790	13,765
Benefits for dependents and survivors	---	---	---	---	---	---	1,915	1,970	2,040	2,200	2,385	2,565
Exclusion of railroad retirement system benefits	---	---	---	---	---	---	380	370	385	400	415	435
Exclusion of workmen's compensation benefits	---	---	---	---	---	---	3,100	3,495	3,965	4,665	5,550	6,635
Exclusion of special benefits for disabled coal miners	---	---	---	---	---	---	95	90	85	85	85	90
Exclusion of disability pay	---	---	---	---	---	---	155	145	135	130	130	130
Net exclusion of pension contributions and earnings												
Employer plans	---	---	---	---	---	---	25,765	27,500	30,545	35,630	42,060	48,540
Plans for self-employed	---	---	---	---	---	---	1,005	1,065	1,050	1,075	1,145	1,215

(Continued)

TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
601 General Retirement and Disability Insurance (continued)												
Individual retirement plans	---	---	---	---	---	---	1,555	2,695	3,255	3,860	4,310	4,855
Exclusion of other employee benefits												
Premiums on group term life insurance	---	---	---	---	---	---	1,900	1,895	1,965	2,110	2,290	2,480
Premiums on accident and disability insurance	---	---	---	---	---	---	100	100	100	100	105	110
Additional exemption for the blind	---	---	---	---	---	---	30	30	30	30	30	30
Additional exemption for the elderly	---	---	---	---	---	---	2,355	2,370	2,375	2,455	2,560	2,730
Tax credit for the elderly	---	---	---	---	---	---	135	135	135	135	135	135
603 Unemployment Compensation												
Exclusion of untaxed unemployment insurance benefits	---	---	---	---	---	---	2,060	2,710	2,410	2,185	2,200	2,250
609 Other Income Security												
Exclusion of public assistance benefits	---	---	---	---	---	---	445	430	430	440	455	470
Deductibility of casualty and theft losses	---	---	---	---	---	---	800	850	930	1,035	1,155	1,310
Earned income credit[f]	---	---	---	---	---	---	555	550	500	475	440	400
700 VETERANS' BENEFITS AND SERVICES												
701 Income Security for Veterans												
Exclusion of veterans' disability compensation	---	---	---	---	---	---	1,360	1,380	1,325	1,320	1,325	1,330
Exclusion of veterans' pensions	---	---	---	---	---	---	85	90	85	90	95	100
702 Veterans' Education, Training and Rehabilitation												
Exclusion of GI bill benefits	---	---	---	---	---	---	175	145	135	120	105	95

(Continued)

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TABLE A-1. (Continued)

Function and Subfunction	Corporations 1982	1983	1984	1985	1986	1987	Individuals 1982	1983	1984	1985	1986	1987
800 GENERAL GOVERNMENT												
806 Other General Government												
Credits for political contributions	---	---	---	---	---	---	80	80	80	80	80	80
850 GENERAL PURPOSE FISCAL ASSISTANCE												
851 General Revenue Sharing												
Exclusion of interest on general purpose state and local debt	3,905	4,395	4,870	5,295	5,660	5,990	1,925	2,165	2,410	2,620	2,810	2,975
Deductibility of non-business state and local taxes (other than on owner-occupied homes)	---	---	---	---	---	---	20,395	21,530	23,810	25,570	28,060	31,280
852 Other General Purpose Fiscal Assistance												
Tax credit for corporations receiving income from doing business in United States possessions	1,195	1,285	1,380	1,500	1,625	1,730	---	---	---	---	---	---
900 INTEREST												
901 Interest on the Public Debt												
Deferral of interest on savings bonds	---	---	---	---	---	---	-80	50	160	225	290	355
TOTAL	55,140	64,025	80,370	96,275	110,715	121,990	198,365	209,110	225,620	251,500	285,260	317,440

SOURCE: Congressional Joint Committee on Taxation.

a. All estimates are based on the tax law enacted as of December 31, 1981.
b. Less than $2.5 million.
c. In addition, the exemption from the excise tax for alcohol fuels results in a reduction in excise tax receipts of approximately $50 million annually for 1982 and 1983, and approximately $100 million annually thereafter.

(Continued)

Footnotes (Continued)

d. The Economic Recovery Tax Act of 1981 terminated the $200 dividend and interest exclusion ($400 for joint returns) after 1981. After 1981, the law reverts to the prior $100 dividend exclusion ($200 for joint returns) with some technical modifications.

e. CBO estimates that this tax expenditure will result in a higher revenue loss than the JCT estimate shown in this table. CBO estimates a loss of $16.5 billion in 1982, $18.1 billion in 1983, $20.2 billion in 1984, $23.3 billion in 1985, $26.9 billion in 1986, and $31.1 billion in 1987.

f. The figures in the table indicate the effect of the earned income credit on receipts. The effect on outlays is: $1,255 million in 1982, $1,180 million in 1983, $920 million in 1984, $850 million in 1985, $780 million in 1986, and $720 million in 1987.

TABLE A-2. CHANGES IN THE TAX EXPENDITURE BUDGET BETWEEN 1981 AND 1982[a]

Additions Because of	Deletions Because of
Legislative Action	**Legislative Action**
New Tax Expenditures	Repealed
Credit for increasing research activities	Excess first-year depreciation
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	Maximum tax on personal service income
Public utility dividend reinvestment plans	Expired
Net interest exclusion	Credit for employment of AFDC recipients and public assistance recipients under work incentive programs
Exclusion of interest on certain savings certificates	**Definitional Changes**
Safe-harbor leasing	Items still in the tax code but no longer included in the budget
Exclusion of interest on state and local industrial development bonds for mass transit	Five-year amortization on pollution control facilities[e]
Amortization of motor-carrier operating rights	Five-year amortization on railroad rolling stock[f]
Exclusion for employer-provided child care	General jobs credit[f]
Deduction for two-earner married couples	Exclusion of other employee benefits
Deduction for adoption expenses	Income of trusts to finance supplementary unemployment benefits
Definitional Changes	Deductibility of interest on consumer credit
Subdivision of items previously in the budget	Asset Depreciation Range[f]
Individual retirement plans[b]	
Accelerated depreciation on equipment other than leased property[c]	
Deductibility of nonmortgage interest in excess of investment income[d]	

a. All changes were legislated in the Economic Recovery Tax Act of 1981 (Public Law 97-34) unless otherwise noted.
b. The change also involved a major legislative expansion.
c. Replaces Asset Depreciation Range.
d. Replaces deductibility of interest on consumer credit.
e. This tax expenditure is no longer large enough to be included in the budget.
f. This item is no longer included in the budget because its revenue effect results only from taxpayer activity in prior years.

APPENDIX B. ILLUSTRATIVE ALLOCATION OF TAX EXPENDITURES TO COMMITTEES WITH AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS

This appendix provides an illustrative allocation of each tax expenditure to the House and Senate committees with authorizing jurisdiction over related direct outlays. This type of allocation has been included in each annual CBO report on tax expenditures since 1978. It is designed to serve as an initial guide if the Congress should decide to incorporate tax expenditures more fully into the Congressional budget process by allocating tax expenditures to other committees in addition to the tax commitees.

The illustrative allocation of tax expenditures in this appendix has no formal status. The actual decisions on such matters would, of course, be made by the House and the Senate and their Parliamentarians. There are a number of instances in which a specific tax expenditure item could easily be assigned to more than one committee. In the list that follows, however, each tax expenditure is assigned to only one committee, based on CBO's best judgment as to which committee has jurisdiction over the most closely related spending programs.

This appendix includes only tax expenditures in effect as of December 31, 1981. No changes during calendar year 1982 are reflected here. Chapter II includes a discussion and listing of the tax expenditure changes enacted in 1982.

TABLE B-1. TAX EXPENDITURES BY CONGRESSIONAL COMMITTEE WITH AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS (In millions of dollars)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
House of Representatives	
Agriculture	
Capital gains treatment of certain ordinary income	480
Expensing of certain capital outlays	560
Deductibility of noncash patronage dividends and certain other items of cooperatives	560
Capital gains treatment of certain timber income	615
Investment credit and seven-year amortization for reforestation expenditures	5
Exclusion of certain cost-sharing payments	50
Subtotal	2,270
Armed Services	
Exclusion of benefits and allowances to Armed Forces personnel	1,940
Exclusion of military disability pensions	170
Subtotal	2,110
Banking, Finance and Urban Affairs	
Exemption of credit union income	115
Excess bad debt reserves of financial institutions	515
Deductibility of mortgage interest on owner-occupied homes	25,490
Deductibility of property tax on owner-occupied homes	10,635
Exclusion of interest on state and local industrial development bonds (IDBs)	2,100

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Banking, Finance and Urban Affairs (continued)	
Exclusion of interest on state and local housing bonds, owner-occupied and rental	1,885
Deductibility of nonmortgage interest in excess of investment income	7,690
Deferral of capital gains on home sales	1,655
Capital gains (other than farming, timber, iron ore, and coal)	16,100
Depreciation of rental housing in excess of straight-line	705
Depreciation of buildings (other than rental housing) in excess of straight-line	400
Investment credit for rehabilitation of structures other than historic structures	595
5-year amortization for housing rehabilitation	100
Exclusion of capital gains on home sales for persons age 55 and over	550
Expensing of construction period interest and taxes	930
Dividend and interest exclusion	550
Reduced rates on first $100,000 of corporate income	7,125
Accelerated depreciation on equipment other than leased property	12,400
Capital gains at death	3,975
Investment tax credit	18,650
Amortization of business start-up costs	105
Safe-harbor leasing	3,615
Deferral of income of domestic international sales corporations (DISCs)	1,665
Deferral of income of controlled foreign corporations	560

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Banking, Finance and Urban Affairs (continued)	
Exclusion of interest on certain savings certificates	1,790
Net interest exclusion[a]	---
Subtotal	119,900
Education and Labor	
Exclusion of scholarship and fellowship income	415
Exclusion of interest on state and local student loan bonds	140
Parental personal exemption for children age 19 and over	900
Deductibility for charitable contributions (education)	925
Credit for child and dependent care expenses	1,465
Employer educational assistance	40
Additional exemption for the elderly	2,370
Additional exemption for the blind	30
Exclusion for workmen's compensation benefits	3,495
Exclusion of special benefits for disabled coal miners	90
Net exclusion of pension contributions and earnings	
Employer plans	27,500
Plans for self-employed and others	1,065
Exclusion of other employee benefits	
Premiums on group term life insurance	1,895
Premiums on accident and disability insurance	100
Exclusion of disability pay	145
Exclusion of interest on life insurance savings	4,805

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Education and Labor (continued)	
Deduction for two-earner married couples	3,980
Deduction for adoption expenses	10
Tax credit for the elderly	135
Earned income credit	550
Deductibility of casualty and theft losses	850
Exclusion of employee meals and lodging (other than military)	680
Exclusion for contributions to prepaid legal services plans	25
Investment credit for employee stock ownership plans (ESOPs)	1,095
Exclusion for employer-provided child care	10
Deductibility of charitable contributions for other than education and health	8,085
Targeted jobs credit	75
Individual retirement plans	2,695
Subtotal	63,570
Energy and Commerce	
Deductibility of medical expenses	4,175
Deductibility of charitable contributions (health)	1,345
Exclusion of railroad retirement system benefits	370
Expensing of exploration and development costs	
Oil and gas	4,530
Other fuels	30
Excess of percentage over cost depletion	
Oil and gas	1,695
Other fuels	425

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Energy and Commerce (continued)	
Capital gains treatment of royalties from coal	95
Alternative fuel production credit	70
Alcohol fuel credit	35
Energy credit for intercity buses	5
Residential energy credits	670
Alternative conservation and new technology credits	600
Exclusion of interest on state and local IDBs for energy production facilities	15
Exclusion of interest on state and local hospital bonds	755
Exclusion of payments in aid of construction in water, sewage, gas and electric utilities	45
Exclusion of income earned abroad by United States citizens	1,285
Reinvestment of dividends in stock of public utilities	365
Exclusion of employer contributions for medical insurance premiums and medical care	16,380
Exclusion of interest on state and local pollution control bonds	975
Subtotal	33,865
Government Operations	
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes)	21,530

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Government Operations (continued)	
Exclusion of interest on general purpose state and local debt	6,560
Subtotal	28,090
House Administration	
Credits for political contributions	80
Interior and Insular Affairs	
Tax incentives for preservation of historic structures	170
Capital gains treatment of royalties on iron ore	20
Expensing of exploration and development costs, nonfuel minerals	55
Excess of percentage over cost depletion, nonfuel minerals	440
Tax credit for corporations doing business in U.S. possessions	1,285
Subtotal	1,970
Merchant Marine and Fisheries	
Deferral of tax on shipping companies	85
Public Works and Transportation	
Amortization of motor carrier operating rights	70
Exclusion of interest on state and local government IDBs for mass transit	50
Subtotal	120

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Science and Technology	
Credit for increasing research activities	575
Expensing of research and development expenditures	2,160
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	120
Subtotal	2,855
Veterans' Affairs	
Exclusion of veterans' disability compensation	1,380
Exclusion of veterans' pensions	90
Exclusion of GI Bill benefits	145
Subtotal	1,615
Ways and Means	
Deferral of interest on savings bonds	50
Exclusion of unemployment insurance benefits	2,710
Exclusion of public assistance benefits	430
Exclusion of Social Security benefits	
Disability insurance benefits	910
OASI benefits for retired workers	10,525
Benefits for dependents and survivors	1,970
Subtotal	16,595
Total	273,135

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Senate	
Agriculture, Nutrition and Forestry	
Investment credit and seven-year amortization for reforestation expenditures	5
Capital gains treatment of certain timber income	615
Capital gains treatment of certain income, agriculture	480
Expensing of certain capital outlays	560
Deductibility of noncash patronage dividends and certain other items of cooperatives	560
Exclusion of certain cost-sharing payments	50
Subtotal	2,270
Armed Services	
Exclusion of benefits and allowances to Armed Forces personnel	1,940
Exclusion of military disability pensions	170
Subtotal	2,110
Banking, Housing and Urban Affairs	
Deferral of income of domestic international sales corporations (DISCs)	1,665
Deferral of income of controlled foreign corporations	560
Exclusion of income earned abroad by United States citizens	1,285
Exemption of credit union income	115
Excess bad debt reserves of financial institutions	515

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Banking, Housing and Urban Affairs (continued)	
Deductibility of mortgage interest on owner-occupied homes	25,490
Deductibility of property tax on owner-occupied homes	10,635
Deductibility of nonmortage interest in excess of investment income	7,690
Deferral of capital gains on home sales	1,655
Dividend and interest exclusion	550
Reduced rates on first $100,000 of corporate income	7,125
Investment credit for rehabilitation of structures other than historic structures	595
Capital gains (other than agriculture, timber, iron ore, and coal)	16,100
Capital gains at death	3,975
Depreciation of rental housing in excess of straight-line	705
Depreciation on buildings (other than rental housing) in excess of straight-line	400
Expensing of construction period interest and taxes	930
Amortization of business start-up costs	105
Investment tax credit	18,650
Accelerated depreciation on equipment other than leased property	12,400
5-year amortization for housing rehabilitation	100
Exclusion of capital gains on home sales for persons age 55 or older	550
Exclusion of interest on state and local housing bonds, owner-occupied and rental	1,885
Exclusion of interest on state and local industrial development bonds (IDBs)	2,100

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Banking, Housing and Urban Affairs (continued)	
Net interest exclusion[a]	---
Exclusion of interest on certain savings certificates	1,790
Safe-harbor leasing	3,615
Subtotal	121,185
Commerce, Science and Transportation	
Expensing of research and development expenditures	2,160
Amortization of motor carrier operating rights	70
Deferral of tax on shipping companies	85
Credit for increasing research activities	575
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	120
Exclusion of interest on state and local IDBs for mass transit	50
Subtotal	3,060
Energy and Natural Resources	
Expensing of exploration and development costs, fuels and nonfuel minerals	4,615
Excess of percentage over cost depletion, fuels and nonfuel minerals	2,560
Capital gains treatment of royalties on iron ore and coal	115
Tax incentives for preservation of historic structures	170
Alternative fuel production credit	70

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Energy and Natural Resources (continued)	
Alcohol fuel credit	35
Residential energy credits	670
Alternative, conservation and new technology credits	600
Exclusion of interest on state and local IDBs for energy production facilities	15
Energy credit for intercity buses	5
Tax credit for corporations doing business in U.S. possessions	1,285
Reinvestment of dividends in stock of public utilities	365
Subtotal	10,505
Environment and Public Works	
Exclusion of interest on state and local government pollution control bonds	975
Exclusion of payments in aid of construction of water, sewage, gas and electric utilities	45
Subtotal	1,020
Finance	
Deferral of interest on savings bonds	50
Exclusion of Social Security benefits	
Disability insurance benefits	910
OASI benefits for retired workers	10,525
Benefits for dependents and survivors	1,970
Exclusion of unemployment insurance benefits	2,710
Exclusion of public assistance benefits	430
Exclusion of interest on general purpose state and local debt	6,560

(Continued)

TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Finance (continued)	
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes)	21,530
Subtotal	44,685
Labor and Human Resources	
Exclusion of scholarship and fellowship income	415
Exclusion of interest on state and local student loan bonds	140
Parental personal exemption for students age 19 and over	900
Deductibility of charitable contributions (education)	925
Credit for child and dependent care expenses	1,465
Exclusion of employee meals and lodging (other than military)	680
Exclusion of contributions to prepaid legal services plans	25
Investment credit for employee stock ownership plans (ESOPs)	1,095
Deductiblity of charitable contributions for other than education and health	8,085
Exclusion of employer contributions for medical insurance premiums and medical care	16,380
Deductibility of medical expenses	4,175
Deductibility of charitable contributions (health)	1,345
Exclusion of interest on state and local hospital bonds	755
Earned income credit	550
Exclusion of railroad retirement system benefits	370
Exclusion of workmen's compensation benefits	3,495

(Continued)

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TABLE B-1. (Continued)

Tax Expenditure	Fiscal Year 1983 Revenue Loss Estimate
Labor and Human Resources (continued)	
Exclusion of special benefits for disabled coal miners	90
Net exclusion of pension contributions and earnings	
Employer plans	27,500
Plans for self-employed and others	1,065
Exclusion of other employee benefits	
Premiums on group term life insurance	1,895
Premiums on accident and disability insurance	100
Individual retirement plans	2,695
Exclusion for employer-provided child care	10
Deduction for adoption expenses	10
Deduction for two-earner married couples	3,980
Additional exemption for the elderly	2,370
Tax credit for the elderly	135
Exclusion of interest on life insurance savings	4,805
Exclusion of disability pay	145
Additional exemption for the blind	30
Deductibility of casualty and theft losses	850
Targeted jobs credit	75
Employer educational assistance	40
Subtotal	86,595
Rules and Administration	
Credits for political contributions	80
Veterans' Affairs	
Exclusion of veterans' disability compensaton	1,380
Exclusion of veterans' pensions	90
Exclusion of GI Bill benefits	145
Subtotal	1,615
Total	273,135

a. There is no projected revenue loss from this tax expenditure until fiscal year 1985.

APPENDIX C. INITIAL AUTHORIZATION FOR CURRENT TAX EXPENDITURES

It is commonly assumed that most current tax expenditures were deliberately designed to serve the purposes they now serve--providing special incentives or relief to particular groups or industries. For many of the more recently enacted tax expenditures, this is true. They are not defended as necessary to the operation of the tax system, but rather as ways of providing government assistance. The first tax expenditure budget was not prepared until 1967 by the Treasury Department, however. Before that time, it was less common to think of such special tax provisions in this way. Provisions that are now viewed as tax expenditures often became part of the tax code for reasons that are quite unrelated to their current major justification. The deductibility of home mortgage interest, for example, dates back to the 1913 income tax law. No explicit rationale was given for its enactment, but committee reports and floor debates suggest that interest payments in general were viewed as reductions in income that should be taken into account in determining ability to pay. Since large-scale home mortgage financing did not begin until the 1940s, however, the provision was not viewed as the major aid to homeownership that it now is.

Each tax expenditure provision has a different history, of course. The compendium of tax expenditures published earlier this year by the Senate Committee on the Budget gives details on the history of each provision.[1] It is instructive, nonetheless, to see how many of the major tax provisions date back to before the 1950s. Table C-1 gives the initial date of authorization--either by law or by regulation--for each tax expenditure. Table C-2 gives some summary data. Measured by dollar amounts, over 80 percent of all current tax expenditures were in place by 1950. This represents only about 50 percent of the total number of current tax expenditures, however. About half of all current tax expenditures were thus enacted after 1950, although the average current revenue loss per tax expenditure for these items is much less than for those enacted earlier.

1. Committee on the Budget, United States Senate, Tax Expenditures (March 17, 1982).

TABLE C-1. INITIAL AUTHORITY FOR CURRENT LAW TAX EXPENDITURES AND FISCAL YEAR 1982 REVENUE LOSS

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Deferral of income of controlled foreign corporations	520	1909	Accepted practice 1909-1962; restricted under the Revenue Act of 1962 (P.L. 87-834)
Exemption of credit union income	110	1909	1909 income tax law
Exclusion of interest on state and local hospital bonds	640	1913	1913 income tax law[a]
Exclusion of interest on life insurance savings	4,535	1913	1913 income tax law
Deductibility of nonmortgage interest in excess of investment income	7,585	1913	1913 income tax law
Deductibility of mortgage interest on owner-occupied homes	23,030	1913	1913 income tax law
Deductibility of property tax on owner-occupied homes	10,065	1913	1913 income tax law
Exclusion of interest on state and local housing bonds for owner-occupied housing[b]	1,070	1913	1913 income tax law
Expensing of construction period interest and taxes	780	1913	1913 income tax law
Deductibility of casualty and theft losses	800	1913	1913 income tax law
Exclusion of interest on general purpose state and local debt	5,830	1913	1913 income tax law
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	20,395	1913	1913 income tax law
Expensing of exploration and development costs for oil and gas	4,070	1916	Expensing of development costs accepted practice until 1945 and specifically enacted in the 1954 Internal Revenue Code; expensing of exploration costs legislated in the 1951 Revenue Act
Deductibility of charitable contributions (education)	895	1917	1917 Revenue Act

(Continued)

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TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Deductibility of charitable contributions (health)	1,360	1917	1917 Revenue Act
Deductibility of charitable contributions other than education and health	8,345	1917	1917 Revenue Act
Exclusion of veterans' disability compensation	1,360	1917	1917 Revenue Act
Exclusion of veterans' pensions	85	1917	1917 Revenue Act
Exclusion of GI bill benefits	175	1917	1917 Revenue Act
Exclusion of disability pay	155	1918	1918 Revenue Act[c]
Exclusion of workmen's compensation benefits	3,100	1918	1918 Revenue Act
Exclusion of employee meals and lodging (other than military)	655	1918	1918-1954 regulation; enacted in 1954 Internal Revenue Code
Excess of percentage over cost depletion--oil and gas, and other fuels	2,350	1918	Depletion on a discovery-value basis accepted practice 1918-1926; 1926 Revenue Act enacted percentage over cost depletion for oil and gas; other fuels included in the 1932 Revenue Act
Excess of percentage over cost depletion--nonfuel minerals	405	1918	Depletion on a discovery-value basis accepted practice 1918-1932; 1932 Revenue Act enacted percentage over cost depletion
Exclusion of other employee benefits--premiums on group term life insurance	1,900	1920	Administrative legal opinion (L.O. 1014, 2 C.B. 8(1920))
Deductibility of patronage dividends and certain other items of cooperatives	545	1920s	Rulings in 1920s; enacted in 1962 Revenue Act (P.L. 87-834)

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Capital gains other than agriculture, timber, iron ore, and coal	19,810	1921	1921 Revenue Act[d]
Capital gains at death	5,245	1921	1921 Revenue Act
Net exclusion of pension contributions and earnings--employer plans	25,765	1921	1921 Revenue Act[e]
Tax credit for corporations receiving income from doing business in U.S. possessions	1,195	1921 and 1976	1921 Revenue Act[f]
Exclusion of income earned abroad by United States citizens	985	1926	1926 Revenue Act
Exclusion of public assistance benefits	445	1930s	Included in revenue rulings on the definition of gross income
Exclusion of railroad retirement system benefits	380	1935	Railroad Retirement Act of 1935
Exclusion of interest on state and local industrial development bonds (IDBs)	1,610	1936	Court decisions[g]
Deferral of tax on shipping companies	65	1936	Merchant Marine Act of 1936[h]
Exclusion of interest on state and local housing bonds for rental housing	465	1937	U.S. Housing Act of 1937
Exclusion of untaxed unemployment insurance benefits	2,060	1938	Revenue Ruling (I.T. 3230, 1938-2, C.B. 136); enacted in 1978 Revenue Act (P.L. 95-600)
Reduced rates on the first $100,000 of corporate income	6,605	1941	1941 Revenue Act
Deferral of interest on savings bonds	-80	1941	1941 Revenue Act
Exclusion of Social Security benefits			
Disability insurance benefits	915	1941	Administrative ruling I.T. 3447
OASI benefits for retired workers	9,980	1941	Administrative ruling I.T. 3447
Benefits for dependents and survivors	1,915	1941	Administrative ruling I.T. 3447
Exclusion of benefits and allowances to Armed Forces personnel	1,885	1942	1942 Revenue Act

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Exclusion of military disability pensions	165	1942	1942 Revenue Act
Deductibility of medical expenses	3,925	1942	1942 Revenue Act
Exclusion of employer contributions for medical insurance premiums and medical care	15,330	1943	1943 IRS Ruling explicitly permitted exclusion; codified in 1954[i]
Capital gains treatment of certain timber income	600	1944	1943 Revenue Act
Additional exemption for the blind	30	1944	1943 Revenue Act
Depreciation on rental housing in excess of straight-line	565	1946	Revenue ruling in 1946; enacted in 1954 Internal Revenue Code
Depreciation on buildings other than rental housing in excess of straight-line	330	1946	Revenue ruling in 1946; enacted in 1954 Internal Revenue Code
Accelerated depreciation on equipment other than leased property	7,300	1946	Revenue ruling in 1946; enacted in 1954 Internal Revenue Code
Excess bad debt reserves of financial institutions	250	1947	IRS ruling in 1947; enacted in 1951 Revenue Act
Additional exemption for the elderly	2,355	1948	1948 Revenue Act
Capital gains treatment of royalties from coal	105	1951	1951 Revenue Act
Expensing of exploration and development costs for other fuels and nonfuel minerals	75	1951	1951 Revenue Act[j]
Capital gains treatment of certain income, agriculture	455	1951	1951 Revenue Act
Deferral of capital gains on home sales	1,525	1951	1951 Revenue Act
Expensing of research and development expenditures	2,000	1954	Explicitly enacted in the 1954 Internal Revenue Code
Expensing of certain capital outlays, agriculture	545	1954	1954 Internal Revenue Code
Dividend and interest exclusion	2,185	1954	1954 Internal Revenue Code
Exclusion of scholarship and fellowship income	465	1954	1954 Internal Revenue Code
Parental personal exemption for students age 19 and over	995	1954	1954 Internal Revenue Code

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Credit for child and dependent care expenses	1,350	1954 and 1976[k]	1954 Internal Revenue Code
Exclusion of other employee benefits--premiums on accident and disability insurance	100	1954	1954 Internal Revenue Code[l]
Tax credit for the elderly	135	1954 and 1976	1954 Internal Revenue Code[m]
Investment credit other than employee stock ownership plans (ESOPs), rehabilitation of structures, reforestation, and leasing	18,445	1962	Revenue Act of 1962 (P.L. 87-834)
Net exclusion of pension contributions and earnings--plans for self-employed	1,005	1962	Revenue Act of 1962 (P.L. 87-834)
Capital gains treatment of iron ore	20	1964	Revenue Act of 1964 (P.L. 88-272)
Exclusion of capital gains on home sales for persons age 55 and over	510	1964	Revenue Act of 1964 (P.L. 88-272); greatly expanded under the 1978 Revenue Act
Exclusion of interest on state and local government pollution control bonds	840	1968	First explicity enacted in the Revenue Expenditure and Control Act of 1968 (P.L. 90-364)
Five-year amortization for housing rehabilitation	90	1969	Tax Reform Act of 1969 (P.L. 91-172)
Deferral of income of Domestic International Sales Corporations (DISCs)	1,560	1971	Revenue Act of 1971 (P.L. 92-178)
Credits for political contributions	80	1971	Revenue Act of 1971 (P.L. 92-178)
Exclusion of special benefits for disabled coal miners	95	1972	Revenue Ruling 72-400 and Black Lung Benefits Act of 1972 (P.L. 92-303)

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Individual retirement plans	1,555	1974	Employment Retirement Income Security Act of 1974 (P.L. 93-406)
Earned income credit	555	1975	Tax Reduction Act of 1975 (P.L. 94-12)
Exclusion of payments in aid of construction of water, sewage, gas, and electric utilities	30	1976	Tax Reform Act of 1976 (P.L. 94-455)[n]
Tax incentives for preservation of historic structures	135	1976	Tax Reform Act of 1976 (P.L. 94-455)
Exclusion of interest on state and local student loan bonds	90	1976	Tax Reform Act of 1976 (P.L. 94-455)
Exclusion of contributions to prepaid legal services plans	20	1976	Tax Reform Act of 1976 (P.L. 94-455)
Tax credit for ESOPs	1,005	1976	Tax Reform Act of 1976 (P.L. 94-455)
Targeted jobs tax credit	235	1977	Revenue Act of 1977 (P.L. 95-30)
Exclusion of certain cost-sharing payments, agriculture	60	1978	Revenue Act of 1978 (P.L. 95-600)
Investment credit for rehabilitation of structures other than historic structures	535	1978	Revenue Act of 1978 (P.L. 95-600)
Employer educational assistance	40	1978	First explicitly enacted in Revenue Act of 1978 (P.L. 95-600)
Alcohol fuel credit	20	1978 and 1980	Energy Tax Act of 1978 (P.L. 95-618)[o]
Residential energy credits, supply and conservation incentives	620	1978	Energy Tax Act of 1978 (P.L. 95-618)

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Alternative, conservation, and new technology credits, supply and conservation incentives	515	1978	Energy Tax Act of 1978 (P.L. 95-618)
Alternative fuel production credit	95	1980	Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223)
Exclusion of interest on state and local government IDBs for energy production facilities	5	1980	Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223)
Energy credit for intercity buses	5	1980	Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223)
Investment credit and seven-year amortiztion for reforestation expenditures	5	1980	Recreational Boating Safety Act and Facilities Improvement Act of 1980 (P.L. 96-451)
Amortization of business start-up costs	70	1980	Miscellaneous Revenue Act of 1980 (P.L. 96-605)
Credit for increasing research activities	390	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Suspension of regulations relating to allocation under section 861 of research and experimental expenditures	55	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Reinvestment of dividends in stock of public utilities	130	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Net interest exclusion	0	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Exclusion of interest on certain savings certificates	400	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Safe-harbor leasing	2,650	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Amortization of motor-carrier operating rights	120	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)

(Continued)

TABLE C-1. (Continued)

Tax Expenditure	1982 Revenue Loss (In millions of dollars)	Year First Enacted or Authorized by Regulation	Act or Regulation
Exclusion of interest on state and local IDBs for mass transit	15	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Exclusion for employer-provided child care	---p	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Deduction for two-earner married couples	705	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)
Deduction for adoption expenses	10	1981	Economic Recovery Tax Act of 1981 (P.L. 97-34)

a. Revenue Ruling 63-20 in 1963 expanded this provision to include tax-exempt not-for-profit hospitals.

b. The 1913 income tax law authorized the exclusion of interest on state and local general obligation bonds. The first general obligation issues for housing were issued after World War I for veterans' housing.

c. The 1954 Code expanded this provision to include employer plans as well as those administered by insurance companies. The Tax Reform Act of 1976 restricted this provision to those under 65, retired, and permanently disabled.

d. The 1921 Revenue Act authorized capital gains treatment for certain individual income. Capital gains treatment of certain corporate income was enacted in the 1942 Revenue Act.

e. The 1921 Revenue Act exempted income from a trust created by an employer as part of a stock bonus or profit-sharing plan for the exclusive benefit of the employees. In addition, the act established the principle that trust income and contributions were not included in an employee's taxable income until the year received. The 1926 Revenue Act explicitly applied these provisions to pension plans. The deductibility of employer contributions to pension trusts was first explicitly sanctioned by the Bureau of Internal Revenue in 1919 (O.D. 110, 1 Cum. Bull. 224 (1919)) and was codified by the 1928 Revenue Act.

f. An exclusion was enacted in the 1921 Revenue Act. This was changed to a credit in the Tax Reform Act of 1976 (P.L. 94-455).

g. IDBs = industrial development bonds. The state of Mississippi issued the first tax-exempt bonds to finance private industry in 1936.

h. This tax expenditure was expanded in the Tax Reform Act of 1976 (P.L. 94-455).

i. Employer contributions to health insurance plans have never been considered taxable income to employees by the IRS.

(Continued)

Footnotes to Table C-1 (continued)

j. 1966 Income Taxes Mining Act (P.L. 89-570) greatly expanded the provision for exploration costs.
k. A deduction for child and dependent care expenses was enacted in the 1954 Internal Revenue Code. The credit was first enacted in the Tax Reform Act of 1976 (P.L. 94-455).
l. Employer contributions to accident and disability insurance plans have never been considered taxable income by the IRS.
m. A retirement income credit, enacted in 1954, was replaced by a tax credit for the elderly in the Tax Reform Act of 1976 (P.L. 94-455).
n. The special treatment of payments in aid of construction had always been permitted until it was called into question by a revenue ruling in 1975 (Rev. Rul. 75-557). The 1976 legislation and subsequent legislation in the Revenue Act of 1978 clarified the authorization of such treatment.
o. The alcohol fuel tax exemption was enacted in the 1978 Energy Tax Act. The Crude Oil Windfall Profit Tax Act of 1980 (P.L. 96-223) expanded the exemption and enacted the alcohol fuel credit.
p. Less than $2.5 million.

TABLE C-2. TOTAL CURRENT LAW TAX EXPENDITURES, BY DATE OF INITIAL AUTHORIZATION

Tax Expenditures Authorized By	1982 Estimated Revenue Loss (In millions of dollars)	Percent of 1982 Total	Cumulative Number of Tax Expend-itures	Percent of 1982 Total
1913	75,360	30	12	12
1920	98,315	39	24	23
1930	153,760	61	31	30
1940	158,785	63	37	36
1950	210,855	83	53	51
1960	220,790	87	65	63
1970	241,700	95	71	68
1980	248,850	98	88	85
1982	253,505	100	104	100
Total	253,505[a]	100	104	100

a. The total here differs from the total listed in Table A-1 because of rounding.

APPENDIX D. TAX EXPENDITURES WITH EXPIRATION DATES

It has become increasingly common in recent years to provide expiration dates for newly enacted tax expenditures. The usual rationale is that the scheduled expiration date will provide an opportunity to review the provision carefully to determine whether it should be reenacted. Provisions are sometimes allowed to expire without full-scale review, however, while others are extended with little, if any, review. Table D-1 gives the expiration dates for all tax expenditures that currently have them, as of the date of publication of this report.

TABLE D-1. TAX EXPENDITURES WITH EXPIRATION DATES

Tax Expenditure	Expiration Date
Business alternative energy investment tax credits, and conservation and supply incentives	December 31, 1982[a]
Credits for cogeneration equipment	December 31, 1982
Deduction for eliminating architectural and transportation barriers for the handicapped	December 31, 1982
Tax-exempt savings certificates	December 31, 1982
Exclusion for employer educational assistance programs	December 31, 1983
Safe-harbor leasing[b]	December 31, 1983
Suspension of regulations relating to allocation under section 861 of research and experimental procedures	December 31, 1983
Exclusion of interest on state and local housing bonds for owner-occupied housing	December 31, 1983
Exclusion of contributions to prepaid legal services plans	December 31, 1984
Targeted jobs tax credit	December 31, 1984
Tax-exempt bonds for purchase of mass transit equipment	December 31, 1984
Exclusion for employer-provided transportation	December 31, 1985
Geothermal equipment credit	December 31, 1985
Credit for intercity buses	December 31, 1985
Solar and wind property credit	December 31, 1985

(Continued)

TABLE D-1. (Continued)

Tax Expenditure	Expiration Date
Credit for ocean thermal energy conversion equipment	December 31, 1985
Biomass property credit	December 31, 1985
Credit for small-scale hydroelectric facilities	December 31, 1985
Public utility dividend reinvestment plans	December 31, 1985
Residential energy conservation credits	December 31, 1985
Residential renewable energy supply credits	December 31, 1985
Tax-exempt bonds for small-scale hydroelectric facilities	December 31, 1985
Tax credit for research and experimentation	December 31, 1985
Charitable contribution deduction for nonitemizers	December 31, 1986
Tax exemption for small issue IDBs	December 31, 1986
Employee stock ownership plan (ESOP) investment tax credit	December 31, 1987[c]
Alcohol fuel tax credit and excise tax exemption	December 31, 1992
Alternative fuel production credit	December 31, 2000

a. Under some circumstances, expiration date expanded to December 31, 1985. Energy incentives with other expiration dates are noted elsewhere.

b. Replaced by a finance leasing provision in the Tax Equity and Fiscal Responsibility Act (P.L. 97-248).

c. After December 31, 1982, the investment tax credit will be replaced by an income tax credit based on aggregate compensation which expires at the end of 1987.

APPENDIX E. TREASURY ESTIMATES OF THE DISTRIBUTION OF TAX EXPENDITURES FOR INDIVIDUALS BY INCOME CLASS

This appendix includes new Treasury Department estimates of the distribution of tax expenditures for individuals by income class (see Tables E-1 and E-2). The estimates were prepared at the request of Chairman Henry S. Reuss of the Joint Economic Committee and sent to him in October 1982.

The Treasury estimates are the most comprehensive that have been done since early 1978. The 1978 estimates were prepared for then Chairman Edmund S. Muskie of the Senate Committee on the Budget and included in the Budget Committee report entitled Tax Expenditures, published in September 1978.

The Joint Committee on Taxation (JCT) prepares estimates of the distribution by income class of a limited number of tax expenditures each year, mainly those that can be estimated on the basis of tax return data. These estimates are printed in March of each year in the JCT's report on the projected revenue losses from tax expenditures for the next five fiscal years.

The Treasury estimates reprinted here are based on adjusted gross income, while the JCT estimates are based on a broader concept of income called "expanded income." Expanded income includes adjusted gross income, plus the income from special tax preference items covered by the Minimum Tax (mostly the excluded portion of capital gains), and minus investment interest expense up to the amount of investment income. It thus comes closer to the concept of real economic income than does adjusted gross income. Most of the differences between the two concepts of income occur in the higher income classes.

The Treasury cover letter transmitting the new estimates to Chairman Reuss cautioned that the estimates reprinted here in Table E-2 are less reliable than those in Table E-1, since the Table E-2 estimates are based on information from sources other than income tax returns. The Treasury also listed a number of tax expenditure items for which there was not enough information to make reasonable distribution estimates. These items appear in Table E-3.

The Treasury Department did not attempt to allocate corporate tax expenditures to individuals. The main reason cited is the difficulty in

TABLE E-1. REVENUE LOSS FROM TAX EXPENDITURES FOR INDIVIDUALS, DISTRIBUTED BY ADJUSTED GROSS INCOME CLASS ON THE BASIS OF TAX RETURN DATA, 1982 LAW AND 1981 INCOME LEVELS (In millions of dollars)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Income Earned Abroad by U.S. Citizens	Investment Credit Other Than Energy Credits[a,b]	Capital Gains, Excluding Home Sales[c]	Residential Energy Credits: Supply Incentives[a]	Residential Energy Credits: Conservation Incentives[a]	Alternative Conservation and New Technology Credits--Supply Incentives[a]
Less than 10	4	75	428	17	28	---
10-15	14	199	384	7	38	e
15-20	21	249	308	19	48	e
20-30	53	557	1,140	43	124	e
30-50	158	744	2,564	68	130	5
50-100	385	745	3,179	34	39	8
100-200	221	414	2,148	8	7	12
200 and over	74	454	3,081	2	2	13
Total	930	3,439	13,231	199	415	38

Adjusted Gross Income Class (In thousands of dollars)	Jobs Credit[a]	Deductibility of Medical Expenses	Additional Exemption for the Blind	Additional Exemption for the Elderly	Tax Credit for the Elderly[a]
Less than 10	e	85	4	406	40
10-15	1	190	1	407	37
15-20	1	299	10	260	21
20-30	8	827	2	360	19
30-50	5	1,201	8	374	16
50-100	10	614	2	225	3
100-200	6	150	1	76	e
200 and over	3	56	e	23	e
Total	35	3,422	28	2,131	135

(Continued)

SOURCE: Office of Tax Analysis, Department of the Treasury (September 23, 1982)
NOTE: Details may not add to totals because of rounding.

a. Based on 1980 distributions.
b. Includes the investment credit for increasing research activities, the rehabilitation of structures, and other investment.

TABLE E-1. (Continued)

Adjusted Gross Income Class (In thousands of dollars)	Dividend and Interest Exclusion	Deductibility of Mortgage Interest on Owner-Occupied Homes	Deductibility of Property Tax on Owner-Occupied Homes	Deductibility of Chartiable Contributions[d]	Credit for for Child and Dependent Care[a]	WIN Credit[a]
Less than 10	24	220	109	36	92	---
10-15	28	343	198	129	218	2
15-20	30	892	374	249	188	e
20-30	87	3,633	1,429	985	382	2
30-50	170	8,639	3,252	2,550	364	4
50-100	128	4,672	2,291	2,109	62	7
100-200	33	979	725	1,126	7	2
200 and over	8	225	302	1,652	1	e
Total	506	19,602	8,679	8,836	1,314	17

Adjusted Gross Income Class (In thousands of dollars)	Deductibility of Casualty Losses	Earned Income Credit	Credit for Political Contributions[a]	Deductibility of Nonbusiness State and Local Taxes Other Than on Owner-Occupied Homes
Less than 10	8	533[f]	8	118
10-15	21	---	9	230
15-20	41	---	9	497
20-30	109	---	18	2,276
30-50	249	---	21	6,289
50-100	178	---	21	5,050
100-200	52	---	11	2,032
200 and over	37	---	1	1,352
Total	695	533[f]	80	17,844

c. Includes capital gains treatment of coal royalties, iron ore, certain timber and agricultural income, and other income.

d. Includes the deductibility of charitable contributions for education, health, and other. The estimates exclude amounts claimed by nonitemizers, estimated to total $180 million.

e. Less than $500,000.

f. The effect of the credit on receipts. The effect on outlays equals $1,283 million, of which is claimed by individuals with less than $10,000 adjusted gross income.

TABLE E-2. REVENUE LOSS FROM TAX EXPENDITURES FOR INDIVIDUALS, DISTRIBUTED BY ADJUSTED GROSS INCOME CLASS ON THE BASIS OF DATA FROM SOURCES OTHER THAN TAX RETURNS, 1982 LAW AND 1981 INCOME LEVELS (In millions of dollars)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Veterans' Preferences[a]	Exclusion of Interest on State and Local Bonds[b]	Deductibility of Interest on Consumer Credit	Deferral of Capital Gains on Home Sales	Exclusion of Capital Gains on Home Sales for Persons Age 55 and Over	Exclusion of Employer Contributions for Medical Insurance Premiums and Medical Care
Less than 10	858	4	9	8	3	888
10 - 15	520	5	98	4	1	1,191
15 - 20	482	7	332	52	9	1,464
20 - 30	815	25	1,566	146	79	3,851
30 - 50	504	230	3,606	341	183	4,470
50 - 100	176	2,019	1,888	294	60	1,450
100 - 200	37	1,441	549	90	30	252
200 and over	8	868	199	34	15	53
Total	3,400	4,599	8,246	967	380	13,619

(Continued)

SOURCE: Office of Tax Analysis, Department of the Treasury (September 23, 1982).

NOTE: Details may not add to totals because of rounding.

a. Includes the exclusion of benefits and allowances to Armed Forces personnel, military disability pensions, veterans' disability compensation, veterans' pensions, and GI bill benefits.

TABLE E-2. (Continued)

Adjusted Gross Income Class (In thousands of dollars)	Exclusion of Social Security and Railroad Retirement Benefits[c]	Exclusion of Workmen's Compensation Benefits	Exclusion of Untaxed Unemployment Insurance Benefits	Exclusion of Disability Pay	Net Exclusion of Pension Contributions and Earnings[d]	Exclusion of Insurance Premiums[e]
Less than 10	5,029	786	1,073	127	964	83
10 - 15	1,787	444	560	22	1,371	112
15 - 20	1,254	314	205	1	1,893	163
20 - 30	1,822	664	272	3	5,495	444
30 - 50	1,278	345	9	---	8,306	642
50 - 100	731	93	---	---	4,345	282
100 - 200	209	20	---	---	1,463	89
200 and over	55	8	---	---	513	36
Total	12,165	2,674	2,119	153	24,350	1,851

b. Includes the exclusion of interest on pollution control bonds, industrial development bonds, housing bonds for owner-occupied homes and rental housing, student loan bonds, hospital bonds, and general purpose state and local debt.

c. Includes the exclusion of disability insurance benefits, OASI benefits for retired workers, benefits for dependents and survivors, and railroad retirement system benefits.

d. Includes the exclusion of contributions and earnings for employer plans and plans for the self-employed and others.

e. Includes premiums for group-term life insurance and accident and disability insurance.

TABLE E-3. TAX EXPENDITURES FOR INDIVIDUALS FOR WHICH DISTRIBUTION DATA ARE UNAVAILABLE

Expensing of research and development expenditures

Expensing of exploration and development costs, fuel and nonfuel minerals

Excess of percentage over cost depletion, fuel and nonfuel minerals

Tax incentives for preservation of historic structures

Cash accounting for agriculture

Exclusion of interest on life insurance savings

Expensing of construction period interest and taxes

Carryover basis of capital gains at death

Amortization of start-up costs

Exclusion of interest on certain savings certificates

Five-year amortization for housing rehabilitation

Exclusion of employee meals and lodging (other than military)

Employer educational assistance

Exclusion of contributions to prepaid legal plans

Exclusion of income of trusts to finance supplementary unemployment insurance benefits

Deductibility of certain adoption expenses

Deferral of interest on savings bonds

Parental personal exemption for students age 19 and over

Exclusions of special benefits for disabled coal miners

SOURCE: Office of the Secretary of the Treasury, Office of Tax Analysis (September 23, 1982).

determining what kinds of individuals benefit from particular reductions in corporate income taxes. The Treasury notes that "this omission is extremely important and means that the tables should not be used to indicate the distribution of all tax expenditures by income class."

In order to give some perspective on the estimates, Table E-4 shows total tax liability by adjusted gross income class, plus the total number of returns filed and the total number of taxable returns.

The models from which the tax expenditure estimates are taken undergo continual updating and improvement, so all of the estimates should be viewed as preliminary and subject to change. This is especially true for those estimates for which no tax return data is available. The estimates nonetheless serve as a useful guide to the approximate distribution by income class of a large number of existing tax expenditures.

TABLE E-4. DISTRIBUTION OF RETURNS AND TAX LIABILITY BY ADJUSTED GROSS INCOME CLASS, 1982 LAW AND 1981 INCOME LEVELS

Adjusted Gross Income Class (In thousands of dollars)	Total Number of Returns	Total Number of Taxable Returns	Tax Liability[a] (In millions of dollars)
Less than 10	34,366	17,207	6,600
10 - 15	13,457	13,226	14,582
15 - 20	10,936	10,832	20,394
20 - 30	17,254	17,176	52,815
30 - 50	13,538	13,498	77,958
50 - 100	3,384	3,375	46,379
100 - 200	549	549	21,288
200 and over	116	116	16,093
Total	93,600	75,979	256,109

SOURCE: Staff of the Joint Committee on Taxation.

a. Tax liabilities do not include the refundable (outlay) portion of the earned income credit. Liability reflects major Economic Recovery Tax Act (ERTA) and Tax Equity and Fiscal Responsibility Act (TEFRA) provisions except Accelerated Cost Recovery System (ACRS), All Savers, IRA, and KEOGH provisions.

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