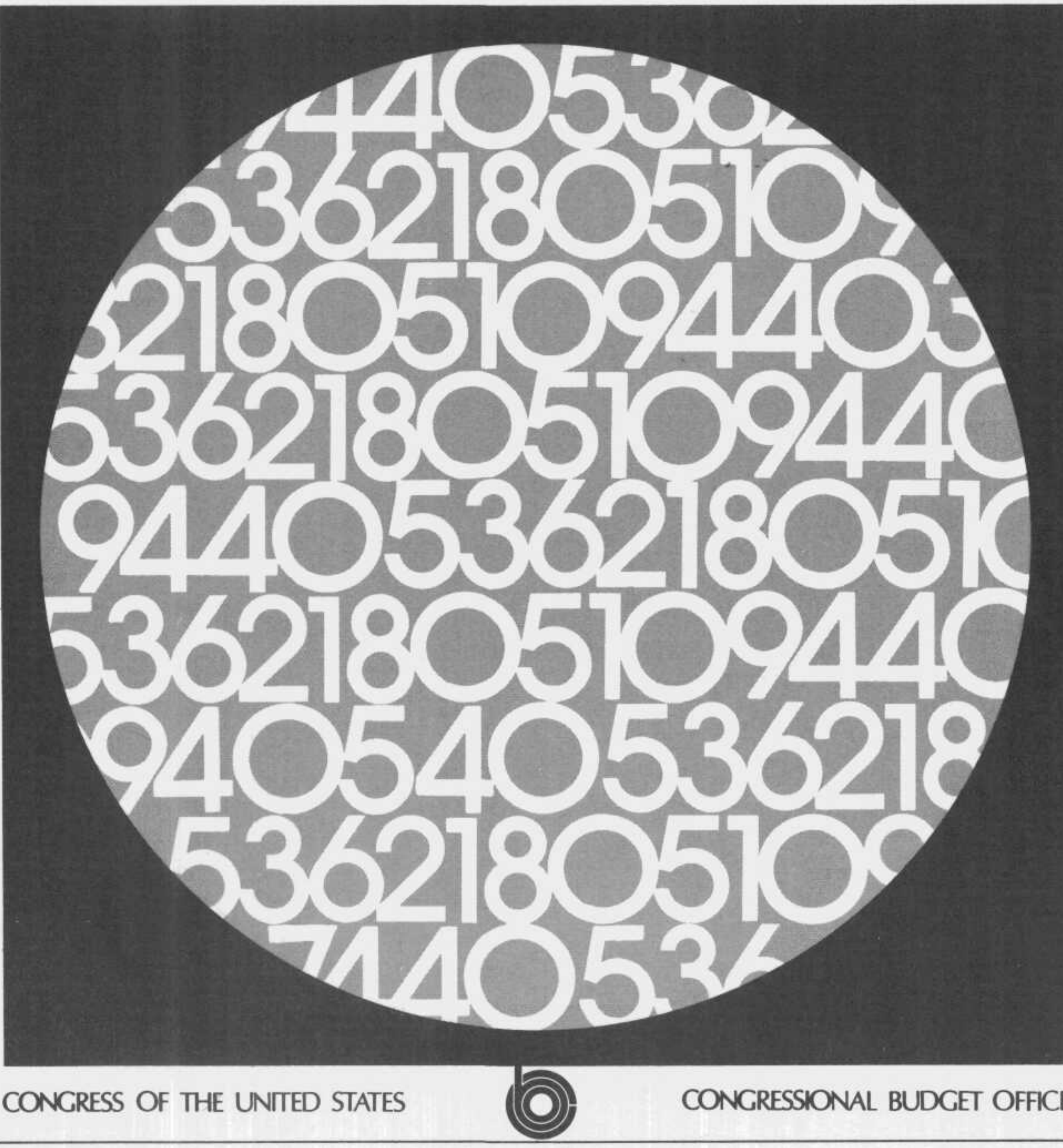
FIVE-YEAR BUDGET PROJECTIONS: FISCAL YEARS 1979-1983

June 1978

As required by Public Law 93-344

SUPPLEMENT ON TAX EXPENDITURES



CONGRESS OF THE UNITED STATES

CONGRESSIONAL BUDGET OFFICE

FIVE-YEAR BUDGET PROJECTIONS: FISCAL YEARS 1979-1983 SUPPLEMENT ON TAX EXPENDITURES

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Congressional Budget Office

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PREFACE

As required by Section 308(c) of the Congressional Budget Act of 1974 (P.L. 93-344), this report by the Congressional Budget Office projects tax expenditures for each fiscal year between 1979 and 1983. It is a supplement to CBO's Five-Year Budget Projections: Fiscal Years 1979-1983, issued in December 1977.

The paper was written by Michael Deich of CBO's Tax Analysis Division. The author is grateful for the helpful comments and suggestions of Jonathan Bernstein, Charles Davenport, David Longanecker, and James Verdier. The manuscript was edited by Patricia H. Johnston and typed by Alda Seubert.

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Director

June 1978

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SUMMARY

This report presents estimates of federal tax expenditures for fiscal years 1979-1983. Tax expenditures are revenue losses arising from tax provisions that allow selective tax relief to certain categories of taxpayers. The resulting revenue losses are called tax expenditures because they are payments made through a special reduction in taxes rather than a direct grant. A tax expenditure can take the form of a special exclusion, deduction, or exemption, or can provide a special credit, preferential tax rate, or deferral of liability.

The tax expenditure budget will be $136 billion in fiscal year 1979, about 20 percent of overall federal expenditures. Assuming no changes in the tax law, tax expenditures will be $188 billion by fiscal year 1983. The growth in tax expenditures will result from rising national income and the progressive structure of the individual income tax. As more income becomes subject to special tax treatment, tax expenditures will rise. Rising incomes will also push individuals into higher tax brackets, increasing the revenue foregone because of tax expenditure provisions.

For the third consecutive year, the Congress in 1977 enacted major tax legislation that will significantly affect the tax expenditure budget. The Tax Reduction and Simplification Act of 1977 (P.L. 95-30) contained one new tax expenditure item (the jobs tax credit) and extended or increased numerous existing ones (the earned income credit and the corporate surtax exemption being the largest among these). The tax expenditure provisions of the act will increase the tax expenditure budget by approximately $6.7 billion in fiscal year 1979.

The Congressional Budget Act of 1974 charges the House and Senate Budget Committees with the responsibility "to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays...," thus recognizing that effective control of the budget often requires comprehensive consideration of both tax expenditures and direct outlays. For example, the Senate has considered the benefits provided by the exclusion from income tax of certain allowances for military personnel when deciding upon funding for those allowances. Joint consideration of both direct outlays and related tax expenditures provides a much clearer view of total support for federal programs and could be more widely adopted by the Congress.

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INTRODUCTION

This report presents estimates of the level of tax expenditures for fiscal years 1979 through 1983. These estimates assume that there will not be any change in tax law during this period and thus provide a baseline against which the Congress can weigh Presidential and Congressional proposals affecting tax expenditures. 1/ This longer-term framework can be useful since the full effects of changes in tax expenditure provisions often are not felt until several years after enactment.

This report first defines tax expenditures and then discusses some of the ways in which they are similar to direct expenditures. Issues in measuring them and in their trends are discussed. The report concludes with a discussion of the changes in tax expenditures resulting from the major tax legislation enacted during the past year.

DEFINING TAX EXPENDITURES

Tax expenditures are revenue losses from the provisions of the tax law that provide special or selective tax relief to certain categories of taxpayers. These revenue losses are called tax expenditures because they are like payments by the federal government, except that they are made through a reduction of taxes rather than by a direct grant. For example, if a taxpayer buys a machine costing $1,000, the 10 percent investment tax credit allows him to reduce his income tax by $100. Instead of allowing this credit, the government could collect this $100 as it does from other taxpayers and then provide financial assistance by a government payment worth $100 after taxes.

1/ Presidential proposals affecting tax expenditures are discussed in Congressional Budget Office, The President's Fiscal Year 1979 Tax Expenditure Proposals (April 1978).

A tax expenditure provision can provide tax relief in any of the following forms:

- o Special exclusions, exemptions, and deductions, which reduce taxable income, and thus result in a smaller amount of tax (for example, tax-exempt municipal bond interest or the deduction of interest paid on consumer loans).

- o Preferential rates, which reduce taxes by applying lower rates to part or all of a taxpayer's income (for example, the special 50 percent maximum tax rate on personal service income).

- o Special credits, which are subtracted from the actual taxes due rather than from the income on which the tax is figured (for example, the investment tax credit).

- o Deferrals of tax, which generally result from allowing in the current year deductions that are properly attributable to a future year (for example, accelerated depreciation).

CHAPTER II. THE RELATIONSHIP BETWEEN TAX AND DIRECT EXPENDITURES

There are several similarities between tax expenditures and direct expenditures. For example, the tax relief offered by tax expenditure provisions is generally available to any taxpayer who meets the requirements of the tax law. Thus, a tax expenditure corresponds to an entitlement program on the spending side of the budget; the amount expended is not subject to any legislated limit but is dependent solely upon taxpayer response to the particular provision. In this respect, tax expenditures closely resemble spending programs that have no ceiling.

There are other parallels between spending through the tax system and direct outlays. As with direct spending programs, a change in one tax expenditure provision will often affect the extent to which related tax expenditures are utilized. For example, if the provision that allows rapid amortization of pollution control facilities were repealed, some affected taxpayers would switch to depreciation with the short lives allowed by the Asset Depreciation Range (ADR). The tax expenditures attributable to ADR would therefore increase. Similar interactions exist on the spending side of the budget. A repeal of the program for Aid to Families with Dependent Children (AFDC), for example, probably would result in increased outlays for other programs such as food stamps.

REFUNDABLE TAX CREDIT

A tax expenditure taking the form of a refundable tax credit is the most similar to a direct spending program. When the amount of a refundable credit exceeds a taxpayer's income tax liability, the Treasury Department refunds the difference to him. Individuals may thus receive payments from the Treasury greater than the amount of income taxes they have paid in. These payments so closely resemble direct outlays that, for budgetary purposes, they have sometimes been treated as direct outlays and sometimes as revenue reductions.

Both the Congress and the Executive Branch have treated the refundable portion of the earned income credit in this changing fashion. In the Mid-session Review of the 1978 Budget, 1/ the Carter Administration adopted the practice of treating the refundable portion of the credit as a reduction in revenue. In doing so, it reversed the budgetary treatment inherited from the Ford Administration, which had considered the refundable portion of the credit to be an outlay. 2/

Congressional budgetary treatment of the refundable portions of tax credits has also varied. In the Budget Committee Reports accompanying the Third Concurrent Resolution on the Budget for Fiscal Year 1977 3/ and both the First and Second Concurrent Resolutions on the Budget for Fiscal Year 1978, 4/ the House of Representatives treated the refundable portion of the existing earned income credit as spending authority. The Senate Budget Committee, however, treated the entire credit as a reduction in revenue, a position adopted in the Conference Reports on the resolutions. The Conference Report on the Second Concurrent Resolution, however, stated that such treatment was limited to the existing earned income credit and did not constitute a precedent that would dictate decisions on the treatment of future refundable tax credit legislation.

The First Concurrent Resolution on the Budget for Fiscal Year 1979, as recently adopted by both the House and Senate,

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1/ Office of Management and Budget, Mid-session Review of the 1978 Budget, (July 1977).

2/ Office of Management and Budget, Mid-session Review of the 1977 Budget (July 1976).

3/ Third Concurrent Resolution on the Budget—FY 1977, Report of the Committee on the Budget, U.S. House of Representatives, February 8, 1977, p. 51 and Third Concurrent Resolution on the Budget—FY 1977, United States Senate, February 10, 1977, p. 13.

4/ First Concurrent Resolution on the Budget--FY 1978, U.S. House of Representatives, April 6, 1977, p. 66; Second Concurrent Resolution on the Budget--FY 1978, U.S. House of Representatives, August 5, 1977, p. 12; First Concurrent Resolution on the Budget—FY 1978, United States Senate, April 12, 1977, p. 17; and Second Concurrent Resolution on the Budget—FY 1978, United States Senate, August 4, 1977, p. 18.

shows another shift in Congressional attitudes on this issue. In a reversal of its earlier position, the Senate treated the refundable portion of the earned income credit as a direct outlay. The House also altered its former stand and regarded the entire credit as a loss of revenue. The Conference Report on the First Concurrent Resolution for 1979 adopted the Senate view, treating the refundable portion of the earned income credit as an outlay and budget authority rather than as a revenue reduction. 5/

INTERACTIONS BETWEEN TAX AND DIRECT EXPENDITURES

In addition to similarities, there are substantive interactions between tax and direct expenditures. The level of the tax expenditure budget depends in part upon the magnitude of related direct outlays. A rise or fall in direct spending will often result in a change in tax expenditure levels in the same direction. Tax expenditures that arise from exempting from income tax certain federal transfer payments (for example, social security benefits, unemployment compensation, and certain other income security transfers) provide a case in point. As will be discussed below, the size of a tax expenditure depends upon the amount being excluded from the income tax as well as the taxpayer's marginal tax rate. As a result, increased outlays for social security, for example, will also increase the benefits provided social security recipients through the tax system.

Some direct spending programs are similarly affected by the availability and size of tax expenditures. The Department of Housing and Urban Development, for example, provides direct subsidies for the construction of housing for low- and moderate-income families through its Section 8 housing program. Given the existing levels of direct subsidies, many developers find it profitable to participate in the program only because they are able to supplement these direct subsidies with the benefits provided by the tax expenditure provisions allowing accelerated depreciation, the expensing of construction period interest and taxes, and other favorable tax treatment of rental housing costs. A cutback in one of these tax expenditure provisions would probably reduce the number of developers finding it profitable to take part in the Section 8 program. Aggregate outlays under the program, therefore, might well decline.

5/ Conference Report on the First Concurrent Resolution on the Budget, Fiscal Year 1979, p. 4, Senate Report 95-866.

The Congressional Budget Act of 1974 reflects a growing Congressional recognition of the relationship between tax and direct expenditures. That act charges the House and Senate Budget Committees with the responsibility "to devise methods of coordinating tax expenditures, policies, and programs with direct budget outlays...." This task is complicated by the fact that these two types of federal expenditures often lie within the jurisdiction of different Congressional committees. All tax expenditures fall within the jurisdiction of the tax-writing committees (the Finance Committee in the Senate and the Ways and Means Committee in the House). By contrast, direct spending programs are within the purview of different authorizing committees, depending upon which policy area that program addresses. Consequently, the same committee often does not control both a tax expenditure and the direct outlays relating to it. Of course, this does not prevent the joint consideration of direct spending and tax expenditures. For example, the Senate has considered both kinds of expenditures when debating the appropriate level of compensation for active duty military personnel. 6/ In determining appropriations for direct pay, the Appropriations Committee has noted the benefits accruing to military members from exempting a portion of this pay from income tax. To assist other committees that may want to consider existing tax expenditures when establishing programs funded by direct outlays, Tables 1 and 2 classify these tax expenditures by the Congressional committee having authorizing jurisdiction over related direct spending programs.

6/ Department of Defense Appropriation Bill, 1978, Senate Report No. 95-325, United States Senate, June 1977, p. 22.

TABLE 1. TAX EXPENDITURES BY SENATE COMMITTEE WITH AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS

Committee	Tax Expenditure
Agriculture, Nutrition, and Forestry	Capital gains treatment of certain timber income Capital gains treatment of certain ordinary income Expensing of certain capital outlays Deductibility of noncash patronage dividends and certain other items of cooperatives
Armed Services	Exclusion of benefits and allowances to Armed Forces personnel Exclusion of military disability pensions Exclusion of veterans' disability compensation Exclusion of veterans' pensions Exclusion of GI Bill benefits
Banking, Housing, and Urban Affairs	Exclusion of income earned abroad by U.S. citizens Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Special rate for Western Hemisphere trade corporations Exemption of credit union income Excess bad debt reserves of financial institutions Deductibility of mortgage interest on owner-occupied homes Deductibility of property tax on owner-occupied homes Deductibility of interest on consumer credit Deferral of capital gains on home sales Dividend exclusion Corporate surtax exemption Investment tax credit Capital gains (other than farming, timber, iron ore, and coal) Capital gains at death Depreciation on rental housing in excess of straight-line Depreciation on buildings (other than rental housing) in excess of straight-line Expensing of construction period interest and taxes Excess first-year depreciation Asset Depreciation Range 5-year amortization for housing rehabilitation Tax incentives for preservation of historic structures Deferral of interest on savings bonds

(continued)

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TABLE 1. (Continued)

Committee	Tax Expenditure
Banking, Housing, and Urban Affairs (continued)	Exclusion of interest on general purpose state and local debt Exclusion of capital gains on home sales for persons 65 or older Exclusion of interest on state and local government pollution control bonds
Commerce, Science and Transportation	Expensing of research and development expenditures 5-year amortization on railroad rolling stock Deductibility of nonbusiness state gasoline taxes Deferral of tax on shipping companies Tax credit for corporations doing business in U.S. possessions Deductibility of nonbusiness state gasoline taxes
Energy and Natural Resources	Expensing of exploration and development costs Excess of percentage over cost depletion Capital gains treatment of royalties on coal Capital gains treatment of royalties on iron ore Tax incentives for preservation of historic structures
Environment and Public Works	Exclusion of interest on state and local government pollution control bonds 5-year amortization of pollution control facilities Exclusion of payments in aid of construction of water and sewage facilities
Finance	Exclusion of social security benefits: Disability insurance benefits OASI benefits for retired workers Benefits for dependents and survivors Exclusion of unemployment insurance benefits Exclusion of public assistance benefits Earned income credit Exclusion of interest on general purpose state and local debt Exclusion of interest on state and local pollution control bonds Exclusion of interest on state and local industrial development bonds
Foreign Relations	Exclusion of income earned abroad by U.S. citizens Deferral of income of Domestic International Sales Corporations (DISC) Special rate for Western Hemisphere trade corporations

(continued)

TABLE 1. (Continued)

Committee	Tax Expenditure
Governmental Affairs (continued)	Exclusion of interest on general purpose state and local debt
	Exclusion of interest on state and local pollution control bonds
	Exclusion of interest on state and local industrial development bonds
	Deductibility of state gasoline taxes
	Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)
	Tax credit for corporations doing business in U.S. possessions
Human Resources	Exclusion of scholarship and fellowship income
	Parental personal exemption for students aged 19 and over
	Deductibility of charitable contributions (education)
	Credit for child and dependent care expenses
	Expensing of removal of architectural and transportation barriers for the handicapped
	Credit for employment of AFDC and public assistance recipients under work incentive programs
	Maximum tax on personal service income
	Exclusion of employee meals and lodging (other than military)
	Exclusion of contributions to prepaid legal service plans
	Investment credit for Employee Stock Ownership Plans (ESOPs)
	Deductibility of charitable contributions to other than education and health
	Exclusion of employer contributions for medical insurance premiums and medical care
	Deductibility of medical expenses
	Deductibility of charitable contributions (health)
	Exclusion of railroad retirement system benefits
	Exclusion of workmen's compensation benefits
	Exclusion of special benefits for disabled coal miners
	Net exclusion of pension contributions and earnings:
	Employer plans
	Plans for self-employed and others

(continued)

TABLE 1. (Continued)

Committee	Tax Expenditure
Human Resources (continued)	Exclusion of other employee benefits: Premiums on group term life insurance Premiums on accident and disability insurance Exclusion of capital gains on home sales for persons age 65 and over Additional exemption for the elderly Tax credit for the elderly Exclusion of interest on life insurance saving Exclusion of sick pay Exclusion of income of trusts to finance supplementary unemployment benefits Additional exemption for the blind Deductibility of casualty losses Jobs credit
Judiciary	Exclusion of contributions to prepaid legal services plans
Rules and Administration	Credits and deductions for political contributions
Veterans' Affairs	Exclusion of military disability pensions Exclusion of veterans' disability compensation Exclusion of veterans' pensions Exclusion of GI Bill benefits

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

TABLE 2. TAX EXPENDITURES BY HOUSE OF REPRESENTATIVES COMMITTEE WITH AUTHORIZING JURISDICTION OVER RELATED DIRECT OUTLAYS

Committee	Tax Expenditure
Agriculture	Capital gains treatment of certain ordinary income Expensing of certain capital outlays Deductibility of noncash patronage dividends and certain other items of cooperatives Capital gains treatment of certain timber income
Armed Services	Exclusion of benefits and allowances to Armed Forces personnel Exclusion of military disability pensions Exclusion of veterans' pensions Exclusion of GI Bill benefits Exclusion of veterans' disability compensation
Banking, Finance and Urban Affairs	Exclusion of interest on state and local pollution-control bonds Exemption of credit union income Excess bad debt reserves of financial institutions Deductibility of mortgage interest on owner-occupied homes Deductibility of property tax on owner-occupied homes Deductibility of interest on consumer credit Deferral of capital gains on home sales Capital gains (other than farming, timber, iron ore, and coal) Depreciation of rental housing in excess of straight-line Depreciation of buildings (other than rental housing) in excess of straight-line 5-year amortization for housing rehabilitation Exclusion of capital gains on home sales for persons age 65 and over Expensing of construction period interest and taxes Exclusion of income earned abroad by U.S. citizens Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Special rate for Western Hemisphere trade corporations Dividend exclusion Corporate surtax exemption Excess first-year depreciation Asset Depreciation Range

(continued)

TABLE 2. (Continued)

Committee	Tax Expenditure
Banking, Finance and Urban Affairs (continued)	Capital gains at death
	Tax incentives for the preservation of historic structures
	Investment tax credit
	Capital gains on home sales
	Jobs credit
	Deferral of interest on savings bonds
Education and Labor	Exclusion of scholarship and fellowship income
	Parental personal exemption for children aged 19 or over
	Deductibility of charitable contributions (education)
	Credit for child and dependent care expenses
	Expensing of removal of architectural and transportation barriers to the handicapped
	Credit for the employment of AFDC and public assistance recipients under work incentive programs
	Additional exemption for the elderly
	Additional exemption for the blind
	Exclusion for workmen's compensation benefits
	Exclusion of special benefits for disabled coal miners
	Net exclusion of pension contributions and earnings:
	Employer plans
	Plans for self-employed and others
	Tax credit for the elderly
	Earned income credit
	Deductibility of casualty losses
	Exclusion of employee meals and lodging (other than military)
	Maximum tax on personal service income
	Exclusion for contributions to prepaid legal service plans
	Investment credit for Employee Stock Ownership Plans (ESOPs)
	Deductibility of charitable contributions for other than education and health
	Exclusion of employer contributions for medical insurance premiums and medical care
	Jobs credit
Government Operations	Tax credit for corporations doing business in U.S. possessions
	Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)
	Deductibility of state gasoline taxes

(continued)

TABLE 2. (Continued)

Committee	Tax Expenditure
Government Operations (continued)	Exclusion of interest payments on state and local industrial development bonds Exclusion of interest on state and local pollution control bonds Exclusion of interest on general purpose state and local debt Exclusion of interest on general purpose state and local debt
House Administration	Credits and deductions for political contributions
Interior and Insular Affairs	Tax incentives for preservation of historic structures Capital gains treatment of royalties on coal Capital gains treatment of royalties on iron ore Expensing of exploration and development costs Excess of percentage over cost depletion
International Relations	Exclusion of income earned abroad Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Special rate for Western Hemisphere trade corporations
Interstate and Foreign Commerce	Deferral of income of Domestic International Sales Corporations (DISC) Deferral of income of controlled foreign corporations Special rate for Western Hemisphere trade corporations Dividend exclusion Exclusion of interest payments on state and local industrial development bonds (other than for education and health) 5-year amortization on railroad rolling stock Exclusion of sick pay Expensing of removal of architectural and transportation barriers to the handicapped Deductibility of medical expenses Exclusion of employee contributions for medical insurance premiums and medical care Deferral of tax on shipping companies Exclusion of payments in aid of construction of water and sewage utilities Deferral of interest on savings bonds Exclusion of interest on life insurance savings

(continued)

TABLE 2. (Continued)

Committee	Tax Expenditure
Interstate and Foreign Commerce (continued)	Exclusion of employee benefits: Premiums on group term life insurance Premiums on accident and disability insurance Tax credit for corporations doing business in U.S. possessions Exclusion of railroad retirement system benefits Exclusion of payments in aid of construction of water and sewage utilities Exclusion of interest on state and local pollution control bonds 5-year amortization of pollution control facilities
Merchant Marine and Fisheries	Deferral of tax on shipping companies
Public Works and Transportation	Deductibility of state gasoline taxes Exclusion of payments in aid of construction of water and sewage utilities
Science and Technology	Expensing of research and development expenditures
Veterans' Affairs	Exclusion of military disability pensions Exclusion of veterans' disability compensation Exclusion of veterans' pensions Exclusion of GI Bill benefits
Ways and Means	Exclusion of unemployment insurance benefits Exclusion of income of trusts to finance supplementary unemployment benefits Exclusion of public assistance benefits Earned income credit Exclusion of social security benefits: Disability insurance benefits OASI benefits for retired workers Benefits for dependents and survivors Earned income credit

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

MEASUREMENT OF TAX EXPENDITURES

In calculating the revenue loss from each tax expenditure, it is assumed that only the provision in question is deleted and that all other aspects of the tax system remain the same. In the case of a tax credit, for example, the amount of the credit is the amount of the tax expenditure. If the tax expenditure takes the form of a special deduction, the amount deducted is added back into taxable income, and a new tax liability is computed by applying the appropriate tax rates to the increased amount of taxable income. The revenue loss is then computed as the difference between the new tax liability and that under existing law. Also for each itemized nonbusiness deduction for individuals, the estimated revenue loss is based on the amount by which the standard deduction (or zero bracket amount) is exceeded. In the case of a deferral, the revenue loss is calculated as the difference between tax under current law and the amount that would be paid if the deferral were not allowed. The revenue loss caused by a preferential rate is calculated by multiplying the base to which the special rate applies by the difference between the normal tax rate and the special tax rate.

Two assumptions are critical to this technique. First, economic aggregates are assumed to remain unchanged despite the hypothetical repeal of the provision in question. Second, any change in taxpayer behavior in response to the change is not taken into account. In short, "second order" effects of the revenue gain are not estimated. This general revenue estimating technique is consistent with the techniques generally used to estimate the changes in outlays that would result from changes in spending programs.

Interaction between tax expenditures should be kept in mind when the estimates of them are considered. For example, the amount of revenue not collected because a particular tax expenditure provision exists may not be the same as the <u>net</u> revenue gain that would be realized if the tax expenditure provision were eliminated. This seeming paradox may be illustrated by an example used earlier. Repealing the provision that allows rapid amortization of pollution control facilities would cause some affected taxpayers to use the Asset Depreciation Range (ADR) instead, thus increasing the tax expenditure accounted for by ADR. Total federal receipts, however, would increase only by the difference between (1) the revenue raised by the repeal of rapid amortization and (2) the revenue lost through the use of ADR. This amount would be smaller than the tax relief shown in Table 3 as attributable to rapid amortization.

The same kind of interaction occurs on the spending side of the budget. For example, a repeal of the program for Aid to Families with Dependent Children (AFDC) probably would result in increased outlays for other programs such as food stamps. Thus, if the AFDC program were repealed, the net reduction in federal expenditures probably would be less than the present AFDC outlays.

TAX EXPENDITURE ESTIMATES

The tax expenditure estimates for the next five fiscal years are shown in Table 3. These estimates were supplied to the Congressional Budget Office by the staffs of the Joint Committee on Taxation and the Department of the Treasury. Where these estimates depend on outlays by the federal government, the estimates are consistent with projections for outlay programs. As with the revenue projections 1/, the tax expenditure estimates are based on the law in effect as of December 31, 1977. However, in contrast to the revenue projections, the underlying assumption is that any provision that has a termination date will expire on that date.

For easier comparison with direct expenditures, the esitmates are grouped under each functional category of the federal budget, and subtotals for each category are shown. The totals for all tax expenditures for fiscal years 1978-1983 are shown in Table 3-A. These will be $136 billion in fiscal year 1979 and $188 billion in fiscal year 1983.

For the period of fiscal years 1979-1983, total tax expenditures accruing to individuals and corporations are projected to grow at an 8.3 percent average annual rate, amounting to a total increase of 37 percent of the period. About 89 percent of the total increase is in individual income tax expenditures, which are expected to grow at an average annual rate of 9.8 percent, for a

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1/ See CBO, Five-Year Budget Projections: Fiscal Years 1979-1983 (December 1977).

TABLE 3. TAX EXPENDITURE ESTIMATES BY FUNCTION AND SUBFUNCTION: BY FISCAL YEAR, IN MILLIONS OF DOLLARS a/

	Individuals						Corporations					
Function and Subfunction	1978	1979	1980	1981	1982	1983	1978	1979	1980	1981	1982	1983
National Defense												
Exclusion of benefits and allowances to Armed Forces personnel	1,260	1,370	1,470	1,585	1,715	1,850						
Exclusion of military disability pensions	115	120	130	135	145	150						
Subtotal	1,375	1,490	1,600	1,720	1,860	2,000						
International Affairs												
Exclusion of income earned abroad by U.S. citizens	360	385	415	475	510	550						
Deferral of income of domestic international sales corporations (DISC)							1,135	1,335	1,525	1,630	1,700	1,830
Deferral of income of controlled foreign corporations							615	665	720	775	835	905
Special rate for Western Hemisphere trade corporations	—	—	—	—	—	—	25	15	5	--	--	--
Subtotal	360	385	415	475	510	550	1,775	2,015	2,250	2,405	2,535	2,735
General Science, Space, and Technology												
Expensing of research and development expenditures	30	30	35	35	35	35	1,450	1,520	1,610	1,695	1,715	1,635
Energy												
Expensing of exploration and development costs	300	300	360	420	480	545	885	965	1,080	1,185	1,265	1,360
Excess of percentage over cost depletion	340	370	405	430	435	440	1,120	1,210	1,310	1,400	1,485	1,570
Capital gains treatment of royalties on coal	50	60	70	75	85	95	15	15	20	20	20	20
Subtotal	690	730	835	925	1,000	1,080	2,020	2,190	2,410	2,605	2,770	2,950

(continued)

Source and footnotes appear at end of Table 3.

TABLE 3. (Continued)

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
Natural Resources and Environment												
Exclusion of interest on state and local government pollution control bonds	110	130	145	160	175	185	220	265	300	330	355	390
Exclusion of payments in aid of construction of water and sewage utilities							10	10	10	10	10	10
5-year amortization on pollution control facilities							b/	b/	40	130	180	140
Tax incentives for preservation of historic structures	c/	5	5	10	10	10	--	5	5	5	5	5
Capital gains treatment of certain timber income	80	65	70	80	85	95	205	230	250	275	300	335
Capital gains treatment of iron ore	5	10	10	10	10	10	5	10	10	10	10	10
Subtotal	175	210	230	260	280	300	440	520	615	760	860	890
Agriculture												
Expensing of certain capital outlays	445	460	480	495	515	530	70	75	80	80	85	85
Capital gains treatment of certain ordinary income	350	365	385	405	425	450	10	10	10	15	15	15
Deductibility of noncash patronage dividends and certain other items of cooperatives	d/	d/	d/	d/	d/	d/	490	525	560	595	635	675
Subtotal	795	825	865	900	940	980	570	610	650	690	735	775
Commerce and Housing Credit												
Dividend exclusion	475	505	530	560	590	620						
Exclusion of interest on state and local industrial development bonds	115	135	155	175	195	220	235	270	315	355	400	445
Exemption of credit union income							80	90	100	115	125	140
Excess bad debt reserves of financial institutions							705	790	930	1,025	1,040	1,085
Deductibility of mortgage interest on owner-occupied homes	4,985	5,530	6,140	6,815	7,565	8,395						
Deductibility of property tax on owner-occupied homes	4,665	5,180	5,750	6,385	7,085	7,865						

(continued)

TABLE 3. (Continued)

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
Commerce and Housing Credit (continued)												
Deductibility of interest on consumer credit	2,120	2,350	2,610	2,895	3,215	3,565						
Expensing of construction period interest and taxes	140	90	145	165	205	230	500	525	555	585	615	645
Excess first-year depreciation	145	155	165	170	180	190	45	50	50	55	55	60
Depreciation on rental housing in excess of straight line	300	290	290	300	315	335	70	70	70	75	80	85
Depreciation on buildings (other than rental housing) in excess of straight line	125	115	105	95	90	95	140	130	115	110	105	105
Asset depreciation range	115	135	165	190	215	245	2,245	2,640	3,120	3,625	4,155	4,725
Capital gains (other than farming, timber, iron ore and coal)	7,430	7,990	8,585	9,230	9,925	10,665	540	575	635	705	780	865
Deferral of capital gains on home sales	935	980	1,030	1,080	1,135	1,195						
Capital gains at death	8,120	8,975	9,910	10,945	12,090	13,535						
Corporate surtax exemption							3,885	3,540	2,905	3,005	3,225	3,480
Investment credit	2,390	2,725	3,020	2,980	2,620	2,745	10,735	12,320	13,650	13,085	11,400	11,410
Subtotal	32,060	35,155	38,600	41,985	45,425	49,900	19,180	21,000	22,445	22,740	21,980	23,045
Transportation												
Deductibility of nonbusiness state gasoline taxes	760	840	935	1,035	1,150	1,275						
5-year amortization on railroad rolling stock							e/	e/	e/	e/	e/	e/
Deferral of tax on shipping companies	—	—	—	—	—	—	105	85	70	60	55	45
Subtotal	760	840	935	1,035	1,150	1,275	105	85	70	60	55	45
Community and Regional Development												
5-year amortization for housing rehabilitation	10	5	5	b/	b/	f/	5	5	5	b/	b/	f/

(continued)

TABLE 3. (Continued)

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
Education, Training, Employment, and Social Services												
Exclusion of scholarship and fellowship income	295	330	355	385	415	450						
Parental personal exemption for students age 19 or over	770	790	815	840	865	890						
Exclusion of employee meals and lodging (other than military)	300	325	350	380	410	445						
Exclusion of contributions to prepaid legal service plans	10	15	20	35	--	--						
Investment credit for employee stock ownership plans (ESOPs)							255	305	330	190	--	--
Deductibility of charitable contributions (education)	585	645	720	795	885	980	255	285	315	350	380	410
Deductibility of charitable contributions to other than education and health	4,370	4,855	5,385	5,980	6,635	7,365	315	350	390	430	470	510
Maximum tax on personal service income	665	800	955	1,150	1,375	1,655						
Credit for child and dependent care expenses	525	575	635	695	765	840						
Credit for employment of AFDC recipients and public assistance recipients under work-incentive programs							15	20	20	20	20	20
Jobs credit	985	860	b/	b/	b/	b/	1,475	1,035	215	110	55	35
Subtotal	8,505	9,195	9,235	10,260	11,350	12,625	2,315	1,995	1,270	1,100	925	975
Health												
Deductibility of medical expenses	2,435	2,655	2,895	3,155	3,435	3,745						
Exclusion of employer contributions for medical insurance premiums and medical care	6,340	7,225	8,240	9,390	10,705	12,205						
Expensing of removal of architectural and transportation barriers to the handicapped							10	10	b/	b/	b/	b/

(continued)

TABLE 3. *(Continued)*

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
Health (continued)												
Deductibility of charitable contributions (health)	875	970	1,075	1,195	1,330	1,475	160	175	195	215	235	255
Subtotal	9,650	10,850	12,210	13,740	15,470	17,425	170	185	195	215	235	255
Income Security												
Exclusion of social security benefits:												
Disability insurance benefits	550	605	685	760	840	925						
OASI benefits for retired workers	4,210	4,700	5,165	5,670	6,205	6,735						
Benefits for dependents and survivors	950	1,040	1,160	1,275	1,395	1,515						
Exclusion of railroad retirement system benefits	265	280	295	305	315	325						
Exclusion of workmen's compensation benefits	835	970	1,115	1,285	1,475	1,695						
Exclusion of special benefits for disabled coal miners	50	50	50	50	50	50						
Exclusion of unemployment insurance benefits	1,200	1,135	1,090	1,105	950	905						
Exclusion of public assistance benefits	345	360	380	395	410	430						
Exclusion of sick pay	75	60	65	65	70	75						
Net exclusion of pension contributions and earnings:												
Employer plans	9,940	11,335	12,925	14,740	16,815	19,175						
Plans for self-employed and others	1,650	1,920	2,205	2,535	2,915	3,355						
Exclusion of other employee benefits:												
Premiums on group term life insurance	905	955	1,010	1,065	1,120	1,185						
Preimums on accident and disability insurance	75	80	85	85	95	100						
Income of trusts to finance supplementary unemployment benefits	10	10	10	10	10	10						

(continued)

TABLE 3. (Continued)

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
Income Security (continued)												
Exclusion of interest on life insurance saving	2,025	2,225	2,450	2,705	2,980	3,290						
Exclusion of capital gains on home sales for persons age 65 and over	70	70	70	70	75	75						
Additional exemption for the elderly	1,155	1,215	1,275	1,340	1,405	1,475						
Additional exemption for the blind	20	20	20	20	20	20						
Deductibility for casualty losses	360	395	430	470	510	555						
Tax credit for the elderly	250	255	255	255	255	255						
Earned income credit:												
Nonrefundable portion	285	265	--	--	--	--						
Refundable portion	945	900	--	--	--	--						
Subtotal	26,170	28,845	30,740	34,205	37,910	42,150						
Veterans' Benefits and Services												
Exclusion of veterans' disability compensation	840	830	855	850	845	825						
Exclusion of veterans' pensions	40	40	40	40	35	35						
Exclusion of GI Bill benefits	200	170	150	130	110	95						
Subtotal	1,080	1,040	1,045	1,020	990	955						
General Government												
Credits and deductions for political contributions	60	75	60	85	65	90						
General Purpose Fiscal Assistance												
Exclusion of interest on state and local debt	1,925	2,150	2,390	2,655	2,950	3,255	3,470	3,865	4,305	4,780	5,310	5,845
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)	8,505	9,440	10,480	11,630	12,910	14,330						

(continued)

TABLE 3. (Continued)

Function and Subfunction	Individuals 1978	1979	1980	1981	1982	1983	Corporations 1978	1979	1980	1981	1982	1983
General Purpose Fiscal Assistance (continued)												
Tax credit for corporations doing business in U.S. possessions	—	—	—	—	—	—	485	520	565	610	660	710
Subtotal	10,430	11,590	12,870	14,285	15,860	17,585	3,955	4,385	4,870	5,390	5,970	6,555
Interest												
Deferral of interest on savings bonds	625	670	725	780	840	905						

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

a/ All estimates are based on the Internal Revenue Code as of December 31, 1977.

b/ This provision initially applied to new facilities added to plants in existence on January 1, 1969. It expired on December 31, 1975. No investment credit was allowed on property subject to this provision. The 1976 Act renewed the provision for property in existence on January 1, 1976. An investment credit of one-half now applies to facilities installed after December 31, 1976. Amortization on these facilities is a tax preference falling under the minimum tax. The interaction of these provisions results in revenue gains of $130 million and $45 million in fiscal year 1978 and 1979, respectively.

c/ Less than $2.5 million.

d/ Some individuals will have their taxable income increased by the dividends paid by the cooperative. It is estimated that these dividends will increase revenues by $175 million, $185 million, $190 million, $200 million, $210 million, and $220 million in fiscal years 1978, 1979, 1980, 1981, 1982, and 1983, respectively.

e/ Before 1976, railroad rolling stock, at the taxpayer's election, could be amortized over five years rather than depreciated. Some property which was amortized is still in service producing income. Because such property has no basis for depreciation, taxable income from it is higher than it would have been if the property had not been amortized. The revenue on this income is greater than the revenue losses on property subject to amortization. The amount accruing to corporations is $40 million in each fiscal year except 1983 when the amount is $35 million.

f/ Since this provision expired on December 31, 1977, revenue gains of $5 million each from corporations and individuals will be produced in 1983.

TABLE 3-A. SUM OF THE TAX EXPENDITURE ITEMS BY TYPE OF TAXPAYER: BY FISCAL YEAR, IN MILLIONS OF DOLLARS

Fiscal Year	Individuals and Corporations	Individuals	Corporations
1978	124,760	92,775	31,985
1979	136,445	101,935	34,510
1980	146,795	110,405	36,390
1981	159,370	121,710	37,660
1982	171,465	133,685	37,780
1983	187,715	147,855	39,860

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

NOTE: These totals represent the sum of the estimated fiscal year effect of each of the tax expenditure items included in the table. The limitations on the use of the totals are explained in the text, in the section on "Measurement and Estimates of Tax Expenditures."

45 percent total increase. This projected growth rate in individual tax expenditures, although less than the projected growth rate for individual income tax receipts, is largely brought about for the same reason--namely, the interaction of the progressive income tax structure and increases in income (both real and inflation induced). A rise in income implies a concommittant increase in income receiving special tax treatment. Furthermore, increased income will push individuals into higher marginal tax brackets and raise the value of some tax expenditure provisions to individuals. For example, a person deducting $1,000 per year in mortgage interest payments would receive a net tax saving of $190 if the marginal tax bracket is 19 percent; if in the following year, the deduction is increased to $1,050 and if the marginal bracket rose to 22 percent, the tax saving would rise to $231.

Corporation income tax expenditures are projected to rise at a 3.7 percent annual rate, for a total increase of 16 percent during the next five years. This rate is also smaller than the rate at which corporate income tax receipts are expected to grow, but it assumes that certain of the corporate tax expenditure provisions will not be extended. An expected rise in corporate profits and the resultant increase in the corporate income tax base account for the anticipated increase in the corporate tax expenditure budget.

Continuing Provisions Due to Expire

These calculations are based on the assumption that all of the statutory tax expenditure provisions due to expire during the projection period will be allowed to do so. If these provisions do not expire but continue, tax expenditures will grow at the faster rate of 9.6 percent during the period, leading to an increase in tax expenditures of 44 percent for the period. As indicated in Table 4, nearly all of the additional revenue loss would be caused by the extension of four tax expenditure items: the corporate surtax exemption and the investment tax credit for plant and equipment at their present levels, the employment tax credit, and the earned income credit.

Tax Expenditures and Outlays Budget

As discussed on page 1, tax expenditures are equivalent to a simultaneous collection and disbursal of funds. Rather than receiving revenues and then providing direct grants, the government allocates resources by selective tax reductions. For

TABLE 4. INCREASE IN TAX EXPENDITURES RESULTING FROM THE EXTENSION OF PROVISIONS THAT ARE SCHEDULED TO EXPIRE DURING THE PROJECTION PERIOD: BY FISCAL YEAR, IN MILLIONS OF DOLLARS

Item	1979	1980	1981	1982	1983
5-year Amortization for Housing Rehabilitation	---	---	5	5	5
Investment Credit					
Used property	---	---	31	98	104
10% credit	---	---	1,564	4,066	4,351
Investment Credit for Employee Stock Ownership Plans	---	---	166	385	416
Tax Incentives for the Preservation of Historic Structures	---	---	---	5	5
Credit for Employment of AFDC Recipients and Public Assistance Recipients Under Work Incentive Programs	---	20	20	20	20
Removal of Barriers to Handicapped	---	10	10	10	10
Additional Tax Expenditure from the Aged and Blindness Exemptions because of the General Tax Credit	56	81	85	86	88
Exclusion of Contributions to Prepaid Legal Services Plans				50	60
Earned Income Credit	---	1,113	1,068	1,025	984
Employment Tax Credit	565	2,245	2,350	2,405	2,425
Corporate Surtax Exemption	1,128	2,593	2,787	2,989	3,199
Total	1,749	6,062	8,086	11,144	11,667

fiscal years 1979-1983, this relation is shown in Table 5 in which tax expenditures are added to both the spending and receipts sides of the budget. When total expenditures for fiscal year 1979 are shown in this fashion, 23 percent of them--over $138 billion--will be tax expenditures. Direct outlays of $491 billion

TABLE 5. FIVE-YEAR BUDGET PROJECTIONS: BY FISCAL YEAR, IN BILLIONS OF DOLLARS

	1979	1980	1981	1982	1983
Current Policy Receipts a/	463	527	603	685	763
Implicit Receipts from Current Policy Tax Expenditures b/	138	153	167	182	199
Total Receipts	601	680	770	867	962
Current Policy Outlays	491	535	574	619	668
Current Policy Tax Expenditures	138	153	167	182	199
Total Outlays and Tax Expenditures	629	688	741	801	867

a/ CBO markup materials for the First Concurrent Resolution on the Budget for the Fiscal Year 1979, Senate Budget Committee, March 1978.

b/ Revenue losses attributable to provisions of the law which would expire during the projection period have been included in these projections. As a result, the tax expenditures shown here differ slightly from the totals shown in Table 3 where the projections were made on the assumption that scheduled expirations will occur.

TABLE 6. OUTLAYS AND TAX EXPENDITURES BY BUDGET FUNCTION IN FISCAL YEAR 1979: IN BILLIONS OF DOLLARS

Budget Function	Outlays and Tax Expenditures			Outlays and Tax Expenditures as a Percent of Total Outlays and Tax Expenditures			Proportion of the Total For Each Function for Outlays and Tax Expenditures		
	Outlays	Tax Expenditures	Total	Outlays	Tax Expenditures	Total	Outlays	Tax Expenditures	Total
National Defense (050)	114.9	1.5	116.4	23.4	1.1	18.5	98.7	1.3	100.0
International Affairs (151)	7.1	2.4	9.5	1.4	1.8	1.5	74.7	25.3	100.0
General Science, Space, and, Technology (250)	5.0	1.6	6.6	1.0	1.1	1.0	76.4	23.6	100.0
Energy (270)	9.2	2.9	12.1	1.9	2.1	1.9	75.9	24.1	100.0
Natural Resources & Environment (300)	12.3	0.7	13.0	2.5	0.5	2.1	94.4	5.6	100.0
Agriculture (350)	6.6	1.4	8.0	1.3	1.1	1.3	82.2	17.8	100.0
Commerce & Housing Credit (370)	3.5	56.2	59.7	0.7	41.2	9.5	5.9	94.1	100.0
Transportation (400)	16.7	0.9	17.6	3.4	0.7	2.8	94.7	5.3	100.0
Community & Regional Development (450)	8.9	a/	8.9	1.8	—	1.4	99.9	0.1	100.0
Education, Training, Employment, & Social Services (500)	30.2	11.2	41.4	6.2	8.2	6.6	73.0	27.0	100.0
Health (550)	50.1	11.0	61.1	10.2	8.1	9.7	81.9	18.1	100.0

(continued)

TABLE 6. (Continued)

Budget Function	Outlays and Tax Expenditures			Outlays and Tax Expenditures as a Percent of Total Outlays and Tax Expenditures			Proportion of the Total For Each Function for Outlays and Tax Expenditures		
	Outlays	Tax Expenditures	Total	Outlays	Tax Expenditures	Total	Outlays	Tax Expenditures	Total
Income Security (600)	158.8	28.8	187.7	32.3	21.1	29.9	84.6	15.4	100.0
Veterans benefits & services (700)	20.2	1.0	21.2	4.1	0.8	3.4	95.1	4.9	100.0
Administration of Justice (750)	4.1	-0-	4.1	0.8	-0-	0.7	100.0	-0-	100.0
General Government (800)	4.0	0.1	4.1	0.8	0.1	0.7	98.2	1.8	100.0
General purpose Fiscal Asst. (850)	9.1	16.0	25.1	1.9	11.7	4.0	36.4	63.6	100.0
Interest (900)	46.8	0.7	47.5	9.5	0.5	7.6	98.6	1.4	100.0
Allowances (920)	1.1	-0-	1.1	0.2	-0-	0.2	100.0	-0-	100.0
Total Before Offsetting Receipts	508.6	136.4	645.0	103.5	100.0	102.7	78.9	21.1	100.0
Undistributed Offsetting Receipts (950)	-17.2	-0-	-17.2	-3.5	-0-	-2.7	100.0	-0-	100.0
Total	491.4	136.4	627.8	100.0	100.0	100.0	78.3	21.7	100.0

SOURCE: Outlay figures from CBO materials prepared for the Senate markup of the First Concurrent Resolution on the Budget for Fiscal Year 1979; tax expenditure figures from Table 3.

a/ Less than $0.1 billion.

will account for the remaining 77 percent. Tax expenditures will remain approximately the same percentage of total federal expenditures through fiscal year 1983.

As shown in Table 6, tax and direct expenditures are distributed differently among the federal budget functions. As a result, neither alone will indicate the proportion of total federal expenditures--including both tax expenditures and direct outlays--in a given budget category. For example, while receiving less than 1 percent of direct outlays, Commerce and Housing Credit accounts for over 40 percent of the tax expenditure budget, which raises its share of total federal expenditures to 9 percent. Similarly, National Defense accounts for 23 percent of direct outlays, 1 percent of the tax expenditure budget, and 19 percent of total federal expenditures. Consideration of both tax expenditures and direct outlays will thus provide a clearer indication of total federal support of a program area.

CHAPTER IV. TAX EXPENDITURES AND THE TAX REDUCTION AND SIMPLIFICATION ACT

For the third consecutive year, the Congress in 1977 enacted major tax legislation with the passage of the Tax Reduction and Simplification Act of 1977 (P.L. 95-30). As with the tax legislation passed during the previous two years, many of the tax provisions contained in P.L. 95-30 will affect the tax expenditure budget in future fiscal years. The act contains 16 major provisions designed to simplify the tax code and to stimulate the economy by reducing individual and corporate tax burdens. Two of these measures provide general tax reductions, while most of the remaining provisions allow selective tax relief through the creation of new tax expenditures or the extension of existing ones.

The provisions of the Tax Reduction and Simplification Act of 1977 shown in Table 7 will increase the tax expenditure budget by approximately $6.7 billion in fiscal year 1979. Of this amount, $2.1 billion will go to individuals and $4.6 billion to corporations.

CORPORATE TAX CHANGES

The major changes in the corporate tax expenditure budget result from a newly created jobs tax credit (which will also result in revenue losses from the individual income tax) and the extension of the corporate surtax exemption. The jobs credit is intended to act as a tax incentive for the creation of new jobs. The credit equals 50 percent of Federal Unemployment Tax Act (FUTA) wages (the first $4,200 of an employee's wages) paid by an employer during the year in excess of 102 percent of FUTA wages paid by the employer in the previous year. In addition, the employer's business deduction for wages paid must be reduced by the amount of the credit claimed. The jobs credit is not refundable but can be carried back three years and forward seven years. This carry-forward provision means that revenue losses from this item will extend beyond the 1978 expiration date. The jobs credit will result in a revenue loss from the corporate income tax of $1.0 billion in fiscal year 1979, declining to $35 million in fiscal year 1983.

TABLE 7. EFFECT OF THE TAX EXPENDITURE PROVISIONS OF P.L. 95-30 ON THE TAX EXPENDITURE BUDGET IN FISCAL YEAR 1979: IN MILLIONS OF DOLLARS

Tax Expenditure	Individuals	Corporations
New Items		
Jobs Tax Credit	860	1,035
Increased tax expenditure from aged and blindness exemptions because of General Tax Credit	56	---
Extension of Existing Items		
Corporate Surtax Exemption	---	3,540
Earned Income Credit	1,165	---
Rapid amortization of child care facilities	a/	---
	2,081	4,575

a/ Less than $2.5 million.

The corporate surtax exemption shields the first $50,000 of corporate income from the 26 percent corporate surtax and thus fixes the corporate tax rate at 20 percent of the first $25,000 of income, 22 percent on the next $25,000, and 48 percent on income in excess of $50,000. The exemption is intended to provide tax relief to small businesses. The corporate surtax exemption will result in a tax expenditure of $3.5 billion in 1979.

INDIVIDUAL TAX CHANGES

For individuals, the major tax expenditure changes will result from the new jobs credit and the extension of the earned income credit. Both of these provisions increase tax expenditures.

The earned income credit provides a refundable tax credit against liabilities equal to 10 percent of the initial $4,000 of earned income. It is reduced by $0.10 for each $1 of income over $4,000 so that it vanishes when income reaches $8,000. Only families maintaining a household for a child under 19, a student, or a disabled dependent are eligible for this credit. Enacted in 1975 for two years, the earned income credit was extended through 1978 by the Tax Reduction and Simplification Act. In 1979, the credit will result in a tax expenditure of $1.2 billion.

The two major tax cut measures contained in P.L. 95-30 will both affect the tax expenditure budget in 1979. The first measure is a permanent simplification of the standard deduction by replacing it with what is called the zero bracket amount, that is, an amount of income on which no tax is paid. Prior law allowed a standard deduction equal to the greater of $1,700 for single returns ($2,100 for married couples filing jointly) or 16 percent of adjusted gross income up to a maximum of $2,400 for single returns ($2,800 for joint returns). This arrangement was replaced with a flat standard deduction--the zero bracket amount--equal to $2,200 for single persons and $3,200 for married couples. The higher standard deduction is expected to reduce the proportion of all taxpayers who itemize their deductions to about 25 percent. Because a significant number of tax expenditures are available only to those who itemize (for example, homeowner deductions for mortgage interest and property tax payments and the deductibility of medical expenses, charitable contributions, and the like), the smaller percentage of taxpayers who itemize deductions is expected to decrease the overall tax expenditure budget.

The other major tax cut for individual income taxpayers was provided by the general tax credit, which is available to all taxpayers. It is a nonrefundable credit against liability equal to the greater of $35 per person or 2 percent of taxable income up to $9,000 (for a maximum credit of $180). The credit was adopted in 1975 (in slightly different form) and was extended through 1978 by the 1977 Act.

Because it is available to all taxpayers, the general tax credit is not a special credit and thus is considered a part of the normal structure of the tax code rather than a tax expenditure. Before the 1977 Act, only one credit was allowed for each taxpayer and each dependent represented on the return. If a taxpayer was aged or blind, the number of credits was less than the number of personal exemption deductions because the aged and blind receive an extra exemption. This difference was not widely recognized, and it often led to inaccurate returns. It also could not be incorporated into tax tables based on exemptions. To remove these sources of error, complication, and confusion, the 1977 Act allowed a credit for each exemption, including the extra ones for the aged and the blind. To the extent that the credit is allowed for these extra exemptions, it is a special credit and not considered a part of the normal tax structure. The revenue loss attributable to the extra credits for the aged and the blind is treated as a tax expenditure and is shown with the revenue loss attributable to these extra exemptions. The cost of these credits will be $56 million in fiscal year 1979 and $88 million in fiscal year 1983.